

# The End of Affordable Housing in Melbourne?



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## List of Abbreviations

<b>ABS</b>	Australian Bureau of Statistics
<b>ACZ</b>	Activity Centre Zone
<b>CBA</b>	Commonwealth Bank of Australia
<b>CBD</b>	Central Business District
<b>CMFEU</b>	Construction, Mining, Forestry and Energy Union
<b>DIAC</b>	Department of Immigration and Citizenship
<b>DPCD</b>	Department of Planning and Community Development
<b>GAA</b>	Growth Areas Authority
<b>GAIC</b>	Growth Areas Infrastructure Contribution
<b>GST</b>	Goods and Services Tax
<b>LGA</b>	Local Government Area
<b>MSD</b>	Melbourne Statistical Division
<b>NLSP</b>	National Land Survey Program
<b>NOM</b>	Net Overseas Migration
<b>NSW</b>	New South Wales
<b>PSP</b>	Precinct Structure Plan
<b>SLA</b>	Statistical Local Area { (B)=Borough, (C) = City, (S) = Shire }
<b>UGB</b>	Urban Growth Boundary
<b>WA</b>	Western Australia

## Melbourne zones

<b>Zone</b>	<b>Local Government Areas</b>
Core (high density)	Melbourne, Port Phillip, Stonnington and Yarra
Inner (predominantly detached housing )	Banyule, Bayside, Boroondara, Darebin, Glen Eira, Maribyrnong, Moreland and Moonee Valley
Middle (established housing)	Brimbank, Frankston, Greater Dandenong, Hobsons Bay, Kingston, Knox, Manningham, Maroondah, Monash and Whitehorse
Outer (new housing)	Cardinia, Casey, Hume, Melton, Mornington Peninsula, Nillumbik, Whittlesea, Wyndham and Yarra Ranges

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The views expressed in this report are those of the authors.

## Executive Summary

When Melbourne 2030 was legislated in 2002 the goal was to make Melbourne a compact city. It was hoped that the plan would facilitate the construction of affordable apartments in and around transport centres.

The architects of *Melbourne 2030* assumed that most of the growth in new households expected in Melbourne would be composed of one and two persons who would welcome apartment living.

*Melbourne 2030* granted developers the right to build apartment blocks in inner city designated areas, in 26 principal activity centres and 94 major activity centres (p. 2)

*Melbourne 2030* has failed.

Dwelling prices in established areas escalated during the 2000s to levels well beyond the financial capacity of most new households (pp. 4-6).

Most of the new dwellings built in established suburbia during the 2000s were in the form of infill (town houses and units), not apartments.

The price increases in established suburbia have deflected demand to the fringe. As a consequence, the share of dwellings in fringe estates has increased, rather than decreased – as intended under *Melbourne 2030*. About 50 per cent of the dwellings added to Melbourne's dwelling stock since 2002 have been built on the fringe.

However, by the late 2000s, house and land prices on the fringe too were no longer affordable for most aspiring first-home buyers. This was largely because the stock of land ready for subdivision had depleted.

The Victorian Labor Government responded to this crisis as follows:

It required municipal councils to introduce new structure plans which would open up additional development rights for medium density housing, particularly along transport corridors (Chapter Three).

The Labor Government added an additional 41,600 hectares within the Urban Growth Boundary (UGB) for potential subdivision (p. 13). It also introduced a new Precinct Structure Plan (PSP) process under the supervision of the newly established Growth Areas Authority (GAA). This was intended to speed up the planning process so as to increase the amount of land ready for subdivision.

These new strategies will only succeed if they provide new households with the type of dwellings they want and can afford. Our projection of the number of these new households likely to form in Melbourne over the decade to 2021 is shown in the following table.

### Estimation of the contribution of household formation and dissolution to the number of households, by age group, Melbourne 2011-2021

	Age group								Total
	15 – 24	25 – 34	35 – 44	45 – 54	55 – 64	65 – 74	75 – 84	85 +	
Net change from household formation/dissolution	69,954	242,111	77,578	15,379	-10,633	-10,848	-21,239	-95,811	266,492
	Net gain in households 15-54 = 405,022				Net loss in households 55+ = 138,531				

Note: Any discrepancies in the summations displayed in the table arise because the numbers displayed here are the rounded version of the numbers generated by the underlying mathematical process used in the model.

Source: Table 4.2 in Chapter Four

There will be 405,022 new households formed in the decade to 2021 and 138,531 exits (as through death or movement to residential care). These exits will be moving from existing dwellings (usually detached houses). Thus there will be a need for an additional 266,492 dwellings over the 2011-2021 decade.

Compact city advocates assume that there will be many more exits from detached houses because older one- and two-person households are interested in moving to apartments. The evidence indicates that very few will do so (pp 28-29).

Most of the new households needing accommodation will be young, including 241,111 aged 25-34. They will be thinking about or starting a family and thus will want family-friendly housing. Apartment living is unlikely to meet this need, especially if all that is available is small apartments.

The report examines whether the planning innovations of *Melbourne 2030* and its 2008 update, *Melbourne @ 5 million*, will lead to the production of the required affordable family-friendly housing.

### *Apartments*

Analysis shows that apartments cannot be put on to the market at a price that those looking for family-friendly housing can afford. Few apartments of 110 square metres or more are being built in Melbourne.

Instead thousands of small apartments of less than 70 square metres are being built in the CBD and its surrounds. These apartments are being purchased off-the-plan by investors. For projects in planning or under construction, the trend is towards even smaller apartments (p. 37).

An oversupply of these small apartments is looming.

Meanwhile the cost of infill in Melbourne has risen to levels that most new households cannot afford. This is largely because the cost of the land on which to build townhouses or units has escalated.

### *Fringe housing*

The price outcomes in established areas mean that the availability of affordable housing on the fringe will be crucial to providing family-friendly housing for new households.

The GAA-managed PSP process has increased the amount of land ready for subdivision. However, there are no mechanisms in place to ensure that the land in question is in the hands of developers and that they will rapidly subdivide it.

In addition, the costs of land subdivision have increased such that it is now difficult for developers to put a conventional house and 450-square-metre land package on the market for less than \$400,000. This price is above the financial capacity of most aspiring first-home owners.

Developers have responded in part by targeting the trade-up market (households who possess a dwelling and wish to upgrade). The typical product, based on a block of 450 square metres and a house of 200 square metres costs around \$450,000 (p. 60).

At the other end of the spectrum there has been an increase in the production of lots of less than 350 square metres. The houses designed for these lots are small (around 150 square metres) and such house and land packages currently cost \$300,000 to \$350,000 (pp. 57-59).

This is within the price range of most first-home buyers but offers a much smaller home than those looking for family-friendly housing would like.

### *The outlook*

There is already evidence of movement to peri-urban areas outside the border of the Melbourne Statistical District, where land and housing can be bought at far lower cost than that within the UGB (Chapter Seven).

Perhaps the affordability crisis will lead to a housing price crash, as has occurred in the United States and Ireland. This is unlikely in Melbourne because the escalation in house prices is largely due to scarcity – that is, where thousands of new households compete for a limited housing stock (Appendix).

It is more likely that there will be a slowdown in dwelling construction in Melbourne because new households cannot afford the product being offered.

The experience in Sydney provides a telling test case. The housing affordability crisis was far more serious there than in any other Australian capital city by 2000. Despite this, housing prices continued to rise in Sydney during the 2000s.

The production of new dwellings in Sydney in the 2000s slumped (relative to the level in the 1990s) because developers could not produce dwellings at a price that most new households could afford. Yet household growth in Sydney continued strongly (mainly from overseas migration), thus ensuring continued competition for the available stock (Chapter Eight).

The outcome in Sydney is that a much higher proportion of young households now live in apartments, especially as renters, than is the case in Melbourne. Household formation has slowed relative to Melbourne as well. Sydney is also experiencing a high loss of people to other locations in Australia.

Those planning Melbourne's future have not come to grips with the causes of Melbourne's affordability crisis. This is primarily to do with the costs of producing apartments, infill and fringe housing.

Proposals to facilitate even more high-rise apartment blocks or to extend the UGB ever further outwards — the current Victorian Government's strategy — will not provide a solution.



## Chapter One: Melbourne's development challenges

### Planning for Melbourne 2002 to 2030

The planning strategy outlined in *Melbourne 2030* was legislated in 2002 by the Victorian Parliament. Its purpose was to create a new planning framework that would accommodate a projected increase of one million in Melbourne's population between 2000 and 2030. As it turned out, Melbourne grew faster than expected. The city's population was projected to grow by about 40,000 a year, but in fact accelerated, peaking at 93,478 in 2008-09. By 2008, the Victorian Government had revised its population projections and now expects the city to grow by 1.8 million over the thirty years (from 2008) rather than the one million originally anticipated in 2002.

At the time of *Melbourne 2030's* release in 2002, opinion within the planning community of professional planners, academic analysts, media commentators and some developers was that Melbourne should become a compact city. Subsequently in this report these groups are referred to as 'urbanists' because of their preference for higher density urban living. Urbanists hoped that the share of new housing located on the fringe would decline as a result of the *Melbourne 2030* initiatives. They did not accept that in the process they might deny the home ownership aspirations of those cut off from frontier housing. Rather, they believed that, under their compact city proposals, affordable housing would be provided in established areas.

A crucial foundation for the urbanist perspective is that the demographic outlook is changing. Urbanists note that there has been an increase in the share of households in Melbourne who are lone-person and couple-without-children households. They believe this trend will continue, and that in such circumstances, there is a need for more apartment-style housing. It is true that the number of one- and two-person-without-children households has expanded rapidly and will continue to do so over the ensuing decades. But, as our analysis of these demographic movements shows below, the majority of these one-and two-person households are, or will be, aged 55 plus. Most live in detached housing and have shown little propensity to move. Our analysis in Chapter Four indicates that the main shortage of available housing in Melbourne is of dwellings suited to new families with children or couples preparing for that phase of their lives. Small apartments are manifestly unsuited to their needs.

Urbanists further argue that people should not be consigned to an ever-distant suburban frontier where they are remote from services and employment, where there are growing conflicts between suburban growth and the environment, and where infrastructure costs are alleged to be far higher than would be the case under their compact-city proposals. Rather, modest- and low-income residents should have access to affordable housing across the city, which urbanists believe can be provided in medium-to-high-density developments in mixed-use settings located near transport hubs. This proposition about affordability is questionable and is explored in detail in Chapter Five.

In *Melbourne 2030*, frontier development was to be reduced in part by the establishment of an Urban Growth Boundary (UGB) which would serve to limit the spread of suburbia. The share of new dwellings attributable to greenfield development was projected to fall from 45 per cent in 2001-05

to 22 per cent by 2026-30. The lower outer-suburban share was to be replaced by a higher share of new dwellings built in 'activity centres' located in or around transport hubs across the city.

In order to bring this vision to fruition, *Melbourne 2030* created new development rights in the 26 principal activity centres and 94 major activity centres designated in the plan. The development rights were to build medium- or high-density apartment blocks in and around all these principal and major activity centres. There was also a category of neighbourhood centres, of which some 900 were identified. These were mainly the smaller shopping precincts. They were to be the site for more modest medium-density (under five storeys) projects. The way in which these rights have been incorporated into municipal planning schemes is discussed in detail later. In essence, municipal councils were expected to adjust their local planning schemes to incorporate the respective development rights for all the activity centres designated within their jurisdiction.

The planning vision, summarised on page one of the *Melbourne 2030* summary document, was as follows:

The main thrust is to continue to protect the liveability of the established areas and to increasingly concentrate major change in strategic redevelopment sites such as activity centres and underdeveloped land. While a good supply of land for development will be maintained in growth areas, over time there will be a shift away from growth on the fringe of the city.<sup>1</sup>

### **Melbourne's development after 2002: the reality**

Although Melbourne's residential landscape has changed markedly since the adoption of *Melbourne 2030*, few of the strategy's key aspirations have been achieved. There has been a surge in the number of small high-rise apartments in the Central Business District (CBD) and its fringe. But elsewhere in established suburbia, though there has been an increase in housing density, it has mainly been in the form of *ad hoc* infill rather than in medium-to-high-density apartment blocks in activity centres. Likewise, the aspiration to limit the outward spread of the city has failed. Around half of all the net growth in the dwelling stock since 2002 has been on the fringe. This is in large part because the surge in dwelling prices in established suburbia since 2002 has made fringe housing the only affordable housing for many new home-owners. However, since 2008, even the fringe option has diminished as housing prices in new developments have also escalated beyond the reach of many aspiring new home-owners. This escalation has largely been due to recent increases in the price of suburban land, such that few new blocks are now available for less than \$200,000.

Developers have responded to this price squeeze by offering more very small blocks. By 2011 almost a third of the new blocks released into the market by developers were less than 350 square metres in size. The housing styles that fit on these blocks are a long way from what family-oriented households moving to the fringe expect. This is one of the reasons why the number of sales of blocks on the fringe has declined since 2010. The key question for analysis is the source of the increased costs of lots. Is it a temporary consequence of a shortage of zoned residential land or a long-term problem deriving from increasing costs of producing lots? This issue, too, is explored in Chapter Five.

Meanwhile, the dream of combining higher density living with affordable housing has come to nothing. Detached houses, units and apartments have escalated in price, (particularly in the inner and core areas of Melbourne where most of the activity centres are located) to the point that the next generation of would-be home-owners in Melbourne have largely been disenfranchised from

purchasing a dwelling in established suburbia. This momentous outcome is documented in the following section of this chapter. An analysis of the causes of this price escalation is presented in the Appendix.

Chapters Two and Three analyse the planning responses of the Victorian Labor and Coalition Governments to the housing affordability crisis. These responses are significant. They have led to a sharp increase in the rights of developers to undertake the building of medium- and high-density apartment blocks across Melbourne. In the case of outer suburbia, they include a major extension of the UGB and the installation of a new planning authority: the Growth Areas Authority (GAA). It is the GAA's responsibility to manage the location new subdivisions and to specify the infrastructure requirements developers must meet. This an important initiative, as yet little discussed in the literature. Its performance will shape the pace and cost of new subdivisions on the fringe.

The rest of the study explores the effectiveness of these responses. The analysis is built on household projections which quantify the numbers of households by age group and household type expected for Melbourne in 2021. These projections are detailed in Chapter Four, along with a discussion of the kind of housing these new households are likely to want. Chapters Five and Six examine the housing market in established and fringe suburbia respectively. Their focus is whether the housing being offered is likely to meet the expectations and financial capacity of new households. So far it has not succeeded in meeting these expectations, one consequence of which is a surge in peri-urban development. This is development physically located outside the metropolitan boundary and, of course, beyond the UGB but linked to Melbourne through residents commuting to metropolitan employment. This outcome is explored in Chapter Seven.

Chapter Eight looks at the recent experience of housing markets in Sydney. It asks what lessons we can learn from Sydney as to the outlook for housing in Melbourne. The annual growth of population and the number of dwellings built in Sydney during the late 1990s was greater than in Melbourne. During the 2000s, this situation reversed. The main factor in this reversal was the extraordinary surge in dwelling prices in Sydney in the late 1990s and early 2000s. Developers could not construct dwellings that many wanting to enter the housing market could afford. We ask whether Melbourne's dwelling price escalation during the 2000s could lead to a Sydney-like outcome in Melbourne.

As will be obvious, we have taken on a huge task in exploring all these issues. There are many players with their own agendas, sometimes ideological, but more often due to the huge financial and wealth implications of the health of the housing industry. Reaching firm conclusions is difficult. The justification for undertaking the task is that one cannot limit the inquiry to just one aspect of the housing industry since the various parts are inter-related. For example, interest in fringe house and land purchase is largely determined by the price of housing in established suburbia. But, by the same token, if housing can be constructed relatively cheaply on the fringe, this sets limits to the price vendors can command for established housing.

The analysis hinges around the extraordinary escalation in the price of housing in the established areas of Melbourne over the past decade; therefore in order to set the scene, we provide a description of this price movement by zones customised for this study.

## Dwelling price movements in Melbourne

Figures 1.1 and 1.2 show the mean price of houses and of units (including apartments), by whether they are located in the zones of core, inner, middle or outer Melbourne. The zones have been designed to capture the main locational distinctions in Melbourne's housing market. The core, as used in this paper, comprises the high-density Local Government Areas (LGA) of Melbourne, Port Phillip, Stonnington and Yarra; the inner comprises the predominantly detached-housing LGAs of Banyule, Bayside, Boroondara, Darebin, Glen Eira, Maribyrnong, Moreland and Moonee Valley; the middle comprises the established-housing LGAs of Brimbank, Frankston, Greater Dandenong, Hobsons Bay, Kingston, Knox, Manningham, Maroondah, Monash and Whitehorse; and the outer comprises the new-housing LGAs of Cardinia, Casey, Hume, Melton, Mornington Peninsula, Nillumbik, Whittlesea, Wyndham and Yarra Ranges.

The information for each zone has been compiled by aggregating the data for the Melbourne LGAs which are published in the Valuer General's annual report on the prices of property sales. The mean has been used because the Valuer General's report does not supply the information necessary to calculate the median price for each zone.

Prices have increased sharply in the core, inner and middle zones and more moderately in the outer zone. By 2010, the mean price of a house in the core was \$1,292,354, an increase of 179 per cent on what it had been in 2000. In the inner zone, the mean price in 2010 was \$940,344, representing an increase of 191 per cent and in the middle zone it was \$574,404, or an increase of 176 per cent.

The rise in prices in the outer zone was much less marked but, even so, by 2010, the mean price of houses sold had reached \$432,319, an increase of 143 per cent on the price of a decade earlier. As explained below, the slightly lower rate of growth for the outer zone is in part due to the fact that many of the houses sold are located on new fringe estates. As such, the scarcity factor, or scarcity premium, that results from strong demand for housing in established areas where there are limits to the growth in the housing stock is less evident.

The result of these pricing trends was that the gulf between housing prices in the core, inner and middle zones of Melbourne and the outer zone has widened. Houses located in the core and inner zones of Melbourne and parts of the middle zone are now way out of reach of all but the more affluent Melbourne residents. According to a report from the planning consultancy SGS Economics and Planning, a household on a median income could afford a \$382,000 home in 2009-10. At this price, their choice was confined to less than 25 per cent of Melbourne suburbs.<sup>2</sup>

Another outcome, not tracked in Figure 1.1, is that by 2010 the cost of new house and land packages on the fringe was also moving out of reach of first-home buyers. This is largely because of a surge in the price of new housing lots. The median price of land sold by developers on the Melbourne fringe increased from \$139,000 in the September quarter of 2007, to \$160,000, \$174,000, \$213,000 and \$222,000 in the subsequent September quarters of 2008, 2009, 2010 and 2011 respectively.<sup>3</sup>

In the early 2000s fringe housing provided a safety value for new entrants to the housing market who could not afford property in established suburbia. As prices in established suburbia increased, more first-home buyers took up this safety-valve option. However, by 2010, as indicated, this option was becoming out of reach. The experience in the City of Casey will illustrate the point. In 2001 the

median price of a new house in Casey on a median-size lot (553 square metres) was \$185,000.<sup>4</sup> Nine years later in 2010, the median price of a new house sold in Casey on a median-sized lot (560 square metres) was \$399,235.<sup>5</sup> By mid-2012, our survey of house and land packages listed in the City of Casey revealed that very few were available with lot sizes of 550 square metres or more. The new standard for a large block had shrunk to about 450 square metres and in the great majority of cases houses on land of this size were priced at around \$450,000.

At \$450,000 the traditional detached home is now well beyond the financial means of most first-home buyers. It is hard to be precise about affordability thresholds because of the variety of factors that must be taken into account in assessing housing affordability for first-home buyers. They include the potential buyers' income and savings, their stage in life (with or without children) and the cost of finance. Unless they have substantial savings, relatively few first-home buyers can afford to service a loan above \$300,000. The average loan taken out by first-home buyers since 2009 is about \$280,000.<sup>6</sup>

The private sector National Land Survey Program (NLSP), on whose analysis we have relied for information on the fringe land market, has attempted to quantify the first-home buyer affordability threshold. Its estimates are based on modelling and on anecdotal information from the development industry. The NLSP concludes that the upper purchasing price of a dwelling for first-home buyers is in the range of \$360,000 to \$460,000, depending on factors listed above. The NLSP has a rule of thumb that once land prices exceed \$200,000 per block, most first-home buyers are priced out of the house and land market.<sup>7</sup>

This situation on the fringe is a transformative event in Melbourne's housing market. The fringe is no longer offering the safety-valve function it provided in the recent past. The reasons for this outcome are explored in Chapter Six. At present, the only way most first-home buyers can afford to enter the fringe market is by accepting house and land packages with much smaller land area and housing size than has traditionally been expected for detached housing. Packages which include land of less than 350 square metres and a house of around 150 square metres (all that can be fitted on to such a tiny lot) are available for between \$300,000 and \$350,000. Whether such product will be attractive to first-home buyers looking for family-friendly housing is discussed in Chapter Six.

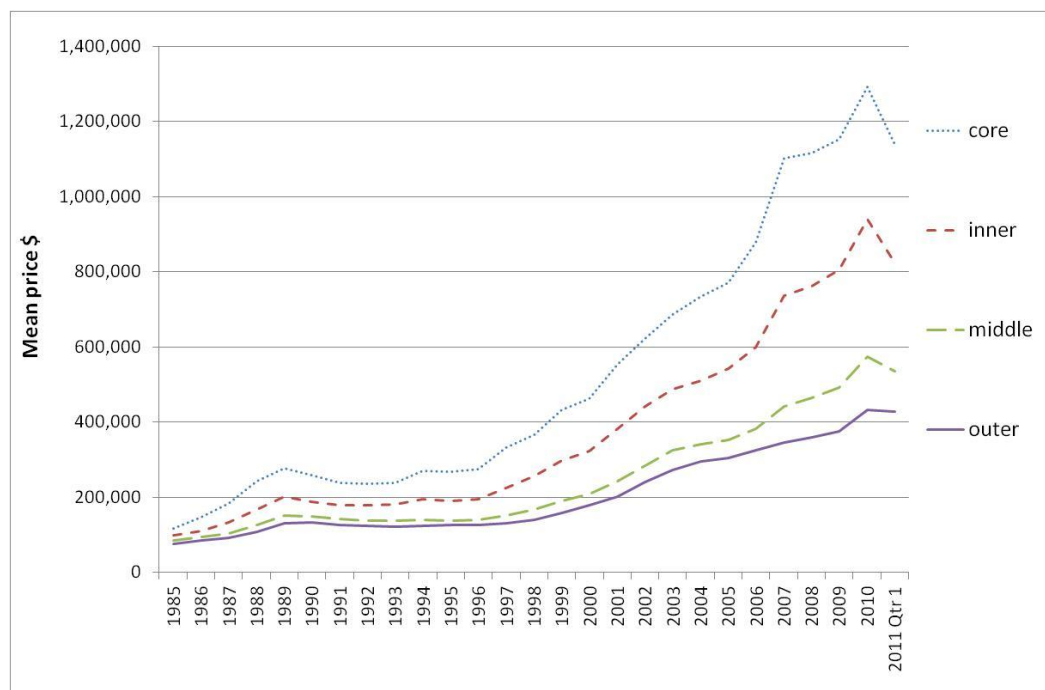
In the case of units and apartments, there has been a parallel escalation to that of houses, such that by 2010 the mean price of a unit/apartment reached \$599,820 in the core and \$535,299 in inner Melbourne. This outcome is significant, from the point of view of those hoping that *Melbourne 2030* would contribute to the provision of affordable medium-density housing. This is because, as Table A.1 in the Appendix shows, most of Melbourne's semi-detached dwellings and units/apartments are located in the core and inner zones of Melbourne. Even in the middle zone, the mean price of a unit/apartment had increased to around \$423,463 by 2010.

By 2010, the median price for a unit or apartment sold in the LGAs with the lowest median unit or apartment prices was \$250,000 in Melton, \$265,000 in Cardinia, \$269,000 in Wyndham, \$295,272 in Frankston and \$295,000 in Casey. The median price paid for units, flats and apartments in all other LGAs was more than \$300,000, including Greater Dandenong, where the median price was \$305,000.

These prices for units reflect the price of surrounding detached houses rather than the actual cost of building units. Units cannot be sold at prices close to the value of detached houses in the vicinity

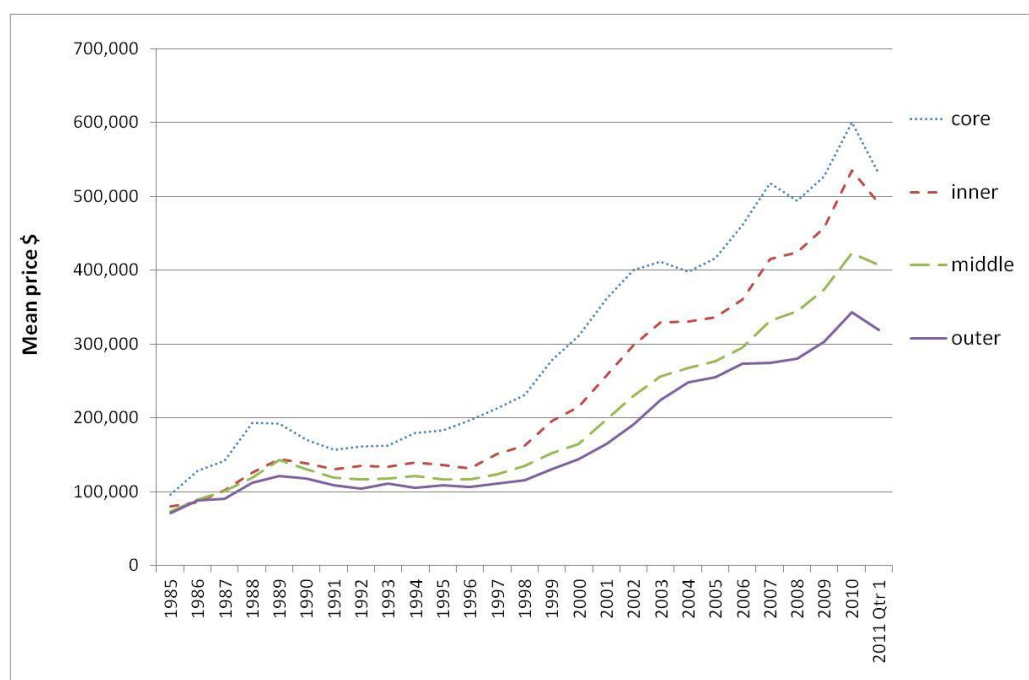
since people will generally chose a detached house if available in the same price range. Conversely, if units or apartments cannot be built at a cost that is competitive with the surrounding detached housing they will not be constructed, because there will be no profit in it. The reasons why the price of detached houses escalated in price are summarized below and explored in detail in the Appendix.

**Figure 1.1: Mean house price by location in Melbourne, 1985 to Mar Qtr 2011**



Includes established and new houses. Mean price is used as the regional data are derived from aggregated LGA data.  
Source: Calculated from *A Guide to Property Values*, Department of Sustainability and Environment, 2011

**Figure 1.2: Mean unit/apartment price by location in Melbourne, 1985 to Mar Qtr 2011**



Includes established and new flats, units and apartments. Mean price is used as the regional data are derived from aggregated LGA data.  
Source: Calculated from *A Guide to Property Values*, Department of Sustainability and Environment, 2011

### *Melbourne loses its comparative advantage in dwelling prices*

Another major implication of this price surge is that Melbourne is losing its attraction as a locus of affordable housing. Figures 1.3 and 1.4 describe this development. Figure 1.3 shows the change in the price of houses in each major capital city compared with the prices current in each city in 2003-04. Perth's surge mainly occurred during the first mineral boom. Since that time, prices in Perth have stabilised. Melbourne, on the other hand, experienced strong but less spectacular growth during this period such that by 2010, as Figure 1.4 shows, the median price of a house in Melbourne exceeded that in Perth and was well above the levels in Brisbane and Adelaide.

Figure 1.4 shows that there was a huge gulf between housing prices in Sydney and the other capitals in the early years of the past decade. In 2003-04 the median price of established houses in Sydney was around \$500,000, or about \$200,000 higher than in Melbourne. After 2003-04 the gap shrank. By 2009 and 2010, the gap was about \$100,000. It is since widened a little because of the fall in house prices in Melbourne since mid-2011.

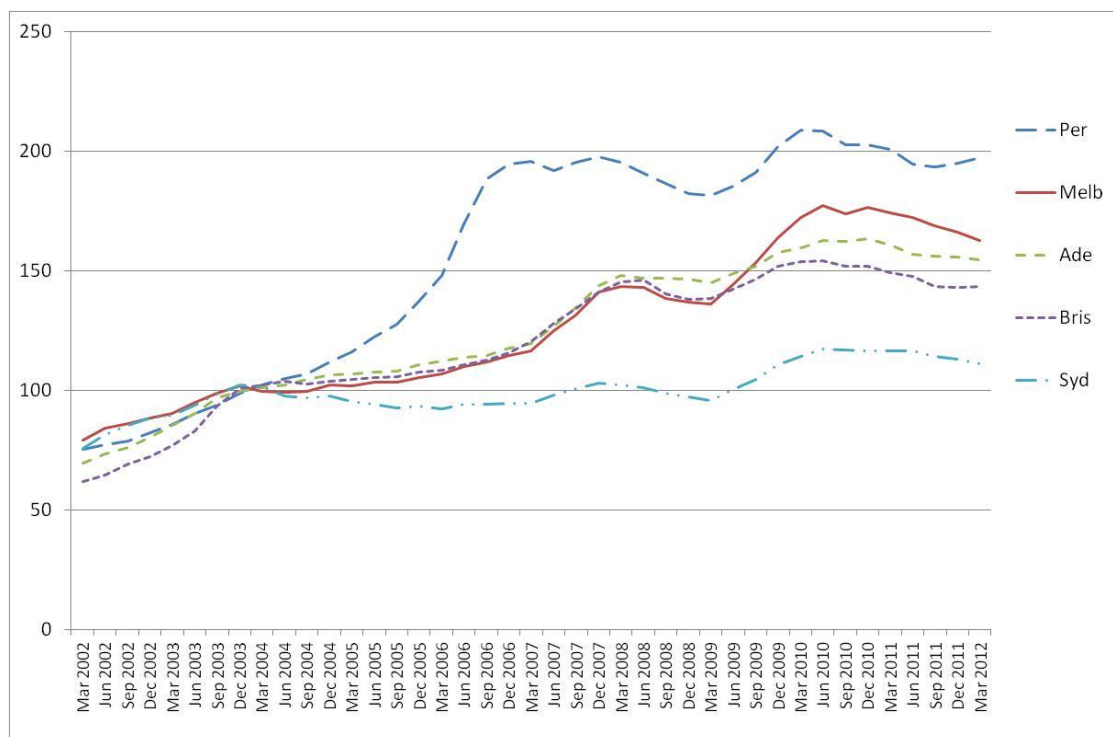
These price movements are profoundly significant for Melbourne's future. They threaten one of the city's most important industries — the provision of housing and related services for a growing population. But what if the price surge is ephemeral? If so, maybe the crisis of affordability is a temporary one.

We provide a detailed analysis of the two main explanations for the surge in dwelling prices in Australia and some other western countries in the past decade or so in Appendix One. The first is the bubble thesis. This is that the housing-price boom was due to the purchases of home owners and investors who were drawn into the market by the expectation of capital gains. There are a number of reputable bubble theorists in Australia who believe that such booms cannot last. Indeed this was the case in the US and Ireland when housing prices collapsed in 2007 and 2008. The second main explanation is that housing price increases are principally due to the rapid rate of population growth in Australia over the past decade. The hypothesis is that competition for housing, particularly in established suburban areas has increased the scarcity value of these locations.

The conclusion from our analysis of these two perspectives in the Appendix lends support to the scarcity hypothesis. The main reason for the escalation in house prices in Australian metropolitan areas is that the available housing stock has fallen behind the net growth in households. This is most obvious in the movement of established house prices, where competition for the limited stock of housing near high-amenity locations has exceeded the capacity of developers to augment the supply, at least at an affordable price. But in the case of Melbourne, the thesis also applies to outer-suburban land where we show that the escalation of demand for blocks in the second part of the decade to 2010 exceeded the capacity of developers to provide the required product.

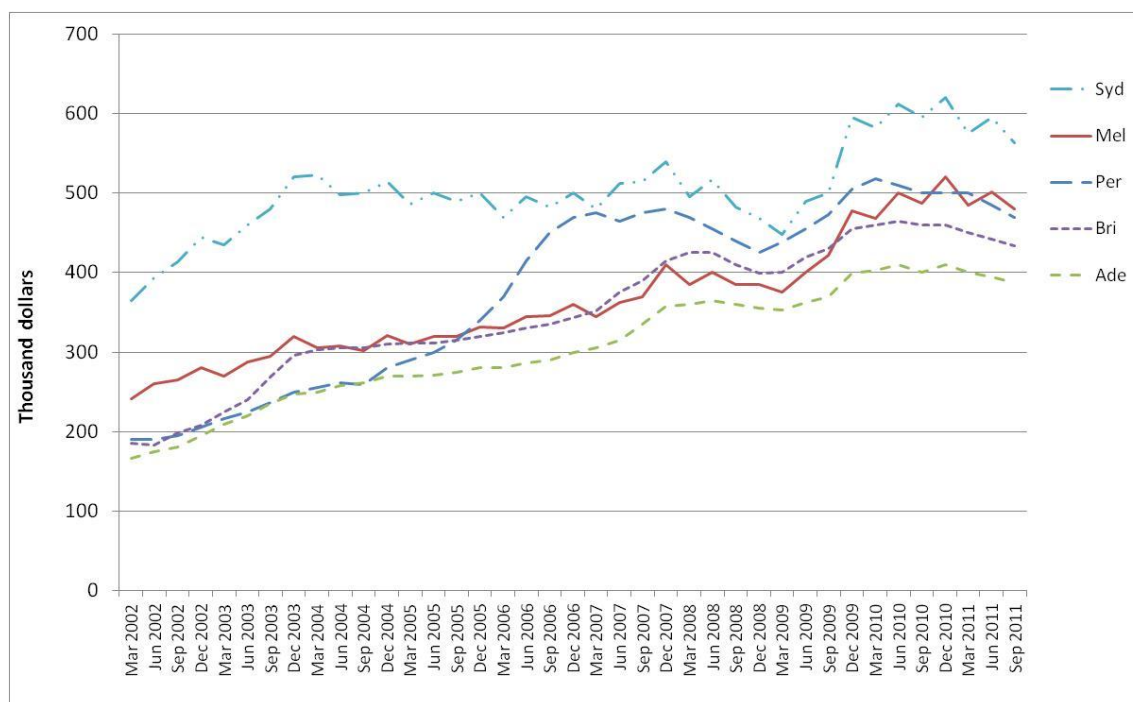
This conclusion means that the problem of housing availability and affordability will not go away due to a sudden price implosion. It will only be resolved if measures to increase the availability of affordable new housing, whether in established suburbia or on the fringe, are successfully implemented. This issue is explored in Chapter Five.

**Figure 1.3: Price index of established houses based on reference year 2003-04, five state capitals, March 2002 to March 2012**



Source: Australian Bureau of Statistics, *House Price Indexes: Eight Capital Cities*, Cat. No. 6416.0

**Figure 1.4: Median price of established house transfers, five state capitals, March 2002 to Sep 2011**



Source: Australian Bureau of Statistics, *House Price Indexes: Eight Capital Cities*, Cat. No. 6416.0



## Chapter Two: The response to the crisis in the supply of affordable housing

By 2008, the Victorian Labor Government was in panic mode in the face of the city's rapid population growth. More housing was needed yet its planning initiatives had failed to deliver on the compact city objective, or, more importantly, to provide housing at a price which aspiring home buyers or renters could afford. As noted, it was also faced with an unexpected surge in Melbourne's population growth. This peaked at 95,963 in 2008-09. By this time the surge had been incorporated into new state government population projections such that Melbourne was projected to reach five million before 2030 (from four million in 2009).

Part of the response was to set up an audit of *Melbourne 2030* in 2007. The audit was led by Rob Moodie, who brought to it a single-minded urbanist commitment to urban consolidation. The audit acknowledged that *Melbourne 2030's* consolidation strategies had failed, particularly the activity centres. It recommended that more housing would have to be located in established suburbs outside activity centres and that new administrative procedures be established to ensure that this occurred. The audit had little to say about outer-suburban development, except that the UGB 'should be retained and strengthened'. To this end, the audit recommended that the UGB should be maintained 'without alteration for at least the next five years unless compelling circumstances arise'.<sup>8</sup>

The government responded with two sets of initiatives. One concerned new measures to expand the area incorporated into activity centres and to enforce municipal compliance in adjusting planning provisions to reflect these new boundaries. The other led to a huge extension of the UGB.

These initiatives were given official form in December 2008 when the Victorian Government published a revision of the *Melbourne 2030* planning scheme entitled *Melbourne @ 5 million*.<sup>9</sup>

Under *Melbourne @ 5 million*, the government proclaimed a new target for Melbourne's growth. It was asserted that Melbourne needed a net increase of 600,000 dwellings over the next 20 years. Some 316,000 of these dwellings were anticipated to be in Melbourne's established areas, and 284,000 (or 47 per cent) in 'Melbourne's growth areas'.<sup>10</sup> This was a far higher share than envisaged when *Melbourne 2030* was legislated. In order to achieve this target, the Victorian Government initiated an assessment of the extra land needed to be rezoned for residential purposes. In doing so, it rejected one of the core aspirations of the urbanists and, of course, the recommendation of its audit team, which was to enforce compact development by restricting alternative settlement options on the fringe through a tight UGB.

Readers may be wondering why, having given up on the compact city priority, the Labor Government nevertheless chose to press on with its compact city agenda. The underlying reason was Labor's concern to sustain a high level of development activity across Melbourne. The then premier, John Brumby, was acutely aware that Melbourne's economy was heavily dependent on population growth and the city building it engendered. For this reason, the government wanted to ensure that the planning regime facilitated development in both established and fringe areas. In the case of the latter, Brumby knew that restricting growth on the fringe would put further upward pressure on land prices. The Labor Government also shared the view of many developers and some

urbanists that municipal councils, egged on by recalcitrant resident groups, were dragging their feet in implementing the compact city agenda.

### **Making the compact city work**

If the compact city policy is to work, substantial numbers of households will have to take on apartment style living. If this is to occur, the apartments constructed will have to provide the space which families require at a price that is within their financial capacity. As noted earlier, if apartments cannot be produced at a cheaper price than the surrounding houses, they will not sell. Perhaps very small apartments will meet this test and be within the financial capacity of families, but such apartments may not meet the space needs of these families. These are huge and unresolved issues. To our knowledge neither the government nor urbanists supporting the compact city policy have provided satisfactory answers.

Instead, the government's response to the failure of activity centres to deliver on the hoped-for expansion of new medium- or high-density housing developments was to go to war with the municipal councils and with the resident groups who opposed medium- and high-density developments. It believed councils were dragging their feet in implementing *Melbourne 2030*. Consistent with this position, the Labor Government sought to enforce the activity centre strategy. It did this by ensuring that councils remove the remaining constraints against apartment projects in their municipal planning schemes for activity centres. It also extended the reach of activity centres to incorporate locations along public transport corridors.

### **Governance**

When *Melbourne 2030* was legislated, the boundaries of the principal activity and major activity centres were not specified. It was left to municipal councils to do this work. They were 'required to review each of their activity centres and its directions for growth and change... [to] ensure that strategic objectives at the local level are consistent with the key directions and policies in *Melbourne 2030*'. The result of this work will be 'a planning scheme amendment which articulates in general terms the direction for change in each centre'.<sup>11</sup>

Councils were required to come up with structure plans which gave precision to activity centre boundaries. These were to incorporate ample space for medium-to-high-density housing projects as well as clear guidelines as to where such projects were permitted. Councils were instructed to frame these plans such that they were consistent with the population growth expectations associated with *Melbourne 2030*.

In 2006, each municipality was given specific population targets that they were expected to achieve. However, in a report prepared for the Property Council of Australia in 2010, the planning firm Urbis indicates that:

...local councils do not have a formalised and legal obligation to deliver certain levels of housing required to deal with what is a metropolitan planning issue. Instead, local scale built form, heritage, and amenity concerns have tended to dominate decision-making.<sup>12</sup>

Urbis recommends that such targets be enforced. It notes that the Victorian Department of Planning (when Labor was still in power) has appointed a consultant to prepare a housing capacity assessment report for Melbourne which was expected to be completed in early 2011.<sup>13</sup> This report

has not been released or acted upon by the new Coalition Government. It could be the basis for a reclassification of urban residential land which might facilitate more intensive infill than is currently permitted. This possibility is explored further below.

In relation to activity centres, the Labor Government set procedures in place to ensure that activity-centre structure planning was done under the close supervision of, and ultimately the approval of, the Department of Planning and Community Development (DPCD) and the Minister. Nevertheless, community input was specified as a mandatory component of the process. Since the inception of the preparation of *Melbourne 2030*, the government had maintained that it wanted community engagement and indeed that the plan itself was a product of the community consultations which had preceded its drafting.

The opportunity for participation in the planning process has meant that, in communities where opposition to apartment projects is strong, structure planning has become a battle ground. Elected council members and municipal-planning officers have been caught in the middle between the conflicting priorities of the government, developers and concerned residents.

This was a conflict that the government normally won because no structure plan could be put into place until approved by the DPCD and the Minister. If the government did not like the municipal plan, the Minister could require a review by a planning panel appointed by the government. If changes were required by the panel, they were then sent back to the municipality for further amendment.

In the aftermath of the Audit Report on *Melbourne 2030* the Victorian Government added further weapons to its arsenal aimed at advancing its compact city objectives. It established Development Assessment Committees (DACs) whose role was to give direction to the structure planning for localities of metropolitan significance, including the 26 principal activity centres. These DACs were to be composed of representatives of the government and the municipalities, and an independent chair.<sup>14</sup>

The Labor Government also established a new Activity Centre Zone (ACZ) which was designed to give greater certainty to communities and developers once the structure planning process for each activity centre was signed off by the government. Each ACZ delineates the boundaries of the activity centre. The ACZ is defined by the government as ‘the preferred tool to guide and facilitate the use and development of land in activities areas.’<sup>15</sup>

Once the ACZ is in place, it is the end of any third-party consultation or objection to appeal against projects in accord with its guidelines. According to the government’s Practice Note of September 2009:

The default provision in the ACZ is that no third party notice, decisions or review rights exist for any permit application subject to the zones. This builds on the community and stakeholder consultations that are the foundation of structure plans.<sup>16</sup>

### **Expanding the coverage of activity centres**

This was a central concern of compact city advocates. In particular they have sought the extension of the activity centre concept to include transport corridors. As the audit of *Melbourne 2030* put it, this should include ‘land along light rail corridors or other major boulevards served by public transport’.<sup>17</sup>

This idea proved attractive to the Labor Government and the DPCD. The transport corridor proposal seemed to offer an easy option to achieve the government's compact city objectives. So much so that the DPCD commissioned a feasibility study of the residential potential of two tramway corridors in routes 112 and 96 which run through Carlton and Fitzroy, and Northcote and Preston, respectively. The study was released in 2009 and was carried out by SGS Economics and Planning, whose principal, Marcus Spiller, has been a leading advocate of this approach. The SGS report recommended that the concept was feasible, that target areas be identified and that planning regulations be changed to allow developers as-of-right access to the property in question for redevelopment purposes. SGS had in mind medium-density apartments adjoining the entire length of the tramway corridors. The firm concluded that:

The potential to house a significant amount of new housing close to existing infrastructure along tramway corridors could inform a re-evaluation of the need to plan for new growth areas, [or] investigation areas outside of the existing Urban Growth Boundary.<sup>18</sup>

This recommendation was consistent with one of the keenest advocates of transport corridor development. This is Rob Adams, Director of Planning within the City of Melbourne. He writes that:

The aim should be that, by 2029, the key linear transport corridors will have developed into medium rise high density corridors that connect all the activity centres, and provide easy access to high quality public transport from the adjacent 'productive suburbs'. Development of these corridors would take development pressure off the existing suburbs, which can then develop as the new 'green lungs' of our metropolitan areas.<sup>19</sup>

Strong support has also come from academics in Melbourne University's planning, architecture and building departments. This has been led by Kim Dovey, Professor of Architecture and Urban Design. The vision of Dovey and his team is that all of the 600,000 growth in households projected over the next twenty years by the Victorian Government could be accommodated in transport corridors. According to their analysis, 'If lower height limits [up to 5 storeys] are enforced then higher market take-up rates will produce more continuous streetscapes with greater protection of privacy and amenity'.<sup>20</sup> Consistent with this goal, the authors' presentation of their argument is accompanied by models of corridor development along tram routes which feature medium-density housing of similar architectural form as far as the eye can see.

The advocates of this vision do not deal with cost or preference issues. If the new households entering the housing market over the next decade do not want to live in apartments, or even they did but could not afford the costs of constructing them, they will not be built. These issues are covered in Chapter Five.

Notwithstanding these omissions, by the time *Melbourne @ 5 million* was issued in December 2008, the transport corridor idea had become official policy. *Melbourne @ 5 million* states that in order to accommodate the higher than expected number of households anticipated by Melbourne 2030:

To manage this growth and preserve liveability, the focus will be on locating more intensive housing development in and around activity centres, along tram routes and the orbital bus routes on the Principal Public Transport Network, in areas close to train stations and on large redevelopment sites.<sup>21</sup>

This objective was incorporated into the State Planning Policy Framework in September 2010. The objective henceforth was, 'To locate new housing in or close to activity centres and employment

corridors and at other strategic redevelopments sites that offer good access to services and transport'.<sup>22</sup> These strategic redevelopment sites were to include sites '...Along tram, train, light rail and bus routes that are part of the Principal Public Transport Network and close to employment corridors, Central Activities Districts, Principal or Major Activity Centres and around train stations'.<sup>23</sup>

Since coming to power in December 2010, the Coalition Liberal-National Party Government has marginally backed away from this policy objective. On 16 December 2010, the new government modified the language in the State Planning Policy Framework. The areas to be considered strategic redevelopment sites were rewritten to include those which are 'on or abutting tram, train, light rail and bus routes' rather than 'along' such routes (16.10-3).

Finally, the Labor Government considered the idea of introducing new classifications of residential areas in order to encourage more medium-density developments in areas near activity centres and where access to public transport was good. This idea, originally floated by the Labor Government in 2007, was taken up in the *Melbourne 2030* audit. It recommended that established suburbia should be classified into 'no-go', 'slow-go' and 'go-go' zones.<sup>24</sup> The 'go-go', or 'substantial change' zone as it was titled in the audit report, included transport corridors.<sup>25</sup> No such zonings were introduced by Labor before losing office in 2010. However, as noted above, the DPCD has initiated work on assessing the housing capacity of areas across Melbourne. It may be that this work could be basis for introducing the new classification. The Coalition Government may release its recommendations on the matter during 2012.

Two questions follow from these Labor Government initiatives. The first is: to what extent have municipal councils expanded their activity centres to incorporate additional areas such as transport corridors. This issue is explored in Chapter Three. The second is: to the extent that activity centres have been expanded, are they likely to lead to the construction of medium- and high-density housing likely to result in affordable housing of the type that those looking for housing want? This question is examined in Chapter Five.

### **Opening up the development frontier**

In August 2010 the Labor Government announced the result of its assessment of land needed for suburban development. Some 41,600 hectares were added within the UGB, about 60 per cent of that which the Labor Government believed would be available for development.<sup>26</sup> This was a huge addition which, when added to the land already within the UGB, will be enough for at least 25 years supply.

At the same time as the UGB was being expanded, the Labor Government was rolling out a new layer in the planning process affecting fringe developments. This, as noted earlier, is the GAA, which was established in 2006. The GAA now has a central role in the fringe planning process. Since 2008 the planning for new suburbs has been directed through Precinct Structure Plans (PSP) which the GAA is responsible for preparing. These PSPs cover parcels of land of several hundred hectares, each of which will eventually accommodate thousands of people. Each PSP denotes the precise location of land to be developed for housing, community facilities and public open space, as well as the contributions that developers must make towards carefully specified and costed local infrastructure.

There has been negligible public discussion about the role of this new layer within the planning process. Has it functioned to facilitate the supply side or, alternatively, to slow growth by imposing restrictions on the use of land covered by PSPs? Has it contributed to improvements in the provision of recreational, community and other infrastructure in new fringe communities? If so, is the GAA partly responsible for the increasing costs of land development on the fringe? Has it managed to extract some of the betterment gains that landowners have reaped when selling land rezoned for urban purposes to developers? These issues are explored in Chapter Five.

One outcome is clear. This is that the Victorian Labor Government added to the land within the UGB and then encouraged the GAA to complete the planning process quickly in order to accelerate the provision of fringe housing. This is a supply-side approach which reflects the advice of those arguing that zoning constraints and the time taken to complete development applications have limited the capacity of the development industry to provide the needed supply of land at an affordable price.

The paradigmatic exemplar of the supply-side theorists is the Texan city of Houston. Houston is famous for its antagonism to zoning controls. Developers decide where new housing estates are located, not governments. Advocates of this arrangement argue that this is the main reason why, despite rapid population growth, median house prices in Houston have remained at the very low level of around \$U.S. 200,000. This is way below the price of housing in areas with restrictive zoning laws, including San Jose and Los Angeles in California. For example, the well known urban academic, Edward Glaesner, asserts that, 'Houston is unique among all American cities in that it lacks a zoning code... Houston's freewheeling growth machine has actually done a better job of providing affordable housing than all of the progressive reforms on America's East and West coasts.'<sup>27</sup>

Breugmann, in his classic study of sprawl, contrasts Houston with Portland (Oregon). The latter city is one of the best known American examples of compact city strategies. Breugmann writes that:

A higher percentage of newcomers to Houston than to Portland have been poor and members of minority groups. The fact that Houston has somehow managed to accommodate all of these new citizens and provide for them a median family income only slightly below that of Portland is an extraordinary achievement. In part, it has been able to do this because of a permissive attitude about growth and land use that has resulted in land and house prices in Houston below the American urban average.<sup>28</sup>

The unconstrained urban growth advocates behind the annual *Demographia International Housing Affordability Survey* delight in reporting Houston's achievements. Their surveys rank major cities on an index based on the ratio of median house prices to median household income. In the 2011 survey, Houston scores a multiple of 2.9 compared with 4.4 for Portland and 6.7 for San Jose. Melbourne and Sydney rank right at the top of least affordable metropolitan markets with their ratio of median house price to median household income at 9.0 and 9.6 respectively.<sup>29</sup>

Perhaps the Victorian government's supply-side response will inaugurate a new era of cheaper land on Melbourne's suburban frontier, as has occurred in Houston? This possibility will be examined in Chapter Five.

## Chapter Three: The outcome of activity centre intensification

It is not easy to generalise about the outcomes of the Labor Government's urgency to ensure that activity centres conform to its compact city objectives. Municipal council engagement in the process has varied. Some began the preparation of structure plans soon after the legislation of *Melbourne 2030* in 2002, others delayed the process for a few years and some are still to get going. DPCD advised its Advisory Committee on Activity Centre Boundaries in April 2009 that 51 per cent of the structure plans for activity centres have been completed and that another 29 per cent were underway. The implication is that structure planning had not even started for the remaining 20 per cent.<sup>30</sup>

An examination of the published municipal activity centre strategy-planning documents indicates that there is a sharp regional divide. Councils located to the north of the Yarra have generally embraced the Government's compact city objectives in their activity centre planning. Councils located in areas to the south of the Yarra, especially in the more salubrious Eastern and Southern municipalities, have resisted them.

This conclusion mirrors that of the Urbis planning group who evaluated municipal performance on delivering development opportunities for the Property Council of Australia. Urbis implies that municipal recalcitrance was the key factor in poor medium density volumes in their jurisdictions and recommends that the councils in question be required to meet legally binding housing-construction targets.<sup>31</sup> In our view there is more to it than this. Even recalcitrant councils have had to accept a significant extension of development rights.

### North of the Yarra

The incorporation of transport corridors into activity centre structure plans is very evident in some northern municipalities, including Moreland, Darebin and Mooney Ponds.

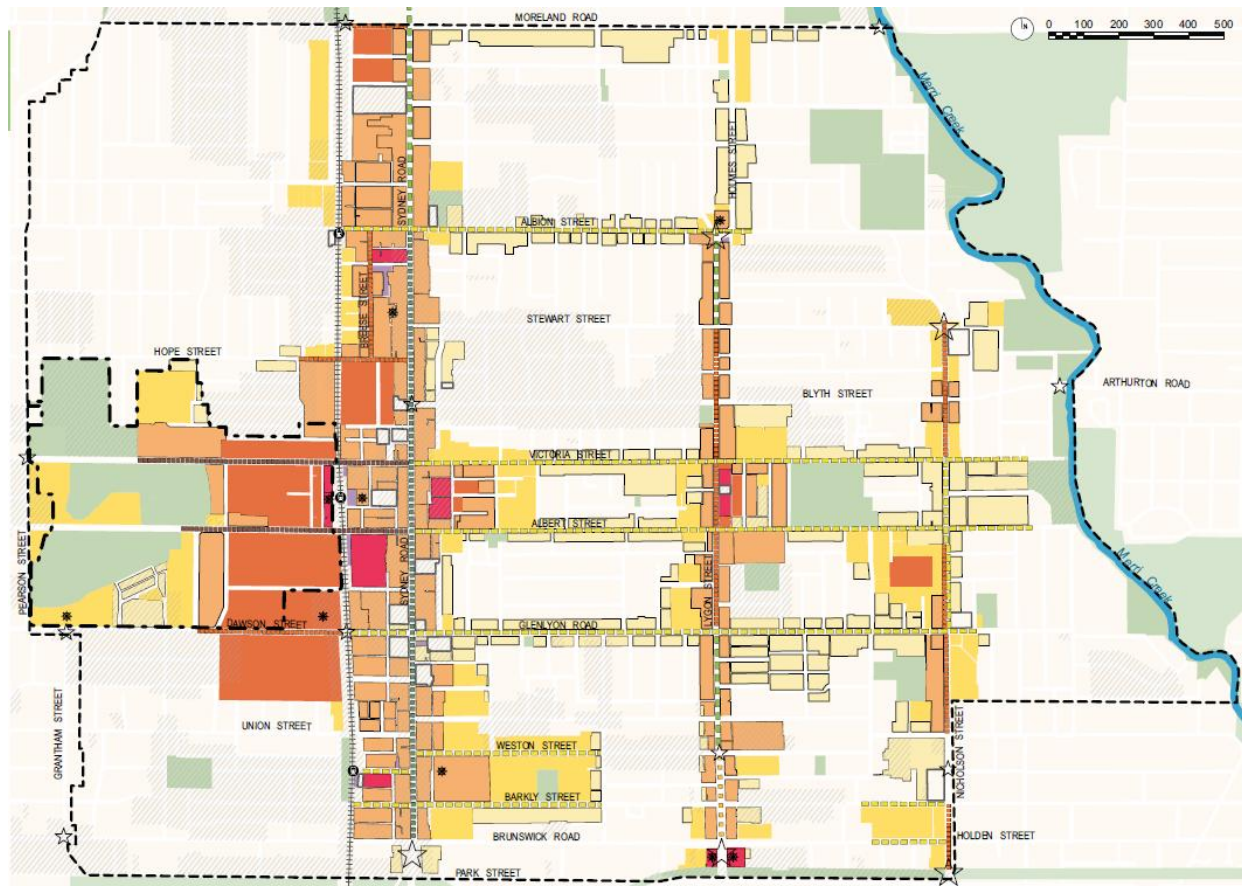
#### *Brunswick case study*

The outcome for Brunswick in the municipality of Moreland is an iconic example. The Brunswick Structure Plan, Strategic Framework, adopted by the Moreland Council on 11 August 2010, is a full-on embrace of the urbanist agenda. The plan, shown in Figure 3.1, incorporates three transport corridors, along Sydney Road, Lygon Street and Nicolson Street. The Sydney Road corridor stretches for about 2.5 kilometres, the Lygon Street corridor for almost two kilometres and the Nicolson Street corridor for about 1.5 kilometres.<sup>32</sup> In each case, tram lines run down the length of the designated corridor.

For most of the length of each of these corridors, the guidelines included in the structure plan are that apartments to a maximum of five storeys should fit with the 'preferred future character for the activity centre'.<sup>33</sup> Where there are existing strip-shopping facades, usually of two storeys, the guideline specifies that apartments built along the corridors should be set back behind these shops. In the small sections of these corridors where the five-storey height maximum is not specified, the guidelines indicate a maximum of three storeys.

The Brunswick activity-centre plan also incorporates large areas in addition to these transport corridors. The activity centre includes all the land between the 2.5 kilometres of the Sydney Road corridor and the suburban railway line running parallel nearly 200 metres away. The height guideline for development of this huge area is a maximum of five storeys.

**Figure 3.1: Built form guidelines, Brunswick Structure Plan**



Source: Moreland City Council, Brunswick Structure Plan – Strategic Framework, final version, 11 August, 2010



In addition, the Brunswick activity centre plan incorporates large blocks of industrial land to the west of the railway line where the guideline is a maximum of six storeys. Finally, as can be seen from the map, housing up to a three-storey maximum is permitted along the main cross streets – Moreland Road, Albion Street, Victoria Street, Albert Street and Glenlyon Road.

The Brunswick activity centre plan meets all the Victorian Government’s expectations. The authors state that: ‘The provision of strategic locations for new forms of residential development is an important measure to contain urban sprawl’.<sup>34</sup> They also indicate that: ‘Encouraging redevelopment to occur on sites that are well serviced by public transport and community infrastructure will also enable Council to surpass the target of 4,500 new household between 2001-2031’.<sup>35</sup> The reference



here is to the population growth targets set for municipalities by the Victorian Government in 2006 referred to earlier.

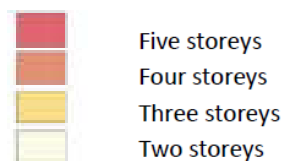
The structure plan ticks all the urbanist boxes. It asserts that, notwithstanding the increase in population, the area's liveability will be enhanced by the plan's commitments to preserving heritage sites, the renewal and expansion of community centres and the development of green spaces. For example, in relation to the public realm, the stated objective is to: 'Develop a range of new or improved public spaces that cater for different users, create choices for everyone, and strengthen informal meeting places in all neighbourhoods'.<sup>36</sup> How all this is going to be achieved is left open. However, the authors admit that implementation will require 'Development of a Development Contributions Scheme which provides the framework for developer contributions towards identified key public realm and infrastructure improvements'.<sup>37</sup>

Though not all on the same scale as the Brunswick activity centre plan, the activity centre planning for the Coburg area of Moreland, the High Street and Georges Road activity centre in Darebin and the Keilor Road area in Moonee Valley (amongst others) all incorporate long stretches of their key arterial roads. The Keilor Road plan is shown in Figure 3.2.

**Figure 3.2: Keilor Road Activity Centre Structure Plan, City of Moonee Valley**



Source: Keilor Road Activity Centre Structure Plan, City of Moonee Valley, March 18, 2008



#### *Darebin case study*

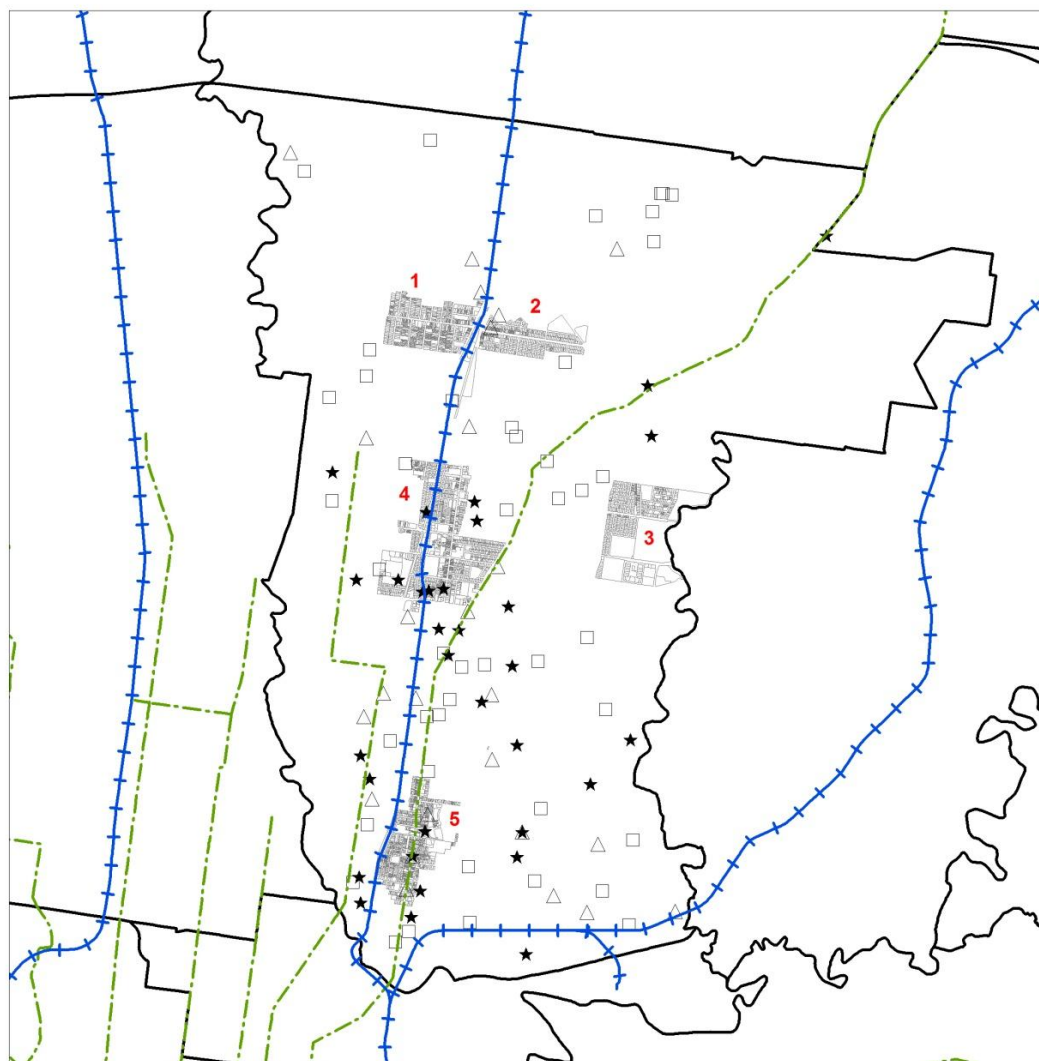
The locations of the activity centres in the City of Darebin are shown in Figure 3.3. Both the Preston and Northcote Activity Centres incorporate long stretches along High Street and Georges Road. The extent of the land involved is also substantial, given that the activity centres incorporate all the land between the two arterial roads.

The map also shows the locations of medium-density and high-density planning applications between 2009 and 2011. These applications have been categorised according to the size of the

proposed building project (whether one to five dwellings; six to ten dwellings, or more than ten dwellings). Although those falling into the more-than-ten-dwellings category are largely clustered in and around the Northcote and Preston activity centres, a number of these developments fall outside these two centres.

The implication is that the Darebin Council is not only cooperating with the government in creating large activity centres, but also in allowing substantial multi-unit development outside these activity centres. This rarely occurs in the eastern or southern suburbs.

**Figure 3.3: Locations of planning applications for medium- and high-density residential developments for the years 2009, 2010 and 2011\*, in relation to major activity centres in the municipality of Darebin, by size of development**



Source: City of Darebin Planning Committee minutes, 2009, 2010 and 2011

\* To June 2011 only

- |                                     |  |
|-------------------------------------|--|
| □ Developments 1 to 5 dwellings     | — Municipal boundary                         |
| △ Developments 6 to 10 dwellings    | <b>1 Reservoir Activity Centre</b>           |
| ★ Developments 10 or more dwellings | <b>2 Reservoir (Oakhill) Activity Centre</b> |
|                                     | <b>3 Northland Activity Centre</b>           |
|                                     | <b>4 Preston Activity Centre</b>             |
|                                     | <b>5 Northcote Activity Centre</b>           |

## South of the Yarra

On the south side of the Yarra, municipal councils have been subject to the same government pressures to help accommodate Melbourne's growing population, and to do so by defining their activity centres (and neighbourhood centres) in a manner consistent with this objective. But the resistance from the resident community and from the councillors and municipal planners representing them has been stronger.

Nevertheless, these councils have had to operate within the *Melbourne 2030* plan. Where *Melbourne 2030* has located principal or major activity centres within their jurisdiction, they have had to acknowledge that new higher density development rights have been created. The uncertainty lies in the boundaries of activity centres and the scope within them for high-rise development. These have to be negotiated between residents, councils and the state government during the structure planning process.

### *Glen Eira case study*

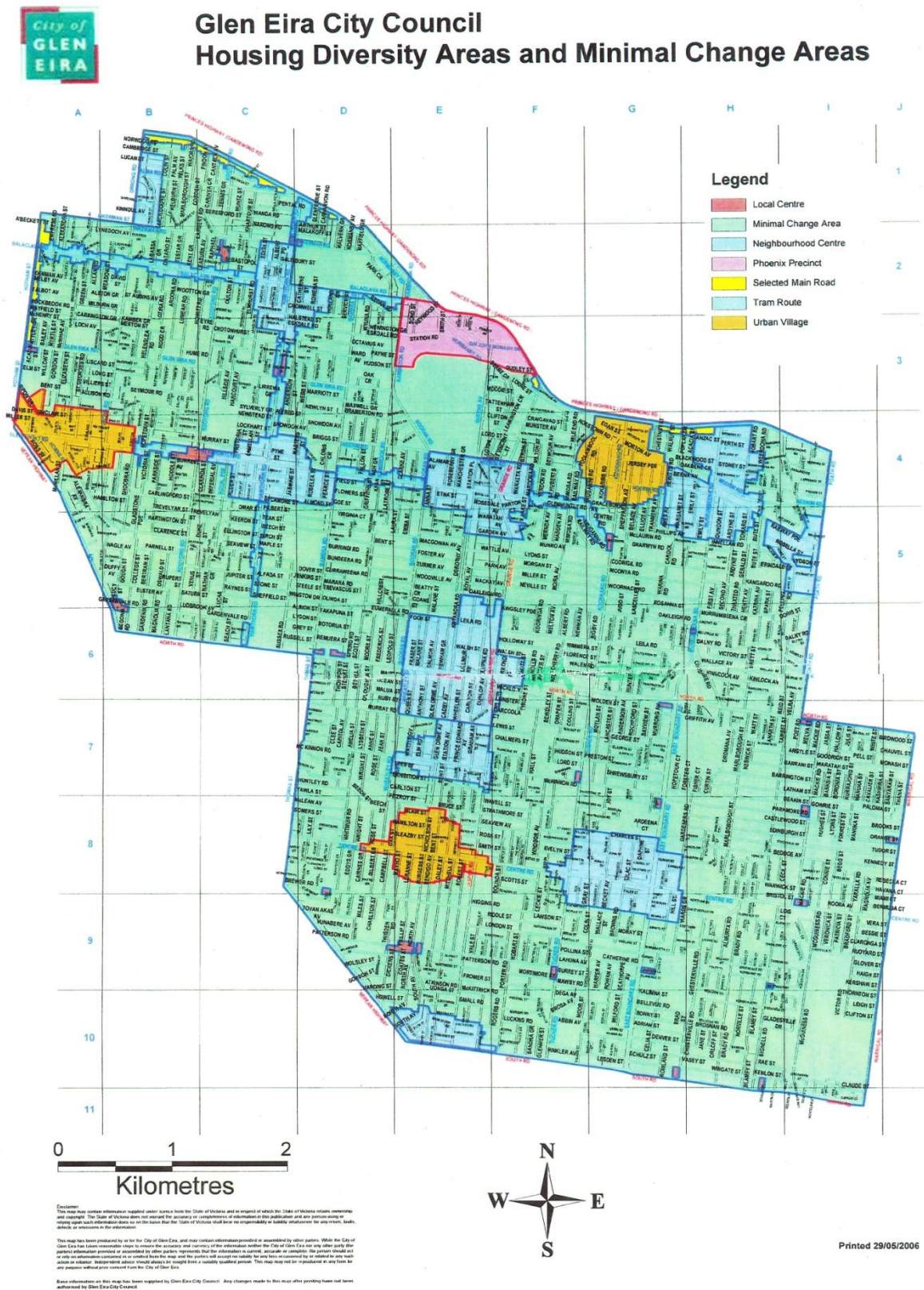
The Glen Eira example illustrates how variable the planning response is. Figure 3.4 shows the hierarchy of land-use classification in Glen Eira. The two main land-use categories are minimal change and housing diversity. The minimal change category covers 80 per cent of the municipality and is composed predominantly of detached housing. The only development permitted is infill (as with dual occupancy or units or townhouses no more than two storeys in height). Much of the rest of the municipality is designated as housing diversity. As well, there are four activity centres located at Elsternwick, Carnegie, Bentleigh and Caulfield. The first three are shown as urban villages. The Caulfield activity centre is now designated as the Phoenix Precinct following amendments to the municipal planning scheme that permit high-rise development in the precinct (detailed below). Finally there is a tram route category. In all these zones, other than the minimal change category, medium- or high-density development at various levels is permitted.

These designations became council policy in 2004. They were not forced by *Melbourne 2030*. Indeed Glen Eira is one of the minority of municipalities noted above that have not initiated structure plans. Rather these land-use classifications were the result of a compromise in the late 1990s and early 2000s when the council sought to control development in residential areas. It was up against developers who were arguing at the Victorian Civil and Administrative Tribunal (VCAT) for developments all over the municipality. In order to limit development in residential areas, yet at the same time satisfy the state government that it was allowing its share of medium density projects, the council decided that it had to designate areas of the municipality in which it would allow apartment developments.

The reason why the council has not initiated any recent activity structure planning (except in the Phoenix precinct) is that it has been reluctant to do so because of the opposition to high-density developments in the communities affected. Any suggestion that this might occur has prompted immediate resistance and the promise of prolonged controversy. So far, it has managed to convince the state government that its designations of housing diversity, tram routes and urban villages meet the government's compact city objectives.



Figure 3.4: Planning zones for the City of Glen Eira



Nevertheless, the upshot of this compromise is that the Glen Eira planning policy does permit plenty of medium-density opportunities. Apartment developments to three storeys are possible in the housing diversity areas, urban villages and along the tram lines. For example, at the time of our investigation in January 2012, the council approved a planning permit for a three-storey apartment block of 21 dwellings in Murray Street in the Caulfield South housing diversity area. The land on which this proposal was located was close to detached houses on one side and commercial buildings and two-storey flats on the other. The original planning application was for a four-storey 30-dwelling building. The developer is currently appealing the council's downsizing of the project to VCAT.

In the case of the Phoenix Precinct, the Glen Eira Council has had no choice but to negotiate with the instigator, the Melbourne Racing Club (MRC). The club wanted to develop land it owned adjoining the race course and, because the Caulfield Station area was designated as a major activity centre in *Melbourne 2030*, it was able to win Labor Government support. The Liberal-National Government and the council approved the project in 2011. The MRC plans to build 1,200 apartments, as well as large amounts of office space and shops in the area.<sup>38</sup> The project has not yet begun because the MRC is still in the process of choosing a developer to bring it to fruition.

This account indicates that the Glen Eira Council and community have put some brakes on Labor Government's enforcement its compact city objective. Yet, as the analysis has shown, Glen Eira's planning scheme offers plenty of opportunities for medium-density apartment developments. Notwithstanding these opportunities, the number of building approvals for three-storey apartments and four-storey-or-more apartments in the two statistical local areas that comprise Glen Eira has been modest. In Glen Eira (C) - Caulfield the number of such approvals has averaged less than 200 a year since 2004-05 and has been tiny in Glen Eira (C) - South.

Since Glen Eira is an attractive and relatively high-status inner-city area this begs the question as to why developers have not made more of these opportunities. Maybe it is not so much council and community obstruction, but the inability of developers to supply family-friendly housing at a price that the market can afford or desires. This issue is explored in Chapter Four.

#### *Boroondara case study*

A similar argument can be made for the City of Boroondara. The city is renowned for the vigour of community opposition to medium-to-high-density development. Any councillor taking a contrary stance would struggle to get elected or stay elected. Nevertheless, the council has had to accommodate to the Victorian Government's planning decisions. These include the designation of three activities centres in the original *Melbourne 2030* plan.

The council has had to prepare a structure plan for the Camberwell Junction principal activity centre and for the major activity centres at Kew Junction and Glenferrie. The structure plan for Camberwell Junction, adopted by the council on 27 October 2008, identified several sites for apartments with preferred height limits up to six storeys.

This constraint has not stopped one development well above these guidelines. The Aerial project, which is currently under construction at the intersection of Riversdale, Camberwell and Bourke Roads, is a celebrated case. It was opposed by residents and the Boroondara council because its proposed scale (14 storeys) was totally at odds with the surrounding low-rise detached housing and

because of the congested nature of the area around its location. Nevertheless, with the strong endorsement of the then Minister for Planning, Justin Madden, it was approved by VCAT in February 2008. The grounds for this decision were that the project was consistent with the government's compact city policy. A senior member of VCAT stated that: 'the time has come for Camberwell to play its part in the 2030 solution to Melbourne's housing needs, and there is no better spot to fit this need than this site'.<sup>39</sup>

However, there have been almost no approvals for three- or four-storey or more developments in the Kew activity centre since Melbourne 2030 was legislated in 2002.

In the case of the city's neighbourhood centres, there are dozens of these which the council classifies at various levels according to their size. The largest is the Balwyn neighbourhood centre located along Whitehorse Road, on either side of Balwyn Road. The structure plan (approved in 2009) states that this is a good site to house additional accommodation 'in accordance with directions of the metropolitan planning strategy: Melbourne 2030'.<sup>40</sup> Furthermore, 'both local and state policy promotes a need to consolidate population into activity centres as a means of promoting environmental and socially sustainable communities'.<sup>41</sup> This rationale — which the document claims the affected community approved of<sup>42</sup> — is the basis for a structure plan which allows three- to four-storey medium-density housing along parts of the strip.

More recently the council has produced structure plans for most of the smaller centres which are designated as community shopping strips or convenience shopping strips. The justification, residents were told in November 2010, was that Melbourne is expected to grow to around five million by 2030 and that, as a consequence:

The state government tells us that we need to play our part in managing this population growth and accommodate an additional 9,100 dwellings in our City by 2026.

To meet this obligation, our strategic planners have prepared a draft strategy for our strip shopping centres, where we believe we can accommodate 60 per cent to 80 per cent of this housing growth in under three per cent of Boroondara's land, rather than directing it towards residential streets.<sup>43</sup>

The council officers did complete the structure plans for the city's neighbourhood activity centres. They specified building height limits which would have allowed some medium-density housing in each of these centres. When released for public review the response was a community outcry. By this time Labor had lost office and the council was under less pressure from the new state government to proceed with the proposed new plans. The manager of strategic planning, Johann Rajaratnam, reported to the council in May 2011 that:

Council finds itself in a changed planning environment due to the election of a new state government. A review of statements made by the Minister for Planning indicates that the state government has recast the debate away from population targets. This message has been reinforced in meetings with the Minister for Planning in which it has been stated that the state government will focus growth in areas such as Fishermans Bend and regional areas.<sup>44</sup>

Subsequently the council modified the original structure plans and, in the case of the Maling Road neighbourhood centre, withdrew the structure plan altogether. Nevertheless, most of the neighbourhood structure plans do permit three- or four-storey medium-density development within the area they encompass.

These developments illustrate how contentious the planning process is in some inner-zone municipalities. But notwithstanding this resistance to change, Boroondara, like the other relevant councils, has had to capitulate to some extent with the State Labor Government's compact city objective. On the other hand, the actual level of medium- to high-density apartment projects in some of the activity centres (notably Kew Junction) and larger neighbourhood centres (particularly the Balwyn neighbourhood centre) is not what might have been expected if developers had utilised all the new development rights created by Melbourne 2030.

The reasons for this situation and for overall failure of *Melbourne 2030* (at least, up to 2010) have to do with other factors, including the construction costs of apartments and their relevance to the needs of new households.

The exploration of this issue requires an examination of the pattern of household growth in Melbourne. We start with the projected scale of population growth in Melbourne, the growth in the numbers of households flowing from this population growth and the family type of these households. This foundation provides the basis for assessing the total volume of additional dwellings needed by type of dwelling.

## Chapter Four: The development task ahead for Melbourne

### The population outlook

The Victorian State Government expects that high levels of overseas migration to Melbourne will continue. This expectation is based on the policy statements of the Australian Government, which has indicated an intention to maintain a permanent migration intake of more than 200,000 a year, and a total net overseas migration (NOM) intake of around 180,000 a year. However, these numbers shroud major changes in the characteristics and destinations of migrants.<sup>45</sup> These changes, as the following analysis indicates, imply that Melbourne's share of NOM could fall.

The Australian Bureau of Statistics (ABS) has estimated that Australia's NOM increased from 156,780 in 2005 to 315,690 in 2008.<sup>46</sup> Half of this growth in NOM derived from one group, overseas students. Their contribution to NOM grew from 42,800 in 2005 to 121,690 in 2008. Seventy per cent of all of the growth in NOM from overseas students over the years 2005 to 2008 was located in New South Wales and Victoria, almost all in Sydney and Melbourne respectively. The result is that overseas students have made a huge contribution to the recent growth in population in Sydney and Melbourne. In the case of Victoria, total NOM (from all sources) grew from 40,200 in 2005 to 83,150 in 2008 (again with almost all of this in Melbourne). Sixty-four per cent of this growth in NOM in Victoria derived from the net movement of overseas students.<sup>47</sup> There was a similar pattern in New South Wales (NSW).

This source of growth for Melbourne is now shrinking. The number of persons holding student visas in Australia has fallen in the past two years because of changes to Australia's permanent entry migration regulations. These have sharply curtailed access to permanent residence following completion of Vocational Education and Training (VET) and university courses. Largely as a consequence, the number of student visas issued at overseas posts for students doing VET courses across Australia fell from 68,729 in the peak year of 2008-09 to 15,556 in 2010-11 and for university courses from 90,616 to 55,922 over the same years.<sup>48</sup> This contraction of the flow of new overseas students, combined with the eventual departure of most of those already here, means that NOM from this source has fallen and will continue to do so for several years. The Department of Immigration and Citizenship (DIAC) projects that this fall will be from the peak of 121,690 in 2008 noted above, to around 19,300 for the year ending June 2012 and around 24,900 in the year ending June 2015.<sup>49</sup>

Because of Melbourne's role as a locus for overseas students, this decline will have a marked impact on Melbourne's population growth. This is already beginning to happen. The ABS estimates that NOM for Victoria fell from 83,528 in 2008-09 to 45,744 in 2010-11.<sup>50</sup> This decline is the main reason why Melbourne's growth in population is estimated to have fallen from 95,963 in 2008-09, to 72,492 in 2009-2010 and 66,918 in 2010-11.<sup>51</sup>

The other major source of migrants is those gaining permanent entry. So far, Melbourne's share of the permanent migration program has held up. This program is now at record levels, reflecting the Federal Labor Government's desire to maintain aggregate economic growth at a high level and its anxiety about skilled labour shortages flowing from the resources boom.<sup>52</sup> In 2010-11 this program



delivered 213,409 additions to Australia's stock of permanent residents (including 34,567 New Zealand residents who declared that they intended to stay permanently in Australia when they arrived during 2010-11). Victoria's share of this 213,409 was put by DIAC at 53,204 or 24.9 per cent.

However, Victoria's share of the permanent-entry migration program (almost all of whom locate in Melbourne), is likely to fall in the medium term. This is because the Federal Government is giving greater priority to migrants sponsored by employers, in the hope that the permanent skilled program will better reflect employers' skill needs, especially those employed in the construction industry in Western Australia (WA) and Queensland. This change in focus will favour WA and Queensland because it is in these states that skill shortages are most acute. The priority given to employer nominations has meant a decline in the share of skilled permanent visas allocated to the points-tested skilled visa subclasses. Most of the applicants gaining these visas over the last few years have been former students, the majority of whom studied in Sydney and Melbourne. The combination of these changes suggests that there will be a decline in the share of total permanent visas allocated to persons already living in or intending to live in Melbourne.

For the longer term, it is also likely that structural changes in Australia's economy resulting from the minerals boom and the effect of the high Australian dollar will work against employment growth in Victoria. This is already evident in the sharp decline in employment in manufacturing in Victoria. In consequence, there will be a reduction in Victoria's attractions for migrants, and an increased pull on resident Melbourne workers to move to the job-rich resource states.

#### *An alternative population projection for Melbourne*

As a result of these developments, it is likely that Melbourne's share of Australia's NOM will fall and that the Victorian Government's current projections are too high. At the time of writing, the Victorian Government issued new population projections. These ignore the points made above. The new, 2012 projections, assume Victoria will continue to receive 27 per cent of Australia's NOM of 180,000. Most of the new migrants are assumed to settle in Melbourne.<sup>53</sup>

Our household estimates are based on lower migration assumptions. For this purpose the ABS Series C population projection for Melbourne has been used. The alternative series B projection is the 'Big Australia' projection, which has Australia reaching 36 million by 2050 and Melbourne reaching 6.5 million at 2050. The assumptions in Series B are similar to those used in the *Victoria in Future 2008* and *Victoria in Future 2012* projections.

The lower growth Series C projection assumes that NOM will contribute 35,660 a year to Melbourne's population each year, rather than 45,116 per year as is assumed in the Series B projection. If net overseas migration for Australia continues at 180,000 a year, but Melbourne's attraction for migrants declines as anticipated, Melbourne's share will fall. The assumption in the Series C projection, that Melbourne will gain 35,660 a year is a plausible outcome in the light of the circumstances analysed above. If so, Melbourne's share of a net 180,000 NOM outcome will fall from the around 25 per cent the city has received in recent years to around 20 per cent.

The Series C projection also assumes that the total fertility rate (TFR) for Melbourne will drop gradually to 1.5 by 2021 rather than continue at 1.7 as in the Series B projection. This fertility

assumption may be on the low side, though the current housing affordability crisis in Melbourne might lead to fewer births than would otherwise have been the case.

Given these assumptions, Melbourne will grow to 5.9 million by 2050, or 600,000 fewer than under the 'Big Australia' projection of 6.5 million. Over the thirty-year period 2010 to 2040, Melbourne is projected to grow by 1.5 million, rather than by 1.9 million as projected under the Big Australia Series B projection and under the current Victorian State Government projection. This is still a very high level of growth, well ahead of the original *Melbourne 2030* expectation that Melbourne would have to accommodate an additional one million residents over the 30 years to 2030. Nearly 70 per cent of Melbourne's growth of 1.5 million between 2010 and 2040, under this low growth scenario, will be attributable to migrants arriving over the time period. This does not include their children born in Australia.

For the ten-year period between 2011 and 2021 that is the focus of our household estimates, on the low growth assumptions Melbourne will grow by 553,559.<sup>54</sup> By contrast, the *Victoria in Future 2012* projection has Melbourne growing by 672,100.<sup>55</sup>

Some 64 per cent of the 553,539 projected increase in population is attributable to net overseas migration (again not including children born in Australia). It was not possible to calculate the number of households resulting from this contribution. This is because of the uncertain nature of household formation amongst recently arrived migrants. However, the share is likely to be much less than 64 per cent. As is made clear in the following account, regardless of the migration contribution, there will be rapid growth in the number of households in Melbourne because of the large number of younger households likely to be formed from the ranks of existing Australian residents as of 2011.

### Household projections

The estimates of household numbers and household type provided in Table 4.1 are based on the propensities for persons in each age band to be in a certain living arrangement such as in a couple family with children, couple family without children, lone parent family and other family or, if not in a family, whether in a group or a lone person household. The propensities in question were calculated by the ABS. They were drawn from the actual living arrangements of persons by family/household type for Melbourne residents, by age and sex in 2006.<sup>56</sup> In Table 4.1 these propensities have been applied to the population projected for Melbourne as discussed above. This methodology was used because the ABS has not used the propensity information to produce household projections which give an indication of family or household type by the age group of the inhabitants. Nor has the Victorian Government.

Table 4.1 provides the family and household estimates for the period 2011 to 2021, by type and age group.<sup>i</sup> This ten-year period was chosen because it is likely to be of the most interest for those

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<sup>i</sup> The number of households by type in each age band is an approximation. The methodology used to estimate the number of households is based on the number of males and females in each age group as projected by ABS for both 2011 and 2021. Persons have been assigned to the different family or household types. In the case of persons living as lone persons or lone parents, each formed one family or household. Where ABS has indicated that a person of a certain age, say 35-44, is projected to be living as a partner in a couple, it was assumed that they formed half of a couple family in the 35-44 age group. The children, including adult children, projected to be living with their parents are not part of the calculations as they do not add to the number of families or households, although they do contribute to the size of these families. To convert the number of families to households, some adjustments have been made to allow for households which comprise

thinking about the accommodation task in Melbourne over the medium term. Table 4.1, which is modelled on the population projection for Melbourne, indicates that the number of households will grow by 266,492. This is little lower than the increase in households projected in *Victoria in Future 2012* of 289,300.<sup>57</sup> The 266,492 number gives an approximate indication of the growth in dwellings needed to accommodate the projected population increase between 2011 and 2021. It implies an average annual addition of around 26,650 dwellings over the ten year period to 2021. By comparison, building approvals for dwellings averaged around 34,450 a year in Melbourne over the ten years 2001-02 to 2010-11 (Table 5.1, Chapter Five). Given that several thousand existing dwellings would have been demolished each year in order to develop new units or townhouses, the implication is that the development task over the next decade is likely to be nearly as high as that achieved in the past decade.

### *Implications of household projections for the housing market*

Official and private-sector household projections invariably show that most of the growth in households over the next few decades will be amongst singles and couples without children. For example, the National Housing Supply Council's latest projections, prepared by ANU demographers, indicate that, for the period 2010 to 2020, total households in Australia under the Big Australia scenario will grow by 1.6 million, of which 706,700 will be lone-person households. Their number dwarfs the projected growth of 466,200 households consisting of couple family with children.<sup>58</sup> As follows from such projections, the average size of households will also fall.

But it does not follow that, as a consequence of this increase in smaller households, there will be an increased preference for living in an apartment or unit. This is especially unlikely over the decade to 2021 because most of the growth of single and couple-without-children households in Melbourne will be amongst older households. For example, over the decade to 2001 when this change in preferences was supposed to have started, there was no net movement of older households into the inner areas of Melbourne where most of the new higher density housing had been built.<sup>59</sup>

Yet, wherever one looks in the planning literature, one finds the assertion that the projected growth in the number of small households means a consequent increase in demand for apartment living. For example, the Boroondara Activity Centres Strategy states that:

This trend to incorporate more residential uses in activity centres is supported by the ongoing decline in household sizes and changes in lifestyle which are driving the popularity of medium and higher density housing forms in the established inner and middle suburbs of Melbourne.<sup>60</sup>

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of two or more families. This was done by reducing the number of families by the factor needed to reduce the number of families in 2006 to match the total family households published by ABS for 2006. Because there was no information on the age structure of such families, the reduction had to be applied equally across the age groups.

To estimate the number of group households, the number of persons in each age group projected by ABS to be living in this arrangement was divided by the average size of all group households in 2006. (No information on the variation in the size of group household by age was readily available to apply to the model. If the size of younger group households is larger than older group households this may overstate the number of younger group households and understate the number of older households.)

In reality, actual households, whether group or family, will be composed of persons drawn from different age bands, as when an older male in the 35-44 age group is partnered by a female in the 25-34 age group. Nevertheless, the estimate gives a good indication of the number of households by household type by age band because most households comprise partners of similar age.

**Table 4.1: Estimates of the number of family and households by type and by age of the inhabitants, based on low population growth projections for Melbourne, 2011-2021**

	15 - 24	25 - 34	35 - 44	45 - 54	55 - 64	65 - 74	75 - 84	85 +	Total
<i>30 June 2011</i>									
Couple family with children	4,498	87,342	186,090	159,833	68,499	19,143	5,376	955	531,737
Couple family without children	15,570	81,448	33,318	40,586	93,793	78,596	38,845	7,132	389,288
Lone parent family	4,518	23,208	45,974	48,578	24,230	12,549	9,846	4,891	173,793
Other family	8,457	7,077	2,267	1,805	1,609	1,357	1,097	460	24,129
Total families ^	33,043	199,075	267,649	250,802	188,132	111,645	55,164	13,438	1,118,947
Family households *	32,425	195,347	262,637	246,106	184,609	109,555	54,131	13,186	1,097,995
Group household	20,729	24,275	6,745	4,690	3,859	2,285	1,030	348	63,962
Lone person	15,021	54,854	51,947	51,047	57,768	53,422	53,196	24,163	361,418
Total households	68,175	274,475	321,329	301,843	246,236	165,262	108,358	37,697	1,523,374
<i>30 June 2021</i>									
Couple family with children	4,869	102,014	207,704	177,889	79,255	27,283	7,217	1,265	607,493
Couple family without children	16,716	94,470	36,960	47,031	112,317	111,352	51,644	9,464	479,952
Lone parent family	4,892	27,330	51,538	54,178	28,153	17,938	13,040	6,484	203,553
Other family	8,881	8,191	2,504	2,012	1,898	1,933	1,452	611	27,481
Total families ^	35,357	232,005	298,705	281,109	221,622	158,505	73,353	17,823	1,318,479
Family households *	33,271	220,834	287,750	274,533	218,327	156,042	71,947	17,575	1,280,279
Group household	21,270	27,442	7,390	5,232	4,564	3,255	1,370	463	70,987
Lone person	15,413	62,010	56,914	56,943	68,319	76,091	70,706	32,205	438,601
Total households	69,954	310,286	352,054	336,708	291,210	235,388	144,023	50,244	1,789,866
<i>Change 2011-2021</i>									
Couple family with children	370	14,672	21,613	18,055	10,756	8,139	1,840	310	75,756
Couple family without children	1,145	13,022	3,642	6,445	18,523	32,755	12,799	2,331	90,663
Lone parent family	374	4,122	5,564	5,600	3,923	5,389	3,194	1,593	29,760
Other family	424	1,114	237	206	289	575	356	151	3,352
Total families ^	2,313	32,930	31,056	30,307	33,491	46,860	18,189	4,385	199,531
Family households *	846	25,487	25,113	28,427	33,719	46,487	17,817	4,389	182,284
Group household	541	3,167	645	542	705	970	339	116	7,024
Lone person	392	7,157	4,967	5,896	10,551	22,669	17,509	8,042	77,183
Total households	1,779	35,811	30,725	34,865	44,975	70,126	35,665	12,547	266,492
<i>Change 2011-2021, percentage in each age group#</i>									
Couple family with children	0	19	29	24	14	11	2	0	100
Couple family without children	1	14	4	7	20	36	14	3	100
Lone parent family	1	14	19	19	13	18	11	5	100
Other family	13	33	7	6	9	17	11	5	100
Total families	1	17	16	15	17	23	9	2	100
Family households	0	14	14	16	18	26	10	2	100
Group household	8	45	9	8	10	14	5	2	100
Lone person	1	9	6	8	14	29	23	10	100
Total households	1	13	12	13	17	26	13	5	100

^ Because some households contain more than one family, there are more families than family households.

\* Estimate of family households derived from reducing the number of families by the factor needed to reduce the number of families in 2006 to match the total family households published by ABS for 2006. This was done because some households contain more than one family as in where elderly parents may live with their adult children, or adult children with their offspring live in their parents' household. Because there was no information on the age structure of such families, the reduction has been applied equally across all age groups. Estimate of other family households calculated using average size of other family households in 2006. Estimate of group households calculated using average size of group households in 2006.

# Percentages may not add to 100 because of rounding.

Source: CPUR estimates derived from ABS Population Projections (released in 2008) by imposing the Series I living arrangement propensities of persons by ten year age group as of 2006 on the Series C Population Projections by ten year age group.

Such conclusions are misleading as a guide to housing needs. This is because they ignore the age structure of the households under discussion. The projected growth in households of 266,492 for Melbourne over the 2011 to 2021 decade, as shown in Table 4.1, is attributable both to the growth assumed in Melbourne's population and to the ageing of the city's population. The latter factor is the main explanation for the finding in Table 4.1 that sixty-one per cent of the household growth over this decade will be amongst households made up of persons aged 55 plus. This is a consequence of the ageing of the baby-boom generation born between 1950 and 1965. The first of these baby boomers will be entering their 60s during the 2011 to 2021 decade. They will be replacing a much smaller cohort of households currently in the 60 or older age group. The latter were born prior to 1950 when the number of births was much lower.

Even more striking, it can be calculated from Table 4.1 (see shaded numbers) that the households made up of persons aged 55 years or older will be responsible for more than 70 per cent of the projected growth in both the number of couple-without-children families and the number of lone-person households over the decade 2011 to 2021. If apartments and units are built with the intention that they should provide future housing for these households, large numbers of households made up of people aged 55 or older (by 2021) will have to move into such dwellings during the decade.

This is very unlikely. Most of these one- and two-person older households will not be entering the housing market over the next decade. They are already ensconced in their own houses. In 2006, as Table A.1 in the Appendix shows, 80 per cent of households in Melbourne where the household head was aged 45-54 owned or were purchasing the dwelling they lived in, as were 85 per cent of those aged 55-64. The evidence documenting the lack of interest on the part of older persons in leaving their current homes is strong.<sup>61</sup> When people leave the workforce to retire, the home becomes a more central component of their lives. Even though most of the older persons who live in detached houses have more bedrooms than is needed for the accommodation of one or two persons, the survey (and anecdotal) evidence indicates that extra rooms are valued as sites for hobbies, for visits from relatives and friends, and space for boomerang children. The outdoor area is also highly valued during retirement years.<sup>62</sup>

Not surprisingly, according to one recent survey of attitudes of older people to detached housing, 'there was an overwhelming desire to remain in their own home for as long as possible for a host of reasons including suitability of the dwelling, proximity to family and friends, shopping, transport and health services, and because of familiarity with the local community and neighbourhoods.'<sup>63</sup> Current federal government policy is to encourage older persons to stay in their homes as long as possible.

#### *The demand for housing will come from new households*

A more appropriate way of thinking about demand for housing is to compare the number of new households likely to be formed amongst younger persons with the number of households likely to exit the population over the projection period. If Melbourne's population were evenly distributed across the age range then new entrants could expect that their housing needs would largely be met from vacancies as older households exit their houses because of death, the need to move to cared accommodation or perhaps to move into their children's households. Melbourne's population is most definitely not evenly distributed. The population aged 75-84 is quite small because it reflects the low birth levels of the pre-World War 2 era.

The implications of this age distribution for dwelling supply are developed in Table 4.2. This shows that, over the decade 2011 to 2021, as one might expect, most of the households in the 75-84 age cohort alive in 2011 do not survive to 2021. As a consequence, there is a loss of 95,811 households in this age group, as well as of 21,239 amongst those aged 65-74 in 2011. These losses will translate into a similar number of exits from the detached housing in which most of these people would have been living.

These losses may look large, but they are dwarfed by the growth in the number of new households that will form over the 2011 to 2021 decade amongst those in the 15-24, 25-34 and 35-44 year age groups (discussed below).

Because of the relatively low number of exits, and because most of the surviving older households by 2021 will remain in their detached houses, judgements about the likely demand for housing should focus on the numbers and preferences of the new households likely to form between 2011 and 2021.

An indication of their numbers can be estimated as follows. Table 4.2 shows that by 2021 there will be 310,286 households composed of persons aged 25-34. Most of these households will form during the decade to 2021 and thus will be new entrants to the housing market. This is because most of the persons aged 25-34 living in their own households in 2021 would have been aged 15-24 in 2011 and thus living in their parents' household.<sup>64</sup> In 2011 such persons would have been classified as a child living in a couple-family-with-children household, that is, in a household headed by their parents.

**Table 4.2: Estimation of the contribution of household formation and dissolution to the number of households, by age group, Melbourne 2011-2021**

	Age group								Total
	15 - 24	25 - 34	35 - 44	45 - 54	55 - 64	65 - 74	75 - 84	85 +	
Number of households in 2011	68,175	274,475	321,329	301,843	246,236	165,262	108,358	37,697	1,523,374
Households of 2011 ageing in place*	-	68,175	274,475	321,329	301,843	246,236	165,262	146,055#	1,523,374
Number of households projected by 2021	69,954	310,286	352,054	336,708	291,210	235,388	144,023	50,244	1,789,866
Net change from household formation/dissolution^	69,954	242,111	77,578	15,379	-10,633	-10,848	-21,239	-95,811	266,492

Net change in number of households by cumulative age groups

	Age group							Total
	15-24	15-34	15-44	15-54	15-64	15-74	15-84	
Additional households	69,954	312,065	389,644	405,022	394,390	383,542	362,303	266,492

\* Based on the assumption that the existing households of 2011 age in place (that is, within Melbourne) over the ten years. This assumption enables an estimation to be made of the net contribution of the formation and dissolution of households to the number of households in 2021.

# Sum of those aged 75-84 and 85+ in 2011

^ The net change from household formation/dissolution is calculated as the difference between the total number of households projected for 2021 minus the households existing in 2011 ageing in place. It therefore indicates both the net growth and net decline in households according to age group. Growth comes from new households being formed by persons who were previously not counted as living in their own household (for example, they lived with their parents), or from in-migration in that they lived outside Melbourne in 2011. Decline comes through the dissolution of households through death, changed living arrangements (for example, by becoming part of other households or entering an institution) or by out-migration from Melbourne.

There were just 68,175 households made up of persons aged 15-24 in 2011. For the purpose of making an estimate of the number of new households formed by this cohort as it ages over the

decade to 2021, it is assumed that these 68,175 households are still intact in 2021, by which time they are included in the 25-34 year old age group. By 2021 it is projected that there will be a total of 310,286 households in the 25-34 age group. This means that 242,111 of these 310,286 households will be additional households which have formed during the decade to 2021.

Likewise, Table 4.2 indicates that another 77,578 households in the 35-44 age group as of 2021 will be added over the decade. In the case of the 15-24 year-old age group as of 2021, all 69,954 households would have formed during the decade as these persons would have been aged less than 15 in 2011 and living with their parents.

The result is that there will be a total of 389,643 newly formed households in these three age groups added over the decade. The net flow of persons from interstate or overseas migration is included in this number. All of these households will be seeking to rent or purchase housing during the decade.

This is an enormous number. It is larger than the 266,492 total number of Melbourne households projected to be added over the same period. The explanation is mainly that thousands of households existing in 2011, especially those aged 75-84 (as noted above – some 95,811 – see Table 4.2), will not survive the decade to 2021.

### **Implications for Melbourne's dwelling needs**

What kind of housing will these new, younger households want? The answer will be shaped by the type of household they form. If they are predominantly singles and couples without children, then medium-density housing may suit their requirements. If they are families with children or are couples planning to embark on having a family, such housing is unlikely to meet their needs.

As might be expected, given the increasing average age of mothers at first birth, well below half of the 25-34 year olds persons in households in 2011 and 2021 are in couple-with-children or lone parent families. The rest of the households in this age group will be composed of couple- without-children families, single persons or unrelated groups. Those who think that the new cohort entering the housing market in this age group will be satisfied with medium-density housing can take heart from these figures.

However, this conclusion underestimates the likely demand for housing suitable for those planning to raise a family.

Most of the persons aged 25-34 in couple-without-children families in 2021 would have given some thought during the preceding decade to the purchase of a house in preparation for starting a family. Table 4.1 substantiates this point. It shows that if those in the 25-34 age group show the same propensity to have children as has been the case in the recent past, then by the time they reach 35-44, the great majority will be in couple-with-children or lone parent families. As a result, though they might choose to purchase a small apartment or unit for a few years, they will probably seek to move to more family-friendly accommodation once they start having a family.

The conclusion is that most of the demand for the additional housing will come from younger people who are in the household formation stages. The majority of these, according to the estimates, will be looking for housing suitable for raising a family. A two-bedroom apartment of around 70 square metres (around the size of most two-bedroom apartments available in Melbourne currently) is

unlikely to satisfy these households. Yet that is what is likely to be offered in activity centres. As shown in the next chapter, the costs of three-bedroom apartments of around 110 square metres are well beyond the financial means of most new households.

### *The Grattan Institute view*

These conclusions have made little impact in the urbanist literature or in the thinking of the Victorian Government's plans for Melbourne. Studies and reports continue to promote the established doctrine that demographic change is generating a preference for apartment living.

An interesting recent addition to this literature comes from a report on housing needs issued by the Grattan Institute on 21 June 2011. The Institute concludes that there is not enough medium- and high-density housing being built in Melbourne. One might imagine that the report offers another version of the argument that the rapid projected growth in the number of lone person and couple-without-children households will exceed the supply of medium-to-high-density housing. However, the Institute pursues a different methodology and for that reason deserves close scrutiny.

The Institute first conducted focus group discussions about housing preferences from which it concluded that the great majority of households would prefer a detached house.<sup>65</sup> This is not a conclusion usually reached by urbanists. Nonetheless, the second part of the study produced findings more compatible with urbanist expectations. In this part, an online survey of 706 people was conducted which probed the factors which people take into account when they choose a house, including the location and price of the dwelling.

The conclusion drawn from this online survey was that, though most respondents would prefer a detached dwelling, the costs of these dwellings in established residential areas were such that many are prepared to trade-off this preference for a cheaper semi-detached dwelling or apartment in an established area location.

In the case of Melbourne, the analysis indicated that there are not enough such dwellings in established areas to satisfy these preferences. The Institute's headline conclusion was that there is a large mismatch between the need for semi-detached housing and apartment-style housing of four-storeys-or-more (though not blocks of up to three storeys) and the amount of such housing in established areas of Melbourne.<sup>66</sup>

This seems to be a plausible conclusion. But there are some serious unanswered questions. In particular, if the demand for such higher density housing is there, why have developers not produced it? The Institute glosses over this issue. However, it reports that there are critical disincentives in the planning process which affect the construction of three- and four-storey-or-more apartment projects in Melbourne. The implication readers are left to draw is that it is these disincentives which are the problem.<sup>67</sup>

The analysis in the following chapter does confirm that developers face severe cost hurdles in constructing family-friendly apartments within the financial range of new households. This does help explain the extraordinary paucity of such apartments on the Melbourne housing market. It may also be, as argued above, that apartment-style living does not accord with the preferences of young households thinking about starting a family. This is not an issue that the Grattan Institute deals with.



Its conclusions about the trade-off between type of dwelling, price and location were based on the aggregated results of its online survey. There is no differentiation in the results presented between the preferences and trade-offs made by the various categories of household (singles, couples, couples with children and so on). What matters in determining the kind of housing needed in Melbourne is the preferences of the new households that will be entering the housing market over the next decade. The Grattan Institute report provides no help on this issue.

## Chapter Five: The housing market in established suburbia after Labor's reformulation of *Melbourne 2030*

The focus in this chapter is on the response to the reformulation of *Melbourne 2030* since 2008. We begin with housing construction in established suburbia. The prospects for fringe housing are explored in Chapter Six.

The context is the remarkable escalation of housing prices across the city during the past decade. Most of this housing is now out of reach of the average first-home buyer and, in the core and inner areas of Melbourne, even beyond the means of new professional households. The key question is: will the push to provide more development opportunities succeed in prompting developers to construct more medium-density housing, and if they do, what sort of apartments and at what cost?

In reviewing Melbourne's experience in the provision of new housing in established suburbia, a four-fold classification has been used. There is some bleeding from one category to another, but for analytical purposes the categorisation has proved useful in understanding the Melbourne housing market. The first category is 'infill'. This refers to the construction of two or more detached or semi-detached dwellings (including townhouses) or units on sites previously occupied by detached houses. The second is apartments that are aimed at a wide demographic. This category includes the medium-density apartments that the *Melbourne 2030* policy architects hoped would provide an affordable and attractive destination for an increasing share of households. The aspiration was that such apartments would be located in and around activity centres. The third is the luxury apartment product aimed at high wealth or affluent consumers. These have been located in prestige locations close to valued amenities in the core and inner zones of Melbourne. The fourth is high-rise small apartments, which in Melbourne's case have primarily been located in the CBD, the CBD fringe and Docklands. Detached housing is a fifth category which is discussed in the next chapter.

Table 5.1 provides an indication of the number of building approvals in these categories in Melbourne since 2001-02. The data is based on a customised purchase of building approval data from the ABS. It was not possible to match exactly the five categories described above. The semi-detached and units/apartments to two storeys grouping includes most of the infill category, though as explained below, some of the detached houses which the ABS records in the inner and middle zones of Melbourne are actually infill. Unfortunately we were not able to match the medium-density category. The closest indication in the table is the three-storey grouping. The final grouping in the table of four-storeys-or-higher includes some medium-density apartments but, as will become evident, mainly consists of high-rise small apartments. The zones into which the data are classified are identical to those utilised for the dwelling price tables in Chapter One.

It will be noted that nearly 45 per cent of the building approvals for Melbourne each year are for detached houses in the outer zone. Almost all of these are for new houses on recently subdivided land. This information indicates how important fringe housing has been in augmenting Melbourne's dwelling stock. However, it understates this contribution because each year there are around 4,000 demolitions of former residences in established suburbia (rising to nearly 5,000 in 2010-11 – see Table 5.2). Since these demolitions occur in established suburbia, in order to compare the

contribution of established suburbia to that of fringe housing, the established area contribution must be reduced by around 4,000 each year. The result of this arithmetic is that the share of detached housing on the fringe to the total net level of building approvals since the early 2000s was actually around 50 per cent.

**Table 5.1: Residential building approvals by dwelling type and number of storeys, Melbourne Statistical Division, 2001-02 to 2010-11\***

Region	Year	Separate house	Semi-detached; and flat unit apartment	Flat, unit or apartment 3 storeys	Flat, unit or apartment 4+ storeys	Total	Separate house	Semi-detached; and flat unit apartment 1-2 storeys^	Flat, unit or apartment 3 storeys	Flat, unit or apartment 4+ storeys	Total
		Number of approvals				Per cent					
Core	2001-02	336	623	259	3,794	5,012	7	12	5	76	100
	2002-03	353	310	243	6,577	7,483	5	4	3	88	100
	2003-04	290	376	249	3,397	4,312	7	9	6	79	100
	2004-05	488	437	174	2,491	3,590	14	12	5	69	100
	2005-06	272	164	91	894	1,421	19	12	6	63	100
	2006-07	330	245	228	1,948	2,751	12	9	8	71	100
	2007-08	485		94	2,463	3,261	15	7	3	76	100
	2008-09	250	347	87	3,139	3,823	7	9	2	82	100
	2009-10	377	609	179	4,011	5,176	7	12	3	77	100
	2010-11	270	338	131	9,683	10,422	3	3	1	93	100
Inner	2001-02	2,654	1,824	258	340	5,076	52	36	5	7	100
	2002-03	2,423	1,593	284	739	5,039	48	32	6	15	100
	2003-04	2,766	1,526	330	911	5,533	50	28	6	16	100
	2004-05	2,830	1,613	338	550	5,331	53	30	6	10	100
	2005-06	2,673	1,117	421	733	4,944	54	23	9	15	100
	2006-07	2,607	1,332	275	671	4,885	53	27	6	14	100
	2007-08	2,852	1,753	550	1,034	6,189	46	28	9	17	100
	2008-09	2,295	1,226	352	1,776	5,649	41	22	6	31	100
	2009-10	2,501	2,046	451	2,576	7,574	33	27	6	34	100
	2010-11	2,272	2,031	448	1,790	6,541	35	31	7	27	100
Middle	2001-02	6,823	2,233	63	87	9,206	74	24	1	1	100
	2002-03	5,427	1,575	111	324	7,437	73	21	1	4	100
	2003-04	5,470	1,711	155	158	7,494	73	23	2	2	100
	2004-05	4,954	1,799	117	221	7,091	70	25	2	3	100
	2005-06	4,330	1,427	131	189	6,077	71	23	2	3	100
	2006-07	4,432	1,512	262	256	6,462	69	23	4	4	100
	2007-08	5,067	1,830	218	279	7,394	69	25	3	4	100
	2008-09	4,449	1,423	158	115	6,145	72	23	3	2	100
	2009-10	4,718	2,282	485	1,362	8,847	53	26	5	15	100
	2010-11	4,457	1,910	565	2,288	9,220	48	21	6	25	100
Outer	2001-02	15,810	1,141	0	0	16,951	93	7	0	0	100
	2002-03	14,424	1,109	48	0	15,581	93	7	0	0	100
	2003-04	14,135	1,179	6	0	15,320	92	8	0	0	100
	2004-05	12,054	965	17	31	13,067	92	7	0	0	100
	2005-06	11,443	869	36	38	12,386	92	7	0	0	100
	2006-07	11,773	984	20	6	12,783	92	8	0	0	100
	2007-08	13,682	1,346	63	0	15,091	91	9	0	0	100
	2008-09	14,429	1,395	24	122	15,970	90	9	0	1	100
	2009-10	18,465	2,039	49	101	20,654	89	10	0	0	100
	2010-11	15,162	1,980	153	0	17,295	88	11	1	0	100
Melbourne Statistical Division	2001-02	25,623	5,821	580	4,221	36,245	71	16	2	12	100
	2002-03	22,627	4,587	686	7,640	35,540	64	13	2	21	100
	2003-04	22,661	4,792	740	4,466	32,659	69	15	2	14	100
	2004-05	20,326	4,814	646	3,293	29,079	70	17	2	11	100
	2005-06	18,718	3,577	679	1,854	24,828	75	14	3	7	100
	2006-07	19,142	4,073	785	2,881	26,881	71	15	3	11	100
	2007-08	22,086	5,148	925	3,776	31,935	69	16	3	12	100
	2008-09	21,423	4,391	621	5,152	31,587	68	14	2	16	100
	2009-10	26,061	6,976	1,164	8,050	42,251	62	17	3	19	100
	2010-11	22,161	6,259	1,297	13,761	43,478	51	14	3	32	100

^ Includes semi-detached, row or terrace house, townhouse; and flats units apartments 1-2 storeys

\* 2010-11 is for 11 months only.

Source: ABS Building Approvals data, customised matrix held by CPUR

**Table 5.2: Domestic demolitions by Melbourne zone, 2001-02 to 2010-2011**

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Core	244	240	239	194	238	266	286	234	280	274
Inner	1,311	1,308	1,441	1,495	1,605	1,663	1,950	1,582	1,937	2,093
Middle	1,084	1,163	1,279	1,371	1,332	1,357	1,603	1,387	1,710	1,787
Outer	349	393	497	567	523	521	612	524	615	681
Total	2,988	3,104	3,456	3,627	3,698	3,807	4,451	3,727	4,542	4,835

Source: Building Commission permits accessed at <<http://www.pulse.buildingcommission.com.au/www/html/2015-welcome-to-pulse.asp>>

Another qualification when interpreting the building approval data is that the approvals do not equate to buildings started or completed. Though there is a good correlation between ABS statistics on building approvals and building completions, this correlation varies by building type. For reasons explored below, the surge in approvals for apartments in four-storey-or-higher buildings since 2009-10 exaggerates their actual contribution to Melbourne's dwelling stock because of the long time-gap (of up to four years) between gaining a building approval and the completion of the project.

### Infill

The column in Table 5.1 headed by the label 'semi-detached houses and flats, units and apartments of one-to-two-storey' includes infill as defined above. Approvals for this category make up around 15 per cent of dwelling approvals. However, much of the separate housing detailed in the first column of Table 5.1 for the core, inner and middle zones should also be regarded as infill. For example, in a dual occupancy development the additional house is counted by the ABS as a separate house if it is not attached to the other house on the block. Likewise, if the original house is demolished and two separate houses are built, they are also counted as separate houses. This means that, as well as the one- or two-storey semi-detached dwellings listed in Table 5.1, an unknown component of the separate houses listed in the table must also be added to the contribution of infill.

Unfortunately, the Victorian Government does not publish any accounting of this contribution either. More information may be available in future. According to Ms Prue Digby, Deputy Secretary, Planning and Local Government in the Victorian Government, unpublished research commissioned by the Victorian Government indicates that ad hoc infill has constituted about 30 per cent of recent dwelling construction in Melbourne.<sup>68</sup>

Infill barely gets a mention in the *Melbourne 2030* documentation, despite making up a large share of the annual number of housing starts in Melbourne at the time *Melbourne 2030* was legislated.<sup>69</sup> All that is said on this topic in the *Melbourne 2030* planning documents is that the infill share was expected to fall from 38 per cent for the years 1997 to 2001 to about 30 per cent in the years 2001 to 2015, to 28 per cent in the years 2016 to 2020 and then to 24 to 25 per cent in the decade 2021 to 2030.

Infill in the form of units and townhouses has been important for those not wanting to move to the fringe because such dwellings usually offer living space in a suburban setting similar to that available in a small house, as well as room for a small private garden.

Infill is essentially unregulated and, at least from the perspective of the planning code, there is no limit on its further expansion. This is despite the Labor Government's pre-election claims in the late

1990s that it would put the protection of neighbourhood character centre stage. In fact, its new zoning code, Rescode, which was implemented prior to the legislation of *Melbourne 2030* in 2002, did not protect existing suburbia from infill. Infill as defined here is regarded by municipal councils (under Rescode) as an 'as of right' privilege, as long as proponents can show that their development accords with the 'neighbourhood character' provisions within the code. A change in a locality's housing density due to infill is not regarded as changing the 'neighbourhood character' of an area, unless a developer proposes to put a large numbers of units on what were formerly sites for detached housing.<sup>70</sup>

This being the case, readers may wonder why infill has not provided an even higher share of new dwellings over recent years. As Table 5.1 shows, the share of infill, tightly defined as semi-detached houses or units has dropped a little since the beginning of the 2000s in both the inner and middle zones. So too has the share of separate houses in these zones (much of which is likely to be infill). This share has been taken up by a surge in the number of approvals for three- and especially four-storey-or-more apartments.

The likely reason is the rise in the price of detached housing in inner and middle suburbia. The cost of infill is largely determined by the price of the existing detached house (and land) which the developer or builder must purchase before the new development can proceed. As the price of such houses has escalated, so has the end cost of units and townhouses.

Figure 1.2, in Chapter One, showed that the average price of a unit or townhouse sold in the inner zone of Melbourne in 2010 had doubled since 2002 to around \$550,000. Developers would be struggling to build new units or townhouses for that price now, because the average price of a house sold in the inner zone was more than \$900,000 by 2010. As a consequence, it is likely that more infill will be constructed in middle and outer suburbia over the next decade. Table 5.2 indicates that this may already be happening. The location of the demolitions reported in the table indicates where infill is occurring. The table shows that though the main focus has been in the inner and middle zones, the number of demolitions recorded in the outer zone has doubled since 2001-02, if from a low base.

### **Medium-density apartments**

Medium-density apartments in four-to-six storey buildings that are targeted to a wide demographic have contributed relatively little to Melbourne's housing stock since 2002, at least by comparison to high-rise apartments. Table 5.1 shows that most of the building approvals for apartments in the '4+ storeys' category are located in the core zone, which we have defined to include the LGAs of Melbourne, Port Phillip, Stonnington and Yarra. As is indicated in the discussion of high-rise apartments below, most of these are actually in blocks of ten storeys or more.

However, Table 5.1 shows that there has been a recent increase in the number of building approvals for four-storey-plus apartments in our inner zone (the LGAs of Banyule, Bayside, Boroondara, Darebin, Glen Eira, Maribyrnong, Moreland and Moonee Valley). According to a recent Property Council Report discussed in detail below, most of the apartments built in this zone are in the four-to-six-storey category.<sup>71</sup> Perhaps these apartments are a sign that the reformulation of *Melbourne 2030* is working and that the resulting development opportunities are delivering at last.

However, the apartments being offered rarely exceed 70 square metres in size. In such apartments there is just enough space for a second bedroom and a combined kitchen, dining and living area. They are not suitable for families with children. For this purpose, an apartment needs to provide a third bedroom and, at a minimum, provide 100 to 110 square metres. As we will see, even the small houses now being constructed on 300 square-metre blocks on the fringe provide around 150 square metres of living space, though that includes space for a single-car garage of about 21 square metres.

The reason why small apartments dominate the offerings is price. Apartments of around 70 square metres sell for \$600,000 to \$650,000 in the higher status inner zone and from \$450,000 in areas not in this category, including the Darebin and Keilor projects pictured below. As a recent review in *The Age Domain* section indicates:

More than anything, though, affordability is driving the acceptance of small units. Agents say many buyers are abandoning the idea of a two-bedroom unit of 70 squares metres to 75 square metres, which can cost \$650,000 — more than most first-home buyers or investors want to pay. These trends should add investment sparkle to well located one-bedders up to 55 square metres.<sup>72</sup>

There have been relatively few apartments built in locations outside our inner zone. This is because there is no market for apartments in locations where larger infill dwellings or detached houses are available at a similar price nearby. According to an analysis by the property advisory firm Charter Keck Cramer, even walk-up apartments to three levels are only economically viable in around 100 of Melbourne's 300 suburbs.<sup>73</sup> As for baby boomers in the vicinity who might be contemplating downsizing to an apartment, they have to consider that, when transaction costs are taken into account (agents' fees on selling and stamp duty on purchasing), they may have to dig into their savings to make the move.

At \$450,000 to \$650,000, medium-density apartments do offer a cheaper alternative to the usually more expensive townhouses and units available in the inner zone. However, they are not an affordable option for most of the new households in the 25-34 year old age group that will be entering the housing market over the next decade. New households looking for family-friendly housing will have to look to either infill or detached housing in outer suburbia, or new housing on the fringe.

What would such a household have to pay for a family-friendly apartment of around 110 square metres in the inner zone? We have to speculate because developers are not building apartments of this size. Indeed, despite the hopes of the compact city advocates, there have been no family-friendly apartment projects initiated in any of Melbourne's activity centres since 2002. It is partly a cost issue and partly that few of the high-income families who could afford such apartments will chose them in preference to more spacious infill or detached housing.

Table 5.3 provides an estimate of the land, construction and total costs of medium-density apartments in Melbourne LGAs. This offers a clue as to what family-friendly apartments would cost if they were to be built. The estimate was prepared by the planning consultancy firm Urbis for the Property Industry Council of Australia. The estimates are for five-to-nine-storey apartments of 80 square metres with two bedrooms and one car space. The construction cost columns do not include fit-out expenses. These, along with the developer's marketing and finance costs, taxes and charges, as well as the profit margin, are included in the final costs.

On the assumption that the completed market price estimates per square metre of internal space detailed in Table 5.3 can be scaled up to a 110 square metre apartment, we can provide a rough estimate of the market price of such an apartment for the LGAs listed. The price would range from around \$900,000 in Boroondara, Yarra and the listed inner suburbs to around \$650,000 in Moonee Valley and Hobsons Bay.

**Table 5.3: Land costs, construction costs and completed value of apartments, per apartment and per square metre, selected Melbourne municipalities**

Urbis classification	Per apartment			Per sqm internal space*		
	Land cost per unit	Construction cost (ex soft cost)	Completed market price (new)	Land cost per unit	Construction cost (ex soft cost)	Completed market price (new)
Inner suburbs						
Melbourne	\$50,000	\$320,000	\$680,000	\$625	\$4,000	\$8,500
Port Phillip	\$90,000	\$320,000	\$700,000	\$1,125	\$4,000	\$8,750
Stonnington	\$90,000	\$320,000	\$700,000	\$1,125	\$4,000	\$8,750
Middle suburbs						
Yarra	\$80,000	\$280,000	\$680,000	\$1,000	\$3,500	\$8,500
Hobsons Bay	\$50,000	\$220,000	\$460,000	\$625	\$2,750	\$5,750
Maribyrnong	\$50,000	\$220,000	\$460,000	\$625	\$2,750	\$5,750
Moonee Valley	\$50,000	\$220,000	\$460,000	\$625	\$2,750	\$5,750
Moreland	\$70,000	\$260,000	\$520,000	\$875	\$3,250	\$6,500
Banyule	\$70,000	\$260,000	\$520,000	\$875	\$3,250	\$6,500
Darebin	\$70,000	\$260,000	\$560,000	\$875	\$3,250	\$7,000
Boroondara	\$80,000	\$280,000	\$660,000	\$1,000	\$3,500	\$8,250
Manningham	\$70,000	\$260,000	\$520,000	\$875	\$3,250	\$6,500
Monash	\$50,000	\$220,000	\$460,000	\$625	\$2,750	\$5,750
Whitehorse	\$50,000	\$220,000	\$460,000	\$625	\$2,750	\$5,750
Bayside	\$70,000	\$320,000	\$660,000	\$875	\$4,000	\$8,250
Glen Eira	\$70,000	\$260,000	\$520,000	\$875	\$3,250	\$6,500
Kingston	\$60,000	\$220,000	\$460,000	\$750	\$2,750	\$5,750

Urbis assumes apartments are of 80 sqm internal area, 2 bedrooms and 1 car-space.

\* Calculated by dividing the costs provided by Urbis by the internal floor area assumed by Urbis.

Source: Calculated from Urbis, *Delivering on Melbourne's Population Plan*, Report prepared for the Property Council of Australia, November 2010, p. 42

The examples pictured below illustrate what is being offered at the lower end of the medium-density price range in the inner zone. The development pictured in Figure 5.1 falls within the Northcote activity centre shown in Figure 3.3 in Chapter Three. As of May 2012, one- and two-bedroom apartments in this four-level apartment block were being advertised for between \$319,000 (one-bedroom, no car space) and \$549,000.<sup>74</sup> A one-bedroom, one-bathroom apartment provides an area of 47m<sup>2</sup> internal space and 9m<sup>2</sup> external space (as in a balcony). A two-bedroom, one-bathroom apartment with one car space is priced at \$449,000 and provides an area of 69 m<sup>2</sup> internal space and 7 m<sup>2</sup> external space.

Figure 5.2 provides an example of the kind of apartment-style living being built in the transport-corridor zonings in the northern suburb activity centres discussed in Chapter Three. The development in question is located along Keilor Road and is part of the northern Moonee Valley activity centre shown in Figure 3.2 in Chapter Three. The building is jammed along the side of the arterial road and its accompanying tramway tracks.

**Figure 5.1: Multi-apartment development at 332 High Street within the Northcote activity centre, estimated completion date early 2014**



Source: <http://www.realestate.com.au/property-apartment-vic-northcote-109523291>

**Figure 5.2: Completed apartment building, Keilor Road activity centre**



Source: Authors' photo

Figure 5.3 shows the developers representation of what the adjoining site to this building will look like. The development is called 'Garden Apartments'.<sup>75</sup> In fact, there is very little green amenity in the vicinity of these two properties. Even the tree shown on the right of the advertisement in Figure 5.3 exists only in the imagination of the developer. As Figure 5.2 shows, there is no space for trees along the side road between the existing building and the proposed building.



**Figure 5.3: Planned apartment building to be constructed on adjacent corner, Keilor Road activity centre, premium apartments, one bedroom from \$325,000, two bedroom from \$425,000**



Source: Authors' photo

Not only would those who choose to live in the Keilor road apartments have to accept living next to a very busy part of the arterial road, but they would also have to pay handsomely for the privilege. Currently, two-bedroom apartments in this complex are selling for around \$480,000. For the 'garden apartments', the two-bedroom apartments are advertised as starting at \$425,000.

As the price of infill grows, small apartments in such blocks may be the only option available in these suburbs for new households of modest means. Like the high rise apartments discussed below they may appeal to mobile young couples in the pre-nesting life-stage. But it is hard to see a household which is looking for family-friendly accommodation choosing an apartment located along a transport corridor. Few young families would contemplate living in an apartment located on a busy arterial road, given the noise and pollution associated with heavy traffic flows and the dangers these flows present for children. Nor are older households who might be tempted to downshift likely to find such accommodation appealing.

The implication is that those households priced out of inner- and, increasingly, middle-zone areas will have to look further afield for affordable housing. This will add to the pressures on the established suburban detached and infill market. It also means that access to affordable housing on the fringe will be crucial if Melbourne is to find a solution to the current affordability crisis.

### **Why are apartment costs so high?**

It seems extraordinary that apartments which are half the size of the standard detached house and occupy far less land are being priced at such high levels. If this pricing structure cannot be changed, there is little prospect of the compact city aspiration being achieved.

In exploring the pricing issue, we have relied on private sector cost estimates as well as interviews with developers. One important source was the National Dwelling Cost Study prepared for the National Housing Supply Council by Urbis (the same company that provided the information in Table 5.3). This study details the price to the consumer for apartments in five-to-nine-storey blocks (which it calls infill) and for fringe housing for Sydney, Melbourne, Brisbane, Perth and Adelaide in 2010. It provides a breakdown of the land, construction and other costs of each type of dwelling. It concludes that 'Construction remains the largest cost component of infill dwellings (45-60%) and a key area to focus reform to improve housing affordability'.<sup>76</sup>

Construction costs for fringe housing include the costs of subdividing the land (building local roads, water and other infrastructure connections), which Urbis puts at around \$46,000 in Melbourne, and another \$176,000 for house construction, or around \$1,000 per square metre.<sup>77</sup> This latter figure is consistent with estimates given to us by developers. By comparison, the construction cost for five-to-nine storey apartments is estimated at \$4,000 per square metre.<sup>78</sup> This is at the high end of the spectrum of costs listed in Table 5.3, which is derived from the first Urbis report cited.

There is not much difference in the land, taxes and charges and other components of the overall price of fringe housing and infill apartments. Rather, as Urbis observes (above), it is the relatively high construction costs of apartments that are the crucial factor in the inability of developers to provide even small apartments of 70 square metres in medium-density projects of five-to-nine storeys for below \$450,000.

Why is this so? There are many factors involved including some that are controversial and contested. Apartments higher than three storeys are more expensive to build than detached houses because they require cranes, expensive scaffolding, stronger beams and pillars than is the case for low-rise buildings and they require more attention to safety. They also usually require expensive underground excavation for parking space. In addition, projects in established suburbia involve more complex and time-consuming planning permission and thus higher holding costs than is the case for fringe housing. Building regulations are also tighter and more exacting.

Construction labour costs are also higher for apartments of four-storeys-or-more. These are referred to as 'commercial', with the workforce usually members of the Construction, Mining, Forestry and Energy Union (CMFEU). In Melbourne the great majority of workers employed on large apartment projects are members of the CMFEU. The pay rates and conditions that the CMFEU has won on these sites are much higher than those applying for the non-union labour employed on other residential development projects.<sup>79</sup> CMFEU coverage of the apartment construction workforce is more complete in Melbourne than in other Australian capital cities. In Sydney, the CMFEU's monopoly has been breached by builders drawn from the Lebanese community. This is one of the factors which explain why construction costs are around ten per cent higher for medium-density projects in Melbourne than in Sydney.<sup>80</sup>

Construction costs, particularly in Melbourne, have also been affected by a severe shortage of skilled construction workers. During the 2000s, there were competing demands on this workforce as massive mineral industry projects got underway and as the building industry in the major metropolises responded to the demand for new dwellings and city-building infrastructure projects. Table 5.4 indicates the scale of the demand on the construction workforce. Despite the draw of construction workers to Perth, there was a simultaneous high demand in Melbourne. The employed

construction workforce in Melbourne grew from an estimated 110,750 in 2000 to 163,000 in 2006, then, after a brief lull, spurted again to reach 191,750 in 2011 (Table 5.4). By contrast, there was very little growth in Sydney's construction workforce between 2000 and 2006. The number of construction workers employed in Melbourne in 2000 (110,750) was much lower than the number employed in Sydney (166,000), but by 2011 the number employed in Melbourne exceeded that of Sydney (191,750 versus 185,000).

**Table 5.4: Employment in the construction industry ('000s), by selected locations, Australia, 2000 to 2011\***

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Perth	57,000	60,000	55,000	60,500	62,000	70,500	81,000	79,250	91,500	92,000	93,000	98,500
Rest of WA	22,250	18,250	21,250	21,500	22,500	28,000	29,750	34,250	34,000	34,000	36,000	32,500
Melbourne	110,750	118,000	136,250	133,000	139,500	149,250	163,000	155,500	170,750	170,500	183,000	191,750
Sydney	166,000	156,000	150,500	164,500	172,500	170,250	172,750	179,500	186,000	189,500	188,250	185,000
Brisbane	60,750	62,750	61,250	64,750	70,750	83,500	90,750	90,750	95,250	100,250	104,000	96,250
Rest of Qld	79,000	74,500	79,250	91,750	100,750	117,500	123,250	141,500	152,000	139,000	132,500	139,250
Rest of Aus.	194,750	177,750	195,250	217,250	230,000	236,500	254,250	270,250	268,750	270,750	287,250	294,750
Australia	690,500	667,250	698,750	753,250	798,000	855,500	914,750	951,000	998,250	996,000	1,024,000	1,038,000

\* Average of four quarters for each calendar year (Feb, May, Aug, Nov)

Source: Australian Bureau of Statistics, 6291.0.55.003 - Labour Force, Australia, Detailed, Quarterly, Feb 2012, data cube E03\_aug94 - Employed Persons by Sex, Industry, Capital City-Balance of State, Hours Worked, August 1994 onwards

This huge surge in the employed construction workforce in Melbourne also contributed to the city's high cost of construction (relative to Sydney). Whether unionised or not, if construction workers are in high demand, this will put pressure on the wages and conditions they can command. This point also applies to the demand for the subcontractors that developers need to engage to do the building work. For example, there are only a limited number of firms who do the form work (preparing moulds before concrete pours in multi-storey buildings). As the demands on their skills increase, delays are likely to occur, as well as increased costs as they are able to charge premium rates to get the job done.

### Upmarket apartment projects

The new development opportunities in activity centre housing opened up by *Melbourne 2030* have been utilised in a few upmarket projects (that is, projects located in high-amenity and prestigious areas, such as Camberwell, Caulfield, Malvern and Prahran). In these localities, residents who own detached houses in the area can contemplate selling their property for one million dollars or more and then moving into a relatively spacious apartment for less than the price they receive for their former home.

These projects invariably stir up resident opposition where they are being built on a scale that jars with the prevailing low-density suburban areas that surround them. In the past, this opposition has made such projects tough going for developers. However, as the case studies of Glen Eira and Boroondara have shown, developers are now in a much stronger position to overcome this resistance. They are likely to have the backing of VCAT and the state government if they are determined to proceed.

The Aerial project in Camberwell Junction, referred to earlier, is a case in point. It offers 144 apartments from \$510,000 for those with one bedroom, from \$699,000 for those with two bedrooms and \$1,375,000 for those with three bedrooms. Some of these apartments are still

available. In the case of the two-bedroom offerings, one with 77 square metres of internal space, eight square metres of balcony and one car space is on the market for \$725,000 and another with 104 square metres of internal space and two car spaces for \$850,000.

Given their price, these projects are unlikely to provide for more than a tiny fraction of the dwellings needed to accommodate the anticipated growth in households in Melbourne.

### **High-density small apartments**

High-density apartments have dominated the apartment market in Melbourne. The recently released Property Council Report, *Making the Numbers Stack Up*, enables an accurate assessment of this contribution. The report relies on a database held by the property consulting group Charter Keck Cramer. This database tracks all urban renewal projects from the time a building approval is gained to completion. Over the period 2005 to 2011 there were 24,495 dwellings completed in buildings of four-to-nine levels and 28,866 in buildings of ten-or-more levels. Most of the latter were located in the CBD, Southbank and Docklands.<sup>81</sup> The Property Council Report also provides forecasts for apartment completions. They indicate that the share of apartments in buildings of ten-or-more levels will increase and that the total number of these completions will rise sharply relative to completions in the years 2009-2011. Most of the high-rise buildings will be completed in the CBD and surrounds.<sup>82</sup>

This is an extraordinary situation. Most observers of the inner-Melbourne scene are staggered by the forest of high-rise apartments that have already sprouted. Does this outlook mean that the compact city is about to have its day — but in designated areas in the city core rather than in widely dispersed activity centres? Does it also mean that Melburnians are about to embrace apartment living?

There are two narratives going on. One was flagged in our account of medium-density housing. This is that, as dwelling prices have escalated, those wanting accommodation in our core and inner zones have had to lower their aspirations from detached-housing to townhouse or units, then to apartments. As to the latter, there has been a movement to ever-smaller apartments, again because of price pressures. The high-rise apartment projects have followed the same pathway. The trend has been towards smaller one- and two-bedroom apartments as well. Currently one-bedroom apartments are listed at around 35 to 40 square metres or about the size of the large suburban living room. Their price starts at around \$300,000 in the northern part of the CBD, though higher in the more up-market precincts of Docklands and Southbank.

The trend to smaller apartments can be interpreted as a sensible developer's response to the needs and financial resources of a wide spectrum of customers, including first-home buyers. Perhaps Melburnians are adjusting to apartment living, even though it implies much less indoor space and no private outdoor-living area (apart from a balcony).

However, there is an alternative narrative. For developers, it makes sense to produce high-rise apartment blocks rather than offices because, according to Urbis, with new apartments selling at \$8,000 to \$9,000 per square metre of liveable space (see Table 5.3), this is more than they can get for new offices which are worth \$6,000 to \$7,000 per square metre fully leased.<sup>83</sup> There are plenty of sites available because the Victorian Government has zoned large areas of the CBD and its surrounds

for high-rise development. Of course, there have to be buyers for these apartments if they are to get off the ground. However, the buyers are investors. The apartment boom is investor, or purchaser driven, not consumer driven.<sup>84</sup> Some 80 to 90 per cent of high-rise apartments are bought off the plan by investors, including many who are overseas buyers. Financial-planning networks are often involved in channelling investors into these projects.<sup>85</sup>

Investors in Australia and overseas are looking for apartments that are not expensive and offer good prospects of capital gain. For this reason, they want apartments where the surrounding amenity is attractive and housing (other than apartments) is expensive. Melbourne has been attractive on all these grounds, especially relative to Sydney, where apartment prices are much higher (see Chapter Eight). But, in order to keep a lid on prices, developers have had to move to lower cost one-bedroom apartments. As the Property Council puts it:

Rising production costs and purchaser sensitivity to price causes developers to reduce the size of apartments to meet the price ceiling imposed by prospective purchasers [or investors].<sup>86</sup>

The second narrative provides a more convincing explanation for the high-rise apartment boom than the consumer-driven narrative. It remains to be seen whether there is a widespread embrace of inner-city apartment living. As the avalanche of completed apartments hits the marketplace and investors look for renters, they may be in for a shock. As with medium-density apartments, there has been some increase in interest in high-rise apartments because most young singles and couples can no longer afford the price of infill or detached-housing in the core or inner zones of Melbourne. Nevertheless, it is hard to see the numbers in this section of the market expanding much. The household projections detailed above in Table 4.1 (Chapter Four) indicate that there will only be a small increase in the number of couple-without-children families or single-person households aged 15-24 or 25-34 between 2011 and 2021. Those in the pre-nesting stage should be able to find apartment accommodation in the dwellings vacated by their slightly older counterparts who, during the decade, move into family-oriented housing. In addition, investors face a decline in the number of overseas students present in Melbourne. As shown in Chapter Four, their numbers in Melbourne are likely to continue to fall in the immediate future. Overseas students have dominated the ranks of renters of one-bedroom or studio apartments at the cheaper end of the high-rise apartment market in Melbourne.

The message which the Property Council communicates to the Victorian Coalition Government in its report is that the Government should continue the former Labor Government's push to open up opportunities for redevelopment. It asserts that there is a market preference for supply in locations 'offering high amenity and transport connectivity' and that 'Metropolitan policy should reinforce this nexus and seek to minimise constraints to new development'.<sup>87</sup>

This is not helpful advice. It mistakes investor preference for small apartments with local consumers' requirements. It takes no account of whether the apartments coming on to the market have any relation to the needs of the great majority of new households that will be looking for accommodation during the next decade. Most will be looking for family-friendly housing. Nor does The Property Council address the question of whether developers can supply apartments which meet such needs at an affordable price. The evidence is unequivocal: they cannot.

## **Chapter Six: New fringe housing within the Urban Growth Boundary**

The prospects of medium-density housing achieving the compact city goals of the urbanists have dominated much of the debate about Melbourne's urban outlook. To the extent that outer-suburban housing is discussed, it is mainly in the context of the alleged poor access to jobs, transport and other services. More recently, compact city advocates have also argued that the social isolation associated with traditional low-density housing has contributed to serious public health problems, including reduced life expectancy, obesity and depression.<sup>88</sup>

These are matters of concern. Yet, far more central to the lives of the families moving into fringe housing is that, at least until recently, the fringe has provided the most affordable option for family-friendly housing.<sup>89</sup> Fringe housing has been crucial to the growth in the stock of dwellings in Melbourne. Our analysis in Chapter Five showed that, when demolitions are taken into account, the fringe provided around 50 per cent of the net growth in Melbourne's residential housing stock during the 2000s. According to the GAA, there were 9,585 dwelling approvals in fringe areas in 2006-07, 11,783 in 2007-08, 12,820 in 2008-09, 16,816 in 2009-10 and 14,812 in 2010-11.<sup>90</sup> If the size of the fringe contribution to the stock had been smaller, even more heat would have been added to the established suburban market (as Chapter Eight shows has been the case in Sydney).

First-home buyers were the main source of the growth of housing sales on the fringe at the end of the 2000s. They made up around 30 per cent of the fringe market before 2008-09. This share increased to about 50 per cent in 2008-09 and 2009-10.<sup>91</sup> Their entry was facilitated with the introduction of the Federal Government's First Home Buyer's Boost in October 2008 which provided an additional \$14,000 over the existing \$7,000 First Home Owner Grant for those building a new home. The First Home Buyer's Boost came to an end in December 2010. Nonetheless, fringe housing, at least until the price of land surged as described below, served as a safety valve for buyers disenfranchised from the established suburban detached-housing market.

By 2008 the Victorian Labor Government was well aware that a shortage of land zoned for development was a potential threat to the fringe housing market. The focus in this chapter is on whether the measures the government took at this time will allow the fringe to keep playing the safety-valve role.

### **The land market in outer suburbia**

As long as there was a strong supply of new housing blocks on the fringe, the consumer was not charged a scarcity premium like that which greatly inflated the price of dwellings in established suburbia during the 2000s. However, this changed from 2008 when land prices began to move up sharply.

The median price of a block of land sold by developers on the Melbourne fringe increased from \$139,000 in the September quarter of 2007 to \$160,000 in the September quarter of 2008, then subsequently to \$222,000 by the September quarter of 2011.<sup>92</sup> By this time, only a small share of the land that developers were putting on the market was priced below \$200,000 a block. At this price, few first-home buyers can afford to enter the market. This is partly attributable to the interest rates prevailing for housing loans which, by 2011, had risen to 7.8 per cent, compared with 5.6 per cent in the fourth quarter of 2009 and the first quarter of 2010. At current interest rates, land priced at

\$200,000 or more is beyond the reach of most first-home buyers since it implies house and land packages of \$350,000 or more. The termination of the Federal Government's First Home Owners Boost at the end of 2009 was an added dampener.

All of the developers whom we consulted confirmed that there has been a sharp fall in first-home buyer participation in the fringe land market since 2010. Partly as a consequence, the sale of blocks by developers fell sharply to just 597 per month in the September quarter of 2011. By comparison, there were 1,023 blocks sold per month in the September quarter of 2010 and 1,462 in the September quarter of 2009.<sup>93</sup>

According to the National Land Sales Program, by the December quarter of 2011:

Melbourne has gone from being the largest new land market in the nation to being equal third with South East Queensland. To rub salt into the wound, Sydney new land sales are now exceeding Melbourne's by thirteen percent.<sup>94</sup>

These are extraordinary developments. If first-home buyers continue to be priced out of the fringe housing market, this will undermine one of Melbourne's chief claims to economic prosperity: that is, its capacity to attract and retain people (to say nothing about the impact on young Melburnians quality of life!). Melbourne's prosperity has depended heavily on the vigour of its residential and city-building activities. This has in turn partly depended on the city's comparative advantage in constructing affordable new housing relative to Sydney and South-East Queensland.

As noted, the former Labor Government sought to address this crisis in 2008 when it introduced changes to the rules governing subdivision and when it began the process of expanding the UGB. The new Liberal-National Party Government has since embraced these changes. If the experience in Houston is any guide, perhaps the vast expansion of the UGB initiated by the Labor Government in 2008 will alleviate the problem.

### **The 2008 Labor Government initiatives**

Up until 2008, the Labor Premier, John Brumby, could claim, as he did in March 2008, that 'Victoria is still the most affordable housing market on the Eastern seaboard for homebuyers and renters'. Compared with the early 1990s when there was a net exodus from Melbourne, Brumby correctly noted that:

The exodus has been turned around — and people are now voting with their feet in favour of Victoria...We have made Victoria a better place to live and work — we are perennially voted one of the world's most liveable places — and we are a magnet for working families and new investment.<sup>95</sup>

However, as the Premier also acknowledged in his March 2008 media release, this happy state of affairs was at risk. The pace of population growth was stretching the capacity of planners and developers to keep up. Brumby noted that migration to Melbourne had surged, and that his government's revised population projections (released shortly thereafter) indicated that Melbourne's task in accommodating population growth was much greater than had hitherto been expected.

In this context, Brumby noted the alarming findings of the 2007 *Urban Development Report* prepared by Victorian Department of Planning. There had only been one extension of the UGB since

the legislation of *Melbourne 2030* in 2002, when in November 2005 some 4,500 additional hectares were added. By 2007, land within the UGB was estimated to provide 15 to 16 years of fringe supply. While this seemed to be ample, the 2007 *Urban Development Report* showed that the supply of land within the UGB which was actually zoned for development, as distinct from being potentially available for development, had shrunk to just seven to eight years supply, in contrast to the nine to ten years estimated in the previous year's report.

As the planning rules stood at the time, developers could only proceed with subdivision planning on land within the UGB that had been incorporated within what was termed the Urban Growth Zone. For this zoning to occur, preliminary outline planning for the particular locality had to be completed by the relevant municipal council. This zone had been established to prevent subdivision proposals being scattered across the length and breadth of the area within the UGB.

The alarming implication of the *Urban Development Report's* figures was that barely half of the land within the UGB was within the Urban Growth Zone. Moreover, some of this land was not in the hands of developers interested in proceeding with subdivision. At the same time, there was a surge in demand for new housing within the UGB, partly because the escalation in the price of established housing had prompted more households to look to the cheaper housing still available on the fringe.<sup>96</sup> The combination of the limited availability of land ready for development and the increased demand meant that the developers were unable to maintain the supply necessary to meet this demand.

The result was a sharp decline in the stock of lots ready for sale. As of December 2010, there were only 1,722 lots available for sale by developers on the Melbourne fringe — less than two months normal sales volume. The response from developers was to push up the price of the available stock, with most of the blocks being pitched above the \$200,000 level.

In 2008, the Premier, John Brumby, announced a two-pronged plan to encourage subdivision. The first prong had to do with the planning procedures. Henceforth, all the land within the UGB would be rezoned into a new Urban Growth Zone. This measure, it was hoped, would speed up the development of the land within the UGB where the preliminary outline planning had not been completed or had not begun. The potential number of blocks from this land was put at around 90,000.

The outline planning was to occur by way of Precinct Structure Plans (PSPs), which were to be prepared under GAA. Each PSP was to cover large parcels of land involving hundreds of hectares which could potentially accommodate communities of between 10,000 and 30,000 residents.

The GAA is tasked to identify the location of land within each PSP that can be subdivided into blocks, as well as the location of trunk infrastructure (including arterial roads) and various items of community facilities (including sports grounds). The PSPs have instituted a more formal structure to local planning than was the case in the past. The practice had been for councils to negotiate with developers about where infrastructure should be located and how much the developer would contribute to the cost.

Developers holding land within a PSP do not need to apply for rezoning of the land. As long as a developer's proposal is consistent with the PSP specifications, it is assured of a planning permit.



The PSP system is a welcome innovation, which, in principle, could lead to a more comprehensive and timely provision of community and recreational infrastructure than has been the case in the past. Whether it will is explored below.

The second prong of the Labor Government's strategy, announced in late 2008, was the enlargement of the UGB beyond the existing borders of the growth corridors of Melton, Wyndham, Sunbury, Hume-Mitchell-Whittlesea and Casey-Cardinia. More than 50,000 hectares were identified as subject to investigation for their suitability to be added within the UGB.<sup>97</sup> In August 2010, the Government announced the results of this review. Some 41,600 additional hectares were incorporated within the UGB, about 60 per cent of which the GAA believed would be available for development.<sup>98</sup> This is a huge addition which, when added to the land already located within the UGB and now incorporated into the new Urban Growth Zone, is enough for at least 25 years supply.

It seemed that the Houston supply-side solution had been put in place. A government apparently committed to a compact city solution to Melbourne's growth was heading down a pathway that was the very antithesis of the compact city aspiration. The difference with Houston, however, was that developers still faced the barrier of the GAA and the time and costs of the PSP requirements before subdivision could proceed.

### **How long does the precinct planning process take?**

The GAA starts with a draft PSP, which is then put up for public comment, during which time municipal councils, developers, the affected land-owners and any other interested party can make submissions. Then, on the basis of an expert panel report, the GAA decides on the final detail of the PSP. The chairman of the GAA, Peter Seamer, acknowledged in November 2011 that 'two years ago that process was taking six years'.

It is not surprising that it is a time-consuming process, given that the draft PSP must specify the location of roads, parks and other community facilities, as well as what is required of each developer in the construction of linkages from their sub-division into adjacent arterial roads and other trunk infrastructure (including water and telecommunications). Each PSP must also itemise the construction costs of the arterial roads within the PSP and the community infrastructure that developers are now required to finance through a payment to the responsible municipal council (which usually does the work). In addition, there are biodiversity requirements. Development in growth areas 'routinely requires the preparation of native vegetation precinct plans, which set out the requirements of protection and removal of native vegetation.'<sup>99</sup> This may require a plan to preserve these features and developers have to pay for the implementation of any such plan.

Developers also complain that, even when the PSP process is ostensibly complete they can still be held up by unresolved disputes with powerful infrastructure providers, such as VicRoads over the location and specifics of intersections with arterial roads.

In the case of the land added to the UGB in 2010, which has not yet entered the PSP stage, there is also an initial planning phase which involves the preparation of a draft Growth Corridor Plan by the GAA. This provides a strategic overview of the land potentially available for development in each of the growth corridors within the expanded UGB. The GAA has completed a draft of this Corridor Plan

and following public consultation a final draft has been sent to the government. This Plan is currently under review by the Coalition Government.

As a consequence it is unlikely that any of the land zoned within the UGB extension in 2010 will be available for subdivision for several years. This means that, if the supply problem is to be remedied over the next four to five years, it will have to derive from the land zoned within the UGB before the 2010 extension. Because of the time taken to complete the PSP process, Colin Keane, Director of the NLSP, has concluded that the amount of land in developers' hands which is ready for subdivision will fall sharply over the next few years.<sup>100</sup>

This judgment is contested by the GAA. According to Peter Seamer, the time needed to complete PSPs has been reduced to 'below two years.'<sup>101</sup> Indeed, the GAA claims that all of the 19 PSPs currently under development, which cover land within the Urban Growth Zone before the extension of the UGB in 2010, will be completed in 2012. If so, this will create development opportunities for over 90,000 new homes.<sup>102</sup> GAA officials indicate that this speed-up has been achieved through efficiencies gained with experience in preparing PSPs and in some cases by removing the panel component of the process.

If this speed-up is achieved, developers may be able to replenish their stock of land ready for development relative to the depleted state of their holdings at the end of the 2001-2010 decade. As it has turned out, this controversy has been overtaken by events. The sharp downturn in sales of developed blocks since 2010 has meant that despite developers' difficulties in obtaining land which has completed the PSP planning process, the stock of blocks on the market and available for sale has increased. According to the latest NLSP report for Melbourne, the stock of blocks fell to its lowest point during the June Quarter 2010 when they totalled 1,059. The stock has since increased to 4,286 by the December Quarter of 2011 and to 4,200 in the March Quarter of 2012.<sup>103</sup>

This has given the GAA some breathing space in catching up with the release of completed PSPs. By the end of 2011, some 30 PSPs had been completed, including 16 prior to 2010-11. Table 6.1 details the amount of land included in the largest of these PSPs and the expected size of the resultant communities. Since they cover more than 60,000 dwellings, or four to five years supply if land production on the fringe recovers to the level of the mid 2000s, it might appear that the supply problem has been solved.

### **The pace of subdivision**

Just because a PSP has been completed does not mean that all the land identified for development is actually in the hands of developers. According to developers consulted on the matter, by the time a PSP is completed only about 50 per cent of the land designated for subdivision within the PSP is usually held by developers. The rest is held by assorted other landowners, including farmers and investors. The PSP process merely provides an institutional framework within which private landholders operate.<sup>104</sup> There is no requirement that landowners sell to developers and no penalty on those who do not wish to sell, other than the holding costs (from land taxes and rates) which they will incur. Nor do these passive landholders have to contribute to the development contributions specified in the PSP. Such payments are only required when subdivision of the land in question occurs.

**Table 6.1: Selected completed Precinct Structure Plans, scale and cost to developers**

Area	Date Released	Net Developable Area (NDA) (ha)	Net Residential Area (NRA) (ha)	Number of dwellings in NRA Total	Dwg/ NRHa Total	Dwg/ NDHa Total	Estimated Population	Development Charge - Contribution per NDHa
Aurora	Dec-07	427.75	Na	7,292	Na	17.05	21,899	
Cardinia Road	Sep-08	807.90	701.80	9,838	Na	14.00	27,546	
Cranbourne North (Stage 1)	Aug-09	234.60	Na	3,931	Na	16.76	10,532	
Cranbourne East	May-10	467.66	405.88	6,608	16	15.24	18,502	
Melton North	May-10	89.07	Na	1,300	Na	14.60		
Taylors Hill West	May-10	162.01	156.31	2,400	15.6	15.00	7,200	
Craigieburn (R2)	Sep-10	361.20	327.00	5,276	16	14.70	14,773	
Greenvale West (R3)	Dec-10	83.85	83.85	1,323	15.8	15.80	3,704	
Toolern	Dec-10	1,719.59	1,217.85	>18,268	Na	>15.00	55,000	
Cranbourne West	Jan-11	603.74	254.02	4,478	17.6	7.42	12,566	
Truganina South	May-11	167.93	158.12	2,472	15.6	14.72		
Cranbourne North (Stage 2)	Jun-11	135.84	131.16	2,056	15.7	15.13	5,821	Circa \$282,614
Clyde North	Sep-11	432.21	426.34	6,610	15.5	15.30	18,500	\$274,844

The Net Developable Area in Toolern and Cranbourne West includes land set aside for the location of employment.

Italicised figures were not supplied as such in the precinct plan but have been calculated from data supplied in the precinct plan.

Source: Growth Areas Authority, various Precinct Plans as supplied at <[http://www.gaa.vic.gov.au/Precinct\\_Structure\\_Plans/](http://www.gaa.vic.gov.au/Precinct_Structure_Plans/)>, Dec. 2012

According to the results of an audit of landholding within the UGB in 2011 by the NLSP, major developers (defined as the top ten producers) hold less than a quarter of the land outside that in ‘active estates’, that is, areas where the PCP process has been completed.<sup>105</sup> Those holding this land can sit on it as long as they like. They make no Development Contribution, and, as is explained below, are not required to contribute to the Growth Area Infrastructure Contribution when they do decide to take their profit and sell to developers.

Even more important, developers typically stage their preparation and release of land so that about 10 to 15 per cent of the land is put on to the market each year. This is a form of land banking, even if comprehensible from the developer’s point of view. Any rush to put lots on to the market would diminish their scarcity value. This means that a large number of PSPs must be active at any one time if the fringe market is to return to its former state when developers produced 12,000 or more blocks a year. Because of the recent reduction in demand for land, the number of lots released in the December 2011 and March 2012 quarters is barely half what would be required to reach the 12,000 level. As a consequence, the PSPs that the GAA promises will be completed during 2012, plus those completed prior to 2012, should provide a sufficient supply of land for developers over the short term.

However, this does not mean that a new era of readily available and cheaper land is imminent — far from it. Even if developers do manage to procure large stocks of raw land within PSPs, it is doubtful whether they can produce blocks at a price within the financial capacity of first-home buyers.

## **The costs of developing land on the fringe**

The current costs of producing subdivided land are detailed below. But before pursuing this detailed cost analysis, it is important to review whether the new infrastructure requirements that developers must help finance have led to any significant improvement in the provision of infrastructure on the fringe. The context is long-standing concern that new fringe-dwellers confront an infrastructure desert when they move into new estates. Is this still the case and, if it is not, who is paying the price?

### *Developing fringe land – who pays?*

In the past, developers and their customers have paid only a small fraction of the costs that state and local governments incur for the infrastructure required to service a new block. This situation is changing in Melbourne but only in respect to the infrastructure provided by local governments. The state government remains responsible for providing the trunk water, sewerage, arterial road and other services required to reach the borders of new subdivisions, as well as for the extensions of the rail transport and freeway networks needed to serve new fringe areas. Developers in Melbourne do not make any up-front contribution to the costs of this infrastructure except for the new Growth Areas Infrastructure Contribution (GAIC).

The GAIC has had a tortuous history. When originally floated in late 2008, the intention was to tax the land owners who benefited from their land being rezoned within the UGB. They reaped windfall gains when they sold their land to developers but made no contribution to the subsequent public costs when the land was turned into housing. However, the original bill to this effect introduced by the Labor Government was defeated in the Upper House of the Victorian Parliament. The amended version, passed in the Upper House, came into effect 1 July 2010. This version shifted the responsibility for the contribution to the purchaser — normally a developer. The Liberal Party, in supporting this switch of responsibility to the purchaser, showed its colours. Apparently profits from land sales are sacred, even if as a result of a government decision to extend the UGB which enriches the original landowner.

The GAIC legislation was amended again by the Coalition Government in 2011. As it now stands, the GAIC applies to land which was added to the area within the UGB either in 2005-06 or 2010. It is set at \$82,550 per hectare for land brought within the UGB in 2005-06 and \$98,030 for land brought in as a result of the 2010 addition to the UGB.<sup>106</sup> The payment of the contribution is triggered by the sale or subdivision of the land. Since February 2012 the contribution can be paid in stages with an initial payment of 30 per cent then the rest as the subdivision proceeds. The Victorian Labor Government originally claimed that the GAIC would fund up to 15 per cent of the state infrastructure works in the growth areas.

Since it is the developer who pays the GAIC, it becomes another charge which developers must include in the overall costs of developing their land. Most of the land currently being developed was incorporated into the UGB in 2005-06 and is thus subject to the GAIC. Assuming 70 per cent of the land is subdivided, the additional cost will be around \$8,000 per block.

This innovation still leaves developers in Melbourne in a more favourable situation regarding up-front infrastructure charges than their counterparts in Sydney and, more recently, those in South-East Queensland. These jurisdictions have implemented a ‘user pays’ approach where developers

have to make up-front contributions for local infrastructure and for regional- or state-financed infrastructure. These charges have reached \$100,000 a lot in some areas of Sydney. Recently, however, the New South Wales Government has limited the local infrastructure charge to \$20,000 a lot (though municipal councils can make a case for a higher contribution) and removed some of the regional infrastructure charges.<sup>107</sup> In Victoria the costs of trunk infrastructure are paid, over the long term, by taxpayers and ratepayers.

The planning firm Urbis, in a review of the costs of development in South East Queensland and Melbourne, observed that 'Melbourne has been regarded as a low cost state in relation to infrastructure charges'. Urbis's review confirmed this understanding.<sup>108</sup>

However, as noted, the Victorian situation is now changing because decisions about developer contributions to infrastructure costs are no longer an outcome of bargaining between developers and municipal councils. This contribution was usually well below \$10,000 per block. Now, the GAA stipulates in each PSP a Development Contributions Plan which specifies the items of infrastructure (and their price) to which each developer must contribute.

This innovation is pivotal. Commentators on outer-suburban development in Australia have long bemoaned the poor level of services and resources available to outer-suburban residents as a consequence of deficiencies in infrastructure provision.<sup>109</sup> This situation appears to be getting worse because Melbourne's outward spread is generating severe diseconomies of scale. These are most evident with rail and road transport.<sup>110</sup> The rail network does not serve large areas of outer suburbia. If lines were extended into these areas, the extra patronage would add to the severe overcrowding already experienced on the suburban rail network.

These issues were addressed by the *East West Link Needs Assessment*, commissioned by the Labor Government. The assessment concluded that a 17-kilometre rail tunnel linking the western and south-eastern suburbs, as well as duplication of the rail tracks serving the south-eastern suburbs, should be the number one priority. It also recommended an 18-kilometre cross-city road connection linking the western suburbs to the Eastern Freeway, which would take the pressure off the Westgate Freeway and its connectors.<sup>111</sup> These two projects would cost in the order of \$10 billion each. In the event, all that the Victorian Government appears to be able to afford is a new rail line connecting Werribee to Sunshine (the Regional Rail Link). This is expected to cost 'only' about \$4 billion, most of which will come from Commonwealth infrastructure assistance.

Out in the south-eastern frontier, the arterial feeders into the Monash freeway (the main link to jobs in middle suburbia) are already choked at peak times. The main arterials through the Cranbourne-Berwick area can back up for kilometres at the roundabouts which handle arterial intersections in the area. The rapid build-up in population resulting from the PSPs now being developed in the area will make things worse.

#### *Infrastructure initiatives in PSPs*

With the introduction of PSP planning, the Victorian Labor Government had an opportunity to do something about this situation by requiring increased upfront development contributions. The government's aspirations for the new communities were high. According to the guidelines intended to shape PSP planning:

The goal of the Growth Areas Authority is to create diverse, compact and well connected communities that are affordable and rich in local jobs, transport access, services and culture.<sup>112</sup>

However, there is little precise direction as to what this means in practice. Instead the guidelines simply state that:

Precinct structure plans provide a balance between meeting complex policy requirements and providing affordable development. Any balancing of conflicting objectives is made in favour of net community benefit and sustainable development.<sup>113</sup>

The only way to decide what the implications of the new PSP process are is to examine the individual plans. Notwithstanding the above rhetoric, which surely implies that the new planning regime will address the obvious deficiencies in the supply of transport, hospital and other services, nothing has changed.

As noted, the state government retains its sole responsibility for trunk infrastructure. However, developers are being required to pay for more of the local infrastructure than previously. The most notable change is that they now must pay for the arterial roads that run through the PSP or are located on its borders. The PSP guidelines specify that arterial roads must be placed at approximately at 1.6 kilometre intervals within each PSP.<sup>114</sup> These costs, as well as those for constructing connections from local streets to the arterial roads, add up to nearly half the total cost of the Development Contributions Plans we examined.

Aside from roads, the PSPs focus on local community infrastructure — mainly that needed for active recreation (sporting ovals), passive recreation (such as walking tracks) and community centres.

For example, in the case of the Clyde North PSP (listed in Table 6.1), these items include the cost of land and construction of several sporting arenas and two community centres. The latter have to provide facilities for kindergartens, maternal and child health centres and neighbourhood houses which include community meeting spaces. The Clyde North PSP is located several kilometres from Cranbourne, which is 45 kilometres from the centre of Melbourne, to the South East. The precinct covers 612 hectares, 426 hectares of which is designated for residential development. The total cost of the Development Contributions Plan comes to \$118,754,167 or \$274,844 per net developable hectare.<sup>115</sup> This is around \$18,000 per block. In the case of Truganina South in the Wyndham growth corridor (also listed in Table 6.1), the total is \$282,614 per net developable hectare, or around \$18,000 to \$19,000 per block. This contribution is payable when subdivision begins.

In addition, the developers have to pay for any biodiversity conservation required within the PSP. In the case of Clyde North this is mainly directed at preserving the habitat of the growling grass frog, which has been found in the locality. The costs of these works (which developers share according to the amount of developable land they hold) are assessed at \$3,495,080 or \$7,204 per developable hectare.<sup>116</sup> This will add another \$500 per block to developers' costs. Land set aside for conservation purposes can also be significant. In the case of the Truganina South PCP, 38.1 hectares were set aside for Golden Sun Moth habitat, which had the effect of reducing the net developable area in the PCP by 18.75 per cent.<sup>117</sup> In this case, it is the owner of the conservation land who loses because the land cannot be developed. Developers therefore, have to plan carefully to ensure they do not buy land likely to be set aside for conservation purposes. If land held by developers is set aside, it will add another cost to the subdivision process.

Developers must also make a contribution to community open space. This has long been required of developers but under the GAA Precinct Structure Planning Guidelines the total amount is specified at ten per cent of the developer's holding. This ten per cent contribution to public open space is worth \$40,000 to \$100,000 per hectare, assuming (as detailed below) that developers would have paid between \$400,000 and \$1,000,000 per hectare when they purchased the property. In assessing the cost per lot, we have assumed that only 70 per cent of the land is taken up by the lots produced (with the rest used for roads and other infrastructure or perhaps unavailable for subdivision because of topographical constraints). This loss of land is taken account of in the Development Contributions Plan, which is expressed in terms of payments per developable hectare. Assuming each developable hectare yields 15 blocks per hectare (as is the assumption in most PSPs), the cost per lot of the land contribution will be between \$3,809 and \$9,523.

We conclude that the requirement to contribute to the cost of local infrastructure and public land is more systematic and costly than it was prior to the PSP innovation. However, these arrangements will do nothing to change the backlogs in transport, hospitals and other services which are chronic in fringe suburbia. There are also questions about the delivery of the local infrastructure specified in the PSPs.

#### *Has the provision of local infrastructure actually improved?*

This is a topical issue. It was kicked along in early March 2012 when *The Age* carried a front page banner story and an accompanying *Focus* report entitled 'Sick Suburbs'. The report reiterated complaints about the poor quality of outer-suburban infrastructure. According to the Wyndham City Council, this was contributing to dependence on automobile transport, lack of exercise and to the alleged poor health of some residents.<sup>118</sup>

One hopeful development cited was that of the Selandra Rise development, where provision was being made for walking tracks and outdoor fitness areas. This project is near the Clyde North PSP discussed above. As noted, all the PSPs in the area are required to provide recreation venues, community centres, conservation areas, walking tracks and the like (the costs of which are charged to developers). This is an improvement over past practice.

However, there is a catch. There is no timetable for the construction of this infrastructure. This depends on the respective municipal council's agenda. These councils usually face a multitude of infrastructure obligations. They are unlikely to proceed with the specified works in PSPs when they have not received the developer contribution. The contribution is only paid at each stage of the subdivision process and payment may occur over several years. In addition, because much of the land within each PSP is held by non-developers, there may be an interval of years before the council receives the money specified in the Development Contribution Plan. Moreover, these passive land holders may be sitting on the land designated in the plan for sporting ovals or other community facilities.

The infrastructure in question looks like a mirage which may not be built for years after the first residents move in. In order to ensure that the mooted infrastructure is provided in a timely manner, measures would have to be implemented to ensure that large tracts of the land within each PSP — large enough tracts to progress the subdivision quickly — get into the hands of major developers and out of the hands of passive landowners or tiny developers.

This is not happening. To take such action would be to interfere in the rights of landowners to do as they please with their land. Instead, the GAA's objective is to ensure that there is an abundant supply of land that has completed the PSP process. It hopes that the more land that is in developers' hands, the greater will be the output of finished lots, and thus that there will be no repeat of the supply blockages that occurred at the end of the 2000s. However, as the following analysis of lot production costs indicates, there is no guarantee that developers will respond as the GAA presumes. This is because there are only a limited number of households that can afford lots priced at the point at which developers can currently sell them at a profit.

#### *The costs of producing sub-divided lots*

The most important component in the cost of a new block is the price of land at the time that the developer procures it for the purposes of subdivision. For the immediate future, this usually means the price the developer paid for land included within the UGB when *Melbourne 2030* was legislated or was added when the UGB border was extended in 2005-06 and 2010. The market price has been high in part because the *Melbourne 2030* legislation put a finite boundary on the land eligible for development, thus allowing landowners to demand a premium. The landowners had developers over a barrel. If developers wanted land they could develop, they had to compete for the available stock. Prices doubled after *Melbourne 2030* was legislated in 2002. In the case of the main South-Eastern corridor in Casey, the increase was from around \$200,000 a hectare to \$400,000 a hectare. This competition continued with the limited land release in 2005-06 and again with the huge release of 41,000 hectares to the UGB in 2010. The Victorian Government identified the land from which the 41,000 hectares was to be chosen when it announced its intention to extend the UGB in December 2008. Anyone — whether a developer or investor — could bid for this land in the expectation that most of it would be rezoned for housing or other urban purposes. The result is that the price for land distant from the current fringe reached around \$400,000 per hectare and land in or near the latest PSPs brought around \$1,000,000 per hectare.

At 15 lots per hectare, the cost of land per lot from broadacre properties purchased for between \$400,000 and \$1,000,000 per hectare would be between \$27,000 and \$67,000. In reality, it will be more as only about 70 per cent of the zoned land that developers purchase can be subdivided (because of the allocation for roads and community infrastructure and perhaps because of drainage or other topographic problems). If the amount of developable land is reduced to 70 per cent, the raw land component per block per will be between \$38,000 and \$94,000.

The cost to the developer of providing infrastructure services, including local roads and the articulation of sewerage, water and telecommunication links, will vary with the block size and nature of the terrain. There is no publically available evaluation of these costs. The sources we consulted, including developers who do not wish to divulge their identity, indicated that the cost of production in Melbourne is around \$50,000 per block. The National Dwelling Cost Study prepared by Urbis, put the subdivision construction price of its Melbourne case study in 2010 at \$45,657. There are also land-holding costs in the form of rates and land taxes, which Urbis estimates to be around \$6,000.<sup>119</sup>

As detailed above, the Development Contribution Plan will cost another \$20,000 per lot (including the biodiversity component), the GAIC another \$8,000 per lot and the ten per cent land contribution another \$3,809 to \$9,523 per lot (depending on the price the developer paid for the land in the first place. Altogether, these costs add to between \$125,809 and \$187,523 per block (Table 6.2).



**Table 6.2: Estimate of current costs of subdivision per block\***

Component	Cost
Raw land	\$38,000 - \$94,000
Development Contribution (including biodiversity)	\$20,000
Land contribution	\$3,809 - \$9,523
Subdivision construction (roads, pipes, etc)	\$50,000
Land holding costs (rates, land tax)	\$6,000
<b>Total</b>	<b>\$125,809 - \$187,523</b>

\* Assumes average block size of 450 square metres.

Finance, developer profit and GST costs are additional.

When the land is ready for sale, there are marketing and sales commission expenses, plus holding charges on bank loans covering the development. These may be significant if the release of the land is staged over a period of a decade or so. Finally, at the point of sale of finished blocks, there is the GST tax. The developer, of course, also expects to make a profit. We were unable to obtain detailed estimates of these costs.

Because of the variation in the raw land component, the costs of producing residential lots can span a wide spectrum. Nevertheless, it is clear that the days of cheap land on the suburban frontier are over. According to all those consulted on this issue, it is now difficult for developers to make a profit on blocks sold below \$200,000. The costs detailed above indicate that this is not the result of special pleading by developers. They also underline why developers may have to increase the proportion of small lots on their estates. If the yield of lots per hectare is 15, this implies lot sizes of around 450 square metres (assuming 70 per cent of each hectare is covered by finished lots). If the average size of lots is reduced to 350 square metres, the yield would be around 20 per hectare. Such a yield would help spread the costs detailed in Table 6.2 across a larger number of lots. Whether this would enhance the developer's profit margin depends on how strong the consumer demand is for small lots. The following discussion on the implications of high costs of fringe land relates to this point.

These cost data suggest that, even if the GAA achieves its aspiration to complete PSPs covering 90,000 lots in 2012 and even if developers have managed to procure this land from the farmers and investors holding it, there may not be a strong financial incentive for developers to accelerate production levels. This is because, in order to sell the increased volume of lots, developers would probably have to lower the current price point to below \$200,000 per block and thus face potential losses.

#### *The implications of high fringe land costs*

Currently the presence of first-home buyers on the fringe has shrunk. The land sales people whom we consulted all agreed that second, third or other trade-up buyers have dominated the land market over the last couple of years. For example, at Cascades on Clyde, which is located on the Berwick Cranbourne Road and is still in production, out of the 800 sales made so far, only 15 per cent have gone to first-home buyers (though some went to spec-builders who may have sold to first-home buyers).

It is noticeable that, even in the current slow market, developers have been reluctant to reduce their posted block prices below \$220,000 in order to move their stock (though discounting of around \$10,000 per block is common). This is partly because they do want to face the protests of those who

bought land in the same project earlier and now find the posted price lowered. But there is also a reluctance to realise the low profit margins or losses that such sales may represent.

One likely response to this situation is that developers will adjust their product range to include more very small blocks that are within the first-home-buyer purchasing range. This is already happening. Developers have had no choice but to move in this direction because, since September 2010, it is official Victorian State Government state planning policy to encourage 'average overall residential densities in the growth areas of a minimum of 15 dwellings per net developable hectare.'<sup>120</sup>

Thus, most blocks currently on the market in Melbourne are less than 500 square metres. According to the National Land Sales Program, just six per cent of the blocks released in Melbourne were smaller than 350 square metres in 2007. However, by the first quarter of 2012, that share had increased to 20 per cent.

Developers are under pressure to pursue a small block strategy because, as the following case study illustrates, they cannot put a house and land package on the market in new estates for less than \$350,000, unless on a small block. Anything above this price will be beyond the means of most first-home buyers. The GAA has recently moved to facilitate such blocks. It has issued a Small Lot Housing Code. As long as developers abide by this code, there is no longer any need to apply for a planning permit for such blocks.<sup>121</sup> They are now treated the same as blocks of larger size, where no planning permit is required in a PSP.

There is a variety of project-builder houses designed for small blocks which prospective home buyer can choose from. The example in Figure 6.1 indicates what is available from a builder in Melbourne. The dwelling is 150 square metres in size (including the single garage). The price for the pictured house sold as a house and land package is \$335,969 in Pakenham, \$343,710 in Clyde and \$328,375 in Melton. The block size in each location is 336 square metres, 308 square metres and 320 square metres respectively. Stamp duty will be extra.

What does the buyer get for this price? The design shown in Figure 6.1, like others scrutinised, includes three bedrooms. To that extent, it does cater for couples with a family or intending to start one. But because of the small size of the house and the block, there are multiple trade-offs, or losses of other amenities that Australian first-home buyers would expect. The garage has space for only one car. The only family space or room for children, separate from the bedrooms, is a combination family room and kitchen. The bedrooms are very small — a little less than three metres by three metres. The house itself is only 8.8 metres wide, with just over a metre between the side wall and the neighbour. If wider, the depth of the block would have to be less than thirty metres at the lot sizes quoted. This is unlikely to be the case since the exterior length of the house is 19.4 metres. There is no possibility of extending such a house should parents decide they need more room for adolescent children.

According to the GAAs Small Lot Housing Code, developers are only required to provide for a 1.5 metres set back from the front property boundary.<sup>122</sup> If the block is about 10 metres by 30 metres, the backyard could be up to about 8.5 metres. In the houses we observed, the front set back was around four metres. A six metre backyard is barely large enough for the play equipment that most

families would regard as a child’s birthright. Also the small block means there is little prospect of building extensions to the house as children age.

**Figure 6.1: Example of a dwelling available for less than \$350,000 on the suburban fringe**



Source: <http://www.carlislehomes.com.au> (downloaded 7 May 2012)

Finally, the street setting does not look like that of a traditional suburb. Figure 6.2 shows a recently completed house and land package on a small block in Clyde North, about five kilometres from Cranbourne. The block in question is almost certainly less than 350 square metres in size. The tiny front yard means that there would only be space for a few small shrubs. Given the one-car garage, a second car (essential given that the nearest train stations are several kilometres away) would need to be parked in the driveway or on the roadside. As Figure 6.3 indicates, a streetscape consisting of houses of this type is dominated by a wall of contiguous houses, with little green respite. The developers have anticipated the lack of off-street parking by incising parking areas from the nature strip.

The final product will look like an inner city setting dominated by the facades of units or townhouses. Yet the houses pictured in Figure 6.2, are some 50 kilometres from the centre of the

city and devoid of the offsetting advantages of an inner city location, including easy access to the city's amenities, public transport and jobs.

**Figure 6.2: Dwelling, suburban frontier housing estate, Clyde North, 2012**



Source: Authors' photo

**Figure 6.3: Streetscape, suburban frontier housing estate, Clyde North, 2012**



Source: Authors' photo

The stereotype of outer-suburban McMansions still pervades much of the critical commentary about outer suburbia. However, the trend in fringe housing is in the opposite direction as lot sizes shrink. The McMansion stereotype has some currency as a description of the houses that are being built for trade-up buyers who can relocate to new suburban-fringe settings on the back of the value of their previous home. Because developers have to keep lots small (due to the 15 per hectare rule), trade-up buyers are limited to building their more expansive homes on lots of 400 to 500 square metres.

Figure 6.4 illustrates the type of house which caters for this market. It includes the features that a buyer looking for a traditional family-friendly detached house would expect. It contains indoor and outdoor space for children to play and room for a modest suburban garden. The floor area of houses of this sort is usually at least 200 square metres. The retail price of project built houses on the fringe is around \$1,000 per square. Thus, at \$200,000 or so for the house and at least \$220,000 for the

land, such housing costs more than \$400,000. The example in Figure 6.4 is priced at \$460,706, which is typical of the prices asked for the houses of this type that were listed for sale as of June 2012.

There are questions about how strong this trade-up market is. The National Land Sales Program suggests that most trade-up buyers would prefer blocks larger than 450 square metres.<sup>123</sup> There is some evidence that they are being attracted to an alternative 'knock down' option, where a new and large house is built after the demolition of the existing house in the outer zone on an established suburban block of 600 square metres or so.

As to first home buyers, it may be too early to pronounce that housing on the fringe will remain out of range of first-home buyers. It is possible that the current caution which consumers are showing in taking on debt is contributing to the withdrawal of first-home buyers. But beyond this caution, there are questions about whether this small lot accommodation to the cost pressures described is one that will attract large numbers of first home buyers.

**Figure 6.4: House-land package \$460,706 (land component \$229,000) Clyde North, March 2012; block 456 square metres**



Source: <http://www.cascadesonclyde.com.au/now-selling/house-and-land.html>

This leaves a great puzzle. What are the families that previously flocked to fringe housing going to do? Maybe they will have to adjust their aspirations to small lots and houses that are within their means. In doing so, most would probably expect that, once they have their foot in the door of the housing market, they can subsequently upgrade to a more traditional family-friendly house.

Many will look for alternatives. First-home buyers appear to be attracted by the modern fittings which new houses on the fringe offer. But if these are too expensive, buyers may fall back on an older house on a larger block in established outer areas. There are still some detached houses available in the outer-suburban zone which can be bought for \$350,000 or less. This is unlikely to remain the case for long if the demand for such housing swells because of increased interest from first-home buyers. Alternatively they may have to accept infill housing in established outer-suburban locations.

Another option is to leap-frog the offerings located within the UGB to the far less regulated market outside the Melbourne Statistical Division (MSD). The feasibility of such an alternative is explored in the next chapter.

## Chapter Seven: Unanticipated outcomes — the peri-urban sprawl

### Defining Melbourne's peri-urban area

Any reader, who has recently travelled through Wallan to the north of the MSD, or Drouin and Warragul on the Princes Highway to the east, would be aware that these towns are rapidly expanding. They have the look and feel of the Melbourne fringe with their real-estate hoardings and their patchwork of new street construction. Perhaps these are the early signs of a potential major shift of households looking for the kind of family-friendly housing they can no longer afford within the UGB. The extent of this movement is uncertain because of analysis of data on the characteristics of recent movers will have to wait until the 2011 Census results are released. There are also many definitional issues. One is the matter of what constitutes the peri-urban fringe. Another is the difficulties of determining whether those who are moving across the MSD border are doing so because of the attraction of lower housing prices.

Peri-urban areas are defined as locations within commuting range of employment in the MSD where available data indicate that recent movers are predominantly employed in the MSD. For the purposes of this study, the focus is on those who make this move primarily because housing is cheaper than within the UGB. We do not include tree-changers or sea-changers who are moving for lifestyle reasons. If a significant number of new residents commute into the MSD from a location then, by definition, it is within commuting range. This judgement is made on the basis of journey-to-work information, detailed in Table 7.1. The issue of whether these movers are primarily attracted by the availability of cheaper housing (rather than by lifestyle attractions) is discussed further below. In absence of field research, we rely on housing construction and price data from the locations investigated, as well as anecdotal information on what is motivating relocation. However, locations with high median house prices, like the Surf Coast (see Table 7.2), are highly unlikely to be attracting people because of the availability of cheap housing.

Until recently much of the attention directed at movers to areas on the edge of the MSD has focussed on tree-changers and sea-changers. Many of these tree-changers and sea-changers are likely to be nearing retirement. Some may already have holiday homes. They can be regarded as downshifTERS when they sell their suburban homes. Some may well have to commute for employment, but it is likely that their main motive for moving is lifestyle based. Others may be younger, but want to live in bush settings as found in the Dandenongs within the MSD. Recent research, conducted by Michael Buxton of RMIT University for the shires in question, documents the high potential for this life-style movement. Though it is difficult to subdivide rural property now, there is a legacy of land fragmentation such that there are thousands of rural parcels (without dwellings) in these shires that could be sold to tree-changers.<sup>124</sup> The consequences for agriculture, in particular, should this take-up occur, are serious. According to Buxton:

The existing pattern of land fragmentation represents the greatest threat to agriculture, with future subdivision a subsidiary threat. Urban and rural residential developments introduce uses which are incompatible with high value, intensive agriculture. They raise land prices, reduce opportunities for lot amalgamation and rural restructure and lower comparative rates of return from agriculture.<sup>125</sup>

There is also evidence that some low income people, including those dependent on Commonwealth benefits or pensions, are leaving Melbourne in search of cheaper housing and perhaps a change of lifestyle. For example, as of 2010, in Bass Shire, around nine per cent of the 25-64 year old population were in receipt of the Disability Support Pension, compared with 5.5 per cent in Melbourne.<sup>126</sup> However, very few of this group would be in a position to purchase new housing, even if relatively cheap in a peri-urban location.

#### *Peri-urban location and house-hunting*

In determining which locations on the fringe of the MSD meet the peri-urban criteria outlined above (that is commuters who have moved because of the attraction of lower cost housing), we have approached this issue inductively by examining recent trends in population growth and building approvals for possible candidates, as well as the evidence on commuting.

**Table 7.1: Potential peri-urban fringe of Melbourne as indicated by number of persons who work in Melbourne in 2006 and population growth from 2009 to 2011**

Areas surrounding the Melbourne Statistical Division (from West to East)	Employed persons			Estimated Resident Population			% Change	
	Total employed persons	Main job in Melbourne Statistical Division	% whose main job was in Melbourne	2009	2010	2011	2009-2011	2009-2011
Surf Coast (S) – East	6,252	631	10	16,063	16,750	17,466	1,403	9
Queenscliffe (B)	1,036	104	10	3,320	3,309	3,306	-14	0
Greater Geelong City - Part B	13,518	1,210	9	37,366	38,154	39,030	1,664	4
Greater Geelong City - Part A	67,210	8131	12	175,913	178,364	180,805	4,892	3
Greater Geelong (C) - Part C	1,098	384	35	3,186	3,198	3,212	26	1
Golden Plains (S) - South-East	4,120	350	8	10,140	10,470	10,801	661	7
Moorabool (S) - Bacchus Marsh	7,040	3,659	52	17,681	18,193	18,953	1,272	7
Moorabool (S) – Ballan	2,517	909	36	6,519	6,634	6,708	189	3
Hepburn (S) – East	2,882	384	13	7,890	7,977	8,016	126	2
Macedon Ranges (S) – Kyneton	3,510	670	19	8,919	8,998	9,077	158	2
Macedon Ranges (S) – Romsey	4,929	2,723	55	11,854	12,029	12,138	284	2
Macedon Ranges (S) Bal	8,924	4,563	51	21,268	21,550	22,026	758	4
Mitchell (S) – South	8,760	4,526	52	22,923	23,706	24,681	1,758	8
Murrindindi (S) – West	3,328	1,584	48	7,154	7,220	7,349	195	3
Baw Baw (S) - Pt B West	12,519	1,999	16	32,456	33,594	34,583	2,127	7
Yarra Ranges (S) - Pt B	210	149	71	623	623	618	-5	-1
Bass Coast (S) - Phillip Is.	2,952	304	10	9,458	9,791	9,940	482	5
Bass Coast (S) Bal	6,481	728	11	20,145	21,133	22,116	1,971	10
South Gippsland (S) – West	3,297	633	19	8,436	8,529	8,701	265	3
Melbourne	-	-	-	3,998,022	4,070,514	4,137,432	139,410	3

Notes: The 2011 population figures are preliminary. The population of Murrindindi (S) - West was increasing until 2008 but dropped in 2009 following the bushfire.

The listed areas are Statistical Local Areas or aggregations of Statistical Local Areas.

Source: ABS, Census 2006, Journey-to-work, Table Builder; Estimated Resident Population from Regional Population Growth, Australia, Cat No. 3218.0. Mar 2012

Table 7.1 shows the recent change in population for locations near the MSD, as well as the commuting pattern. Table 7.2 shows the recent record of dwelling approvals. When these two factors are examined in conjunction with each other, two locations stand out. These are Mitchell (S) - South (which contains Wallan) to the north of the MSD, and Baw Baw (S) - West (which contains Drouin and Warragul) to the east. Both locations have experienced a sharp increase in building approvals by comparison with the annual average for the three previous years of 2005-06 to 2007-



08. By 2010-11 both areas had reached the large total of around 600 building approvals. This compares with 1,298 in Craigieburn in 2009-10. Craigieburn is the nearest suburb to Wallan in the northern growth corridor within the UGB.. In the case of Drouin and Warragul the nearest suburb with parts within the UGB is Cardinia (S) – Pakenham. There were 1,576 building approvals in Pakenham in 2009-10.

As regards commuting, In the case of Mitchell (S) - South, 52 per cent of the residents employed in 2006 were working within the MSD. Only 16 per cent commuted from Baw Baw (S) – West into the MSD in 2006. But this is not indicative of the recent situation in the two main towns of Drouin and Warragul. These towns are far further than Wallan is from the MSD and its jobs. (Warragul is 104 kilometres from the Melbourne CBD). The anecdotal information we gathered from informants in Warragul suggests that it is only recently that the towns have attracted commuters motivated to move to the two towns by housing prices.

**Table 7.2: Potential peri-urban fringe of Melbourne as indicated by number of new dwelling approvals, 2008-09 to 2010-11 and median house price 2010**

Areas surrounding the Melbourne Statistical Division (from West to East)*	No. of new dwellings approved				Median house price	
	Average 2005-06 to 2007-08	2008-09	2009-10	2010-11	Local Government Area	2010
Surf Coast (S) – East	331	316	353	397	Surf Coast Shire	550,750
Queenscliffe (B)	54	38	46	35	Queenscliffe Bor.	715,000
Greater Geelong (C) - Pt B	476	465	602	550	} Greater Geelong City	345,000
Greater Geelong City Part A	1,148	828	1,530	1,334		
Greater Geelong (C) - Pt C	11	7	12	9		
Golden Plains (S) - South-East	116	123	153	169	Golden Plains Shire	301,000
Moorabool (S) - Bacchus Marsh	147	202	433	298	} Moorabool Shire	305,000
Moorabool (S) – Ballan	52	66	67	52		
Hepburn (S) – East	84	71	76	69	Hepburn Shire	270,000
Macedon Ranges (S) – Kyneton	70	52	94	93	} Macedon Ranges Shire	390,000
Macedon Ranges (S) – Romsey	92	83	123	104		
Macedon Ranges (S) Bal	155	165	270	220		
Mitchell (S) – South	246	260	562	619	Mitchell Shire	289,750
Murrindindi (S) – West	63	48	277	120	Murrindindi Shire	237,750
Baw Baw (S) - Pt B West	349	504	598	628	Baw Baw Shire	265,000
Yarra Ranges (S) - Pt B	3	4	2	2	Yarra Ranges Shire	415,137
Bass Coast (S) - Phillip Is.	257	139	203	200	} Bass Coast Shire	330,000
Bass Coast (S) Bal	320	297	412	396		
South Gippsland (S) – West	60	80	95	86	Sth Gippsland Shire	245,000
Melbourne	29,298	31,587	42,251	47,444		

\* These areas are Statistical Local Areas or aggregations of Statistical Local Areas.

Source: ABS, Building Approvals 2005-06 to 2009-10 from customised data set held by CPUR, 2011 from Cat. No. 8731.0 Building Approvals, Australia, February 2012, data cube; Median house prices from Valuer General - Victoria, A Guide to Property Values 2010, Department of Sustainability and Environment

### *The potential reach of the peri-urban spread*

Though Mitchell (S) - South and Baw Baw (S) - Pt B West seem to be at the epicentre of the current peri-urban movement as defined here, it could extend to several other locations. The 2006 data on commuting shown in Table 7.1 indicate that there is an extraordinary range of locations where at least ten per cent of the employed residents work in Melbourne. These include Surf Coast (S) - East, Greater Geelong City Part A and the Phillip Island area of Bass Shire, where in each case about ten



per cent of the residents who are employed, worked in the MSD (usually in the suburban locations nearest to their home).

We have not included these coastal locations, or Central Geelong, in our peri-urban category because, as Table 7.2 shows, the price of housing in many of these locations is not cheap, relative even to what is available on the UGB fringe. Neither Ballarat nor Bendigo are included either, despite the huge Victorian State Government expenditure on a fast rail link to Ballarat, because the proportion of resident workers who commute to Melbourne (not included in Table 7.1) is very low.

Data on house prices drawn from the Victorian Valuer General housing sales records confirm that the price of housing in Mitchell (S) - South and Baw Baw (S) - West is relatively cheap by UGB fringe standards. These data support the hypothesis that housing costs are part of the attraction of moving to these locations. The median price for all houses sold in Mitchell (S) in 2010 was \$289,750 and \$265,000 in Baw Baw (S).

One other location stands out as showing high potential for peri-urban movement. This is Moorabool (S) - Bacchus Marsh, where the median price of houses in 2010 was \$305,000. By contrast, the median prices of houses in 2010 were \$390,000 in Macedon Ranges. The Statistical Local Area (SLA) of Macedon Ranges (S) - Balance is showing signs of significant growth, particularly in Gisborne (the closest town to the MSD). But with median house prices in 2010 being \$390,000 it is likely that much of this growth reflects tree change movement.

The accompanying map in Figure 7.1 shows the location of the three areas which seem to best exemplify the peri-urban phenomena. There is little doubt that the peri-urban frontier could spread if demand in these three locations pushes up the price of local housing. Opportunities for commuting can only grow as freeway connections improve and as the range of available jobs in the middle and outer zones of the MSD increase, thus potentially reducing commuting time.

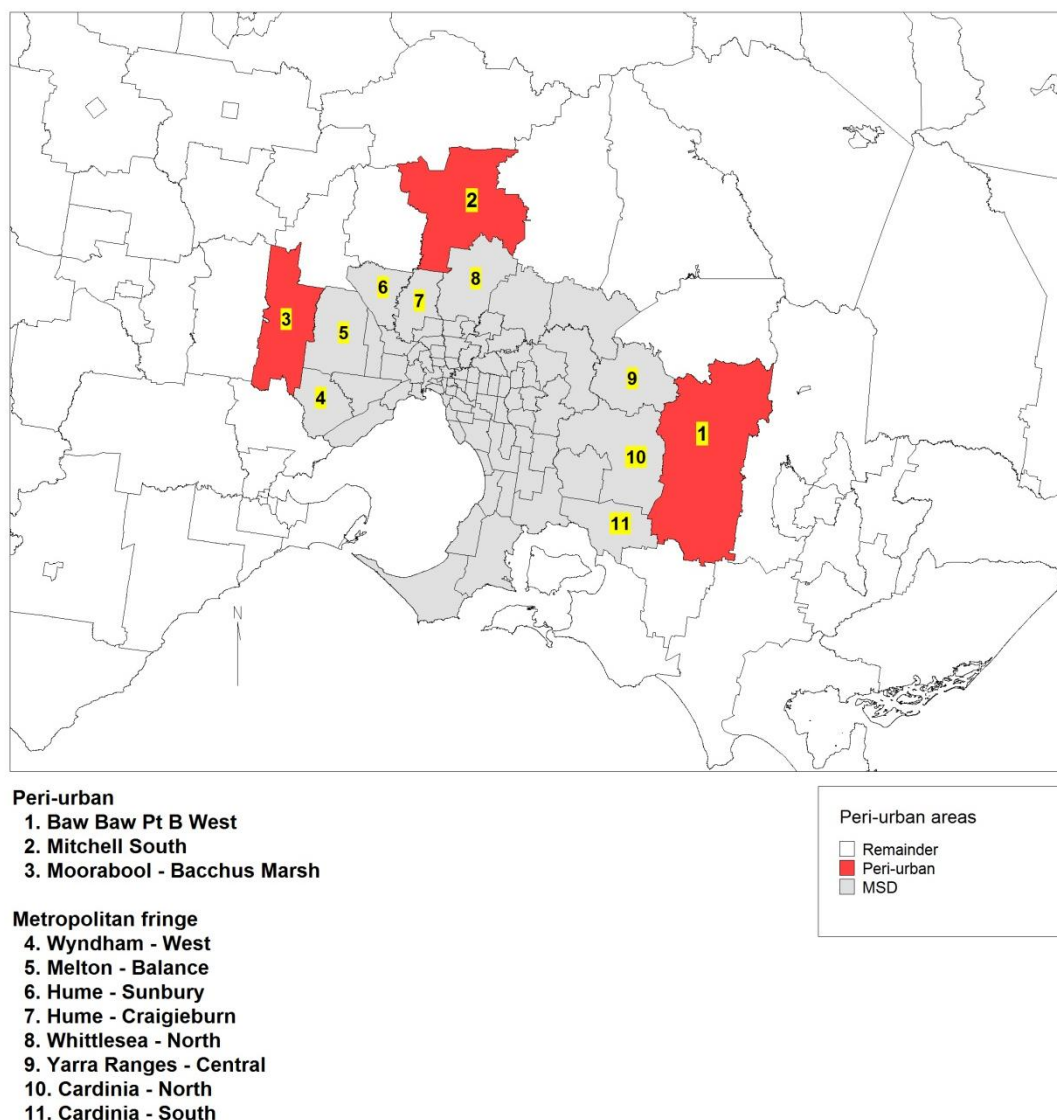
### **Housing opportunities in peri-urban areas**

The incentive for peri-urban movement for those concerned about housing affordability is enormous. First-home buyers, as we have seen, are unlikely to find family-friendly housing for less than \$350,000 on the UGB fringe. However, housing on blocks of around 500 to 600 square metres is available for this price in Wallan, Drouin and Warragul. An example is shown in Figure 7.2. This new four-bedroom house is advertised for construction on a 668 square metre block in Warragul for \$340,611. The block is located on the Waterford Rise project on the fringe of Warragul (advertising feature shown below). This is a massive development of 1,225 lots half of which is already zoned for residential purposes and the other half is under review by the Baw Baw Shire Council.

It is instructive to compare the price for the Waterford Rise house with the house within the UGB featured in Figure 6.1, Chapter Six. That house was advertised for \$335,969 in Pakenham, \$343,710 in Clyde and \$328,375 in Melton. Yet it offered a block of around 300 square metres, half the size of the 668 square metres block the Warragul house is located on. In addition, the Warragul house is 210.3 square metres rather than 150 square metres for the UGB house. Not surprisingly, the rooms in the Warragul house are all much larger than those in the UGB house. In addition, there is a fourth bedroom, a rumpus room and a two car garage (all missing in the UGB house).

Houses such as this may also be attractive to the lower end of the trade-up market. Some couples may have been forced to compromise their aspiration to live in a new, family-friendly house and instead start their housing career by purchasing a unit or a tiny house and land package on the UGB fringe. They may find the relatively ample housing and block sizes available on the peri-urban fringe an attractive option when thinking about moving. It proved to be difficult to estimate the split between first-home buyers and trade-up purchasers who are moving to our peri-urban locations. However, information from the Victorian State Government's first-home buyer grant data set indicates that many of those locating in Wallan, Drouin and Warragul are first-home buyers.<sup>127</sup>

**Figure 7.1: Statistical Local Areas adjacent to the Melbourne Statistical Division designated as peri-urban**



The potential for further peri-urban development based on the low price of housing relative to Melbourne is enormous. Developers in peri-urban locations face no growth boundaries like the UGB which place strict limits on where subdivision is permitted. Nor is there any parallel to the green-wedge zoning for land located between the UGB and the MSD boundary. In effect, the compact city policy framework ceases at the MSD border.

Figure 7.2: Example of a dwelling available for less than \$350,000 in the peri-urban area



**Dimensions**

Family	5140 x 3630
Meals	4360 x 2200
Rumpus	3890 x 3490
Master Suite	4700 x 3300
Bed 2	3390 x 2800
Bed 3	2950 x 3000
Bed 4	3030 x 2800
Garage	5500 x 6000
Alfresco	4920 x 2380

Measurements displayed in mm.

Exterior Length	20.95m
Exterior Width	11.3m
House Area Total	210.31sqm
Squares	22.64





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Source: <http://www.carlislehomes.com.au> (downloaded 7 May 2012)

Successive Victorian State Governments have not differentiated policy designed to promote regional development from peri-urban development. As far as the State Government is concerned, there is no peri-urban zone. For example, first-home buyers in peri-urban locations are eligible for the \$6,500 bonus applying to the purchase or construction of new homes in regional Victoria (due to

expire 30 June 2012). It has long been state government policy to put a high priority on growth in regional Victoria. Any growth outside the MSD is considered good, regardless of where it occurs, even if it is in conflict with the compact city policies applying within the MSD.

According to the State Planning Policy Framework, the objective for urban growth (including in regional areas) should be to, 'Ensure that sufficient land is available to meet forecast demand.' In order to achieve this objective, strategies should '...ensure the ongoing provision of land and supporting infrastructure to support sustainable urban development.' Also, municipalities are instructed to '...plan to accommodate projected population growth over at least a 15 year period and provide clear direction on locations where growth should occur. Residential land supply will be considered on a municipal basis, rather than a town-by-town basis'.<sup>128</sup>

This means that peri-urban municipalities must accommodate any subdivision proposals where there is evidence of consumer demand. The peri-urban planners we spoke to said that their shires, just like MSD municipalities, have been expected to do their bit to accommodate Victoria's rapidly expanding population. The implication of this directive is that if one or two towns are the main focus for development within the municipality, most of the development task will have to be met in these towns.

The procedures by which municipalities achieve this urban growth objective may take the form of detailed planning statements that specify where growth is expected to occur, or may involve more *ad hoc* negotiations with developers who seek the go-ahead for their projects.

The Mitchell Shire makes clear in its planning documents that it intends to release sufficient land, mainly in the Wallan area, to keep pace with expected strong demand for settlement in the shire. The shire's stated policy is 'to retain a particular focus on Wallan, and to consolidate development in and around Wallan in favour of other nearby towns'.<sup>129</sup> In the case of the Shire of Baw Baw, developers wishing to initiate a new subdivision usually negotiate directly with the shire's planning department concerning the location of their project and the contributions that the developer must make in the provision of infrastructure. The shire has been subject to numerous inquiries from land owners and their agents about rezoning prospects.

An officer from the GAA was sceptical about the alleged ease of gaining planning permission for developments in peri-urban localities and indicated that it could take up to five years for planning approval to be completed. It may take a few years if the developer does not hold land already zoned for residential development in the local planning scheme. Such land would normally be zoned for farming. However, in these circumstances the municipal planners consulted indicated it might only take a year for the council to rezone the land, after which state government approval will be required. The major concern at this level currently appears to be about loss of high quality farmland.

#### *Development costs in peri-urban locations*

This relatively open-ended planning arrangement means that developers do not have to pay the premium prices for raw land applying within the UGB. Development contributions are also much lower than the around \$20,000 per block payable under the current PSPs within the UGB. Nor is there any GAIC tax on land when it is developed. This is why blocks can be put onto the market at well below the prices currently prevailing within the UGB. Developers can also tailor their product to

the market preference for relatively large blocks. They do not have to achieve the 15 lots per developable hectare as is now the case within the UGB.

## Outlook

There can be no mistake that this peri-urban movement is functionally part of Melbourne, even though occurring outside the city's formal borders. Commuters are tied to employment in the city. The consequence is a significant increase in private car use. Such commuters do not use public transport, mainly because they work in jobs dispersed across the parts of the metropolitan area nearest their place of residence. At present, peri-urban movement of those looking for affordable housing still only represents a small fraction of the volume of new housing being developed within the UGB. But, if no solution is found to the escalating costs of fringe development, the appeal of peri-urban location is bound to increase.

For the families doing the commuting, it must add stress to their lives. Yet, they obviously see it as a sensible adaption to the lack of affordable family-friendly housing within the MSD. They get the compensating benefits of ample housing in a country setting. In places like Drouin and Warragul, they can also take advantage of well-established sporting facilities and clubs for children, as well as schools and hospitals. These are sometimes better than what is available in newly developed fringe metropolitan locations.

### *Wallan becomes part of the UGB*

Just prior to completing this report, the Victorian Government announced further additions to the UGB. This had to do with resolving complaints from parties aggrieved that their land was not included in the massive extension to the UGB declared in 2010.

The government has added another 5,958 hectares within the UGB. This decision was based on recommendations from the GAA, which were reviewed by an independent Logical Inclusions Advisory Council. Our main interest in this outcome is that nearly half the land added, or 2,705 hectares, is located around Wallan within the Shire of Mitchell. It includes the existing Wallan township area, some of which is already zoned for urban development within the Shire of Mitchell planning scheme (around 1,400 hectares) and another 1,367 hectares currently zoned for farming to the south of the Wallan township.

None of this land was part of the area originally designated in 2008 to be included in the investigation for future inclusion within the UGB. All of it is outside the existing Melbourne metropolitan area — which was why we included Wallan in our peri-urban zone.

Wallan is no longer classifiable as peri-urban. The GAA has arrived at the same judgement we have. Wallan, according to the GAA's report on the area, 'is effectively already part of Melbourne's northern growth corridor'.<sup>130</sup> For this reason, the GAA has decided, and the Government accepted, that the area should be incorporated within the UGB and subject to the existing GAA planning process.

The GAA has in effect admitted that those moving to Wallan are doing so because of the failure of UGB planning process to deliver affordable housing. The decision on Wallan means that these escapees are to be corralled within the UGB. Henceforth, the Wallan area will have to undergo the

more comprehensive and costly PSP process, which includes the Development Contribution Plan regime and other UGB infrastructure levies, notably the GAIC.<sup>131</sup>

The implication is that land development in and around Wallan will slow, other than in areas already zoned for urban development under the Shire of Mitchell planning scheme. Most of the rest of the land is likely to be put at the end of the queue for PSP processing while land further south in the northern corridor is developed. This could take years.

By the time the area around Wallan is developed, it will no longer constitute a 'country setting'. It will be another featureless suburb at the end of a continuous belt of housing stretching all the way from Craigieburn to Wallan.

Those wanting cheaper housing than the housing which can be provided within the UGB will have to look to other peri-urban locations.

## Chapter Eight: Is Melbourne becoming like Sydney?

What can be learned from the Sydney experience? By the early 2000s the housing market in Sydney was in a state of crisis because of a decline in housing affordability. Housing in Sydney by this time was far more expensive than in any other Australian capital city (see Figures 1.3 and 1.4 in Chapter One). A decade later the gap in housing affordability between Sydney and Melbourne, though still evident, had shrunk because of the extraordinary escalation of housing prices in Melbourne described in Chapter One.

There has been a decade of experience since Sydney's housing market showed unmistakable evidence of a housing affordability crisis. We examine what happened to the Sydney housing market since 2000 with an eye to gaining a better understanding of what can happen in a metropolitan housing market when it hits a serious affordability threshold. Do prices implode as a consequence of a decline in demand, as predicted by Keen and by Garnaut (amongst other bubble theorists discussed in the Appendix)? If prices do not collapse, perhaps the government authorities responsible for housing, and/or the developers, will respond by providing more housing, thus improving matters on the supply side. Another possibility is that if there is no improvement in affordability, consumers will have to revise downwards their dwelling aspirations and accept accommodation in small units or apartments. Alternatively, some may leave in pursuit of affordable housing elsewhere in Australia.

This is not to argue that what happened in Sydney over the decade since the early 2000s will occur in Melbourne. Rather Sydney's experience will be used as one part of the jig-saw in evaluating what might happen in Melbourne as a result of the affordability crisis now enveloping the city's dwelling market.

### The housing market in Sydney since the early 2000s

There was no implosion of housing prices during the 2000s in Sydney. Rather, as Figure 1.4 shows, house prices in Sydney continued to rise until the end of 2003 then subsequently plateaued at very high levels, before a renewed upward spurt in late 2009. Throughout this period, Sydney remained the least affordable housing market of all the Australian capital cities.

It is our view (discussed further in the Appendix) that Sydney housing prices defied gravity because the supply of new dwellings did not keep pace with demand. This scarcity has helped sustain competition for the available housing stock. This was particularly evident in areas of high amenity and close to the commercial heart of Sydney. Sydney residents coped with the continuing high cost of housing in part by devoting an increasing share of the rise in household incomes during the decade to rent or mortgage payments (see Appendix).

The argument about scarcity is anchored to the record of dwelling approvals in Sydney during the 2000s. They fell sharply relative to the 1990s, despite continuing strong population growth in Sydney. Sydney's population grew by an annual average of 49,427 between 1996 and 2001.<sup>132</sup> Dwelling approvals in Sydney over the same period totalled 158,070 (or an average of 31,600 a year). As Table 8.1 shows, since 2001-02, dwelling approvals in Sydney have fallen to way below the 31,600 a year mark to 17,453 in 2006-07 and 14,013 in 2008-09. They have since recovered somewhat, but are still well short of the late 1990s level.

This decline in dwelling approvals was not due to any fall in population growth. Sydney's annual average population growth was 49,907 during this time — that is, almost the same as the annual average growth between 1996 and 2001 of 49,427.

**Table 8.1: Dwelling Units Approved by structure, Melbourne, Sydney and Rest of Australia, 2001-02 to 2010-2011**

	Sydney			Melbourne			Rest of Australia		
	Houses	Other	Total	Houses	Other	Total	Houses	Other	Total
2001-02	13,268	18,998	32,266	25,658	11,714	37,372	82,833	20,554	103,387
2002-03	10,799	20,712	31,511	22,657	13,792	36,449	83,905	27,116	111,021
2003-04	9,509	20,144	29,653	22,698	10,675	33,373	89,997	31,453	121,450
2004-05	7,284	14,950	22,234	20,351	9,874	30,225	80,813	30,355	111,168
2005-06	6,563	11,403	17,966	18,742	6,626	25,368	80,126	28,754	108,880
2006-07	6,460	10,993	17,453	19,169	8,120	27,289	80,688	27,985	108,673
2007-08	6,686	11,689	18,375	22,124	10,273	32,397	80,690	31,270	111,960
2008-09	6,038	7,975	14,013	21,441	10,440	31,881	66,459	20,735	87,194
2009-10	8,104	11,609	19,713	26,080	16,400	42,480	80,793	28,443	109,236
2010-11	8,338	14,464	22,802	24,211	23,924	48,135	67,246	26,068	93,314
Total	83,049	142,937	225,986	223,131	121,838	344,969	793,550	272,733	1,066,283
Per cent	37	63	100	65	35	100	74	26	100
Share of Australia			14			21			65

Source: Australian Bureau of Statistics, Building Approvals, Cat. No 8731.0, Tables 6 and 10

Since the late 1990s, building approvals for both houses and other dwellings (which include semi-detached dwellings, flats and apartments) have declined in Sydney. As to the latter, this was not supposed to be the case because, by the 2000s, the NSW Government's strategies to promote urban consolidation were in place. The reasons for the failure of these strategies are explored below. However, the decline in building approvals for houses was a direct consequence of the government's policy to restrict the release of land for residential purposes on the city's fringe. In the late 1990s the number of building approvals for houses was around 15,000 a year. By the mid-2000s the number had fallen to between 6,000 and 7,000 (Table 8.1). Since the late 1980s the NSW Government has discouraged residential development on the fringe by limiting the pace of land release on the frontier and by requiring developers to pay high up-front development levies (discussed in detail in Chapter Six). This policy has in large part been driven by concerns about the infrastructure costs the government was incurring in facilitating outer-suburban expansion.<sup>133</sup>

As a consequence, the number of lots produced in greenfield areas on Sydney's fringe fell from 8,107 in 1998-99 to 5,214 in 2001-02.<sup>134</sup> Since that time there has been no improvement in lot production in Sydney. According to the NSW Government's *Metropolitan Plan for Sydney 2036*, released in 2010, by the beginning of the 2000s, around 70 per cent of dwelling production in Sydney occurred as infill (not just as defined earlier for Melbourne, but medium- and high-density apartments as well). Between 2005 and 2010, it is estimated that 86 per cent of the extra dwellings in Sydney were built in established urban areas and just 14 per cent in new release areas.<sup>135</sup>

By contrast, in Melbourne during the 2000s, lot production was around 12,000 to 15,000 lots a year, or more than double the number in Sydney.<sup>136</sup> As we have seen, around half of all the net growth in new dwellings in Melbourne during the 2000s occurred in fringe locations. As noted in Chapter Six, developers on Sydney's fringe have responded by pitching their limited offerings to the more affluent trade-up market. Very few first-home buyers can afford the product being offered.



Some may regard this outcome as a welcome outcome of the NSW Government's compact city objective. But, from the point of view of accommodating Sydney's growing population, it could be read as a serious mistake unless accompanied by compensating increases in the volume and variety of housing in established areas of the city. The NSW Government has been anxious to achieve such an increase. Since the late 1980s it has been government policy to encourage infill in the form of units, townhouses, and medium- and high-density apartment blocks, as well as the redevelopment of inner Sydney sites previously occupied by factories or other uses considered to be redundant. The NSW Government has required councils to put in place planning policies which facilitate urban consolidation. This policy has included dwelling targets, much like those introduced by the Victorian Labor Government after the legislation of *Melbourne 2030* in 2002.

For a compact city policy to work, it must result in a significant increase in units and apartments, and include some that less affluent households can afford. Neither outcome has occurred in Sydney. Rather than increasing, the number of infill dwelling approvals decreased during the 2000s, as is evident from the column for 'other' housing in Table 8.1. Nor has the infill produced affordable housing (discussed below).

Why this failure? The answer is similar to that offered in our analysis of the medium-density apartment sector in Melbourne. It is that the costs of a small apartment in a medium- (and high-) density apartment block are beyond the means of most prospective new home owners. According to the Urbis National Dwelling Cost study, the cost in Sydney to the eventual purchaser of a small two-bedroom medium-density apartment in a five-to-nine-storey block (which included all the developer's costs and profit margin) in 2010 was \$624,702. By comparison, the cost to the consumer of a similar apartment in Melbourne was put at \$603,845.<sup>137</sup> The per-square-metre costs for such apartments are well above those for walk-up apartments, units or detached houses.

The factors responsible for this cost structure are similar to those described for Melbourne in Chapter Five. They include the higher labour costs of using union rather than contract labour in five to nine storey apartments, the lengthy time to gain planning approval, and the more demanding building regulations governing medium-density apartment construction by comparison with low rise buildings. Urbis's detailed analysis of costs in Sydney and Melbourne show that developers in Sydney face much higher infrastructure levies than in Melbourne and higher land costs. However, these costs are somewhat offset by higher construction costs in Melbourne than in Sydney. These are estimated to be about ten per cent lower in Sydney than Melbourne.<sup>138</sup> This may be because of the lower density of union membership in Sydney by comparison with Melbourne (see Chapter Five) and, as some developers have told us, the more cordial working relations with the CMFEU in Sydney.

The Sydney apartment market differs from that in Melbourne in that there are more walk-up, two-to-three-storey apartment blocks than in Melbourne. The building of such flats was popular for much of the second half of the twentieth century and as a result there are significant concentrations of these apartments across Sydney, including in locations in middle and outer areas such as Bankstown and Liverpool.<sup>139</sup> One might imagine that construction of this kind of housing would have continued to flourish given the expectation that it was cheaper to build than medium-density apartments. But, as the building approval data in Table 8.1 shows, this has not been the case. According to Rod Fehring, Australand's Executive General Manager, Residential, there is 'a chronic undersupply of detached dwellings, townhouses and apartments in the \$400,000 to \$700,000 range'

and this is where there is most demand.<sup>140</sup> Fehring's comments were published in a Fairfax press analysis of the situation. He went on to tell the press that the inability of developers to supply such product is attributable to 'Sydney's infrastructure, planning and other bottlenecks.'<sup>141</sup>

In response to our enquiries, Rod Fehring elaborated on these quotations and provided some industry cost data on walk-up apartments. Construction costs are about \$2,200 per square metre, which is well below the around \$3,000 per square metre level which applies for medium-density apartments. But other expenses are high. They include the costs and time of gaining planning approval for these projects, the high infrastructure levies (which can vary between \$30,000 and \$130,000 per unit in Sydney) and the high cost of aggregating the land required. This latter cost reflects the very high price of acquiring the detached housing and the accompanying land upon which walk-up apartment blocks would normally be built.

The bottom line is that even in suburban areas far distant from central Sydney, small walk-up 70-square-metre apartments cost \$450,000 to \$500,000. Larger apartments of 120 square metres, if built, would cost at least \$700,000. At this price they cannot compete with older houses and units nearby. As a consequence, they are not being built. To rub salt into the wounds, developers of new dwellings competing with nearby established housing have to pay GST on every sale, whereas the vendors of established houses or units do not have to pay the tax.

Another aspect of the Sydney experience during the 2000s which is relevant to the Melbourne situation is the incidence of high-rise apartment developments. We have marvelled at the spurt in dwelling approvals for high-rise apartment blocks in inner Melbourne over the past couple of years. However, it was argued that such apartments are unlikely to play a major role in accommodating the household growth projected for Melbourne. Sydney appears to offer a test case. Given the need for more housing in that city and Sydney's denser urban pattern, it might be expected that the construction of high-rise apartments would flourish.

However, there has been no parallel spurt in high-rise apartment construction in Sydney. In the Inner Sydney Statistical Subdivision (which covers a larger area than the core region of Melbourne as defined for this report), building approvals were issued for just 723 new dwellings (includes 78 houses) in 2009-10 and 2,742 (292 houses) in 2010-11.<sup>142</sup> By contrast, there were 5,257 new dwellings (458 houses) approved in our core zone of Melbourne in 2009-10 and 12,008 (710 houses) in 2010-11.

The main reason for this lack of activity in Sydney is the costs of producing high-rise apartments. Even modestly sized apartments are very expensive. The block pictured in Figure 8.1 is located at Zetland, just four kilometres from the Sydney CBD along the busy Eastern Distributor. The two-bedroom apartments are currently being sold off-the-plan for around \$750,000. According to Harry Triguboff, the owner of Sydney's largest apartment builder (and the owner of Zetland development pictures), most of his buyers come from China, because, so he asserts, the costs imposed by authorities and interest rates; 'make it very difficult for Australians to buy'.<sup>143</sup> Triguboff's opinion is shared by other property experts we spoke to. As in Melbourne, the high-rise market is dominated by investors. But such is the price of Sydney apartments that investors have turned their attention to cheaper markets, notably Melbourne.

The consequence of this cost squeeze in Sydney, and more recently in Melbourne, is for developers in the inner city market to move towards smaller, particularly one-bedroom or studio apartments of 40 square metres or less which cost \$350,000 or so. For example, according to David Milton, managing director of CBRE Residential Projects; 'There's been a big change and developers are looking increasingly to one-bedroom apartments, which are a lot more affordable for young people or investors'. The reason is affordability. According to the communications manager for Metro Property Development; 'Research told us the appetite [in Sydney] for inner-city apartments priced between \$600,000 and \$750,000 was quite subdued, with a trend towards smaller, cheaper apartments'.<sup>144</sup>

**Figure 8.1: Meriton VSQ North apartments in Zetland, at 27 levels, the tallest building in Green Square, completion estimated by early 2013**



1 bedroom	\$498,000 - \$583,000	1 bedroom + study	\$589,000 - \$612,000
2 bedroom 2 bath	\$694,000 - \$808,000	2 bedroom Maisonette	\$711,000 - \$801,000
3 bedroom 2 bath	\$859,000 - \$1,104,000		

Source: <http://www.meriton.com.au/properties/vsq-north-apartments-zetland/> (downloaded 21 May 2012)

## Implications

The housing provided in medium- and high-density apartments and low-rise infill in Sydney is catering largely for two-person and single-person households. There is a market for this housing and some experts are tempted to say that it is in response to the changing demography of the city (that is more single and couple households). This is at best a partial truth, because the age structure and

growth pattern of households in Sydney is similar to that of Melbourne. As a result, most of the new households entering the Sydney housing market over the next decade will be couples, most of whom will either be starting a family or intending to start a family. Small apartments will not meet their needs.

The NSW experience offers a cautionary tale for compact city advocates. The NSW Government put all its eggs in the compact city strategy basket for Sydney. It has not delivered and cannot deliver, given the cost structures discussed. Sydney is trapped. It continues to be the main settlement point for overseas migrants to Australia and with record numbers of arrivals during the 2000s there has been strong demand for additional housing. In the absence of a vigorous supply response, this demand adds to the scarcity value of established housing. At the same time, it also adds to the costs of obtaining land on which to build apartments.

The NSW Government may have achieved metropolitan growth at a lower cost in infrastructure expenditure by packing people into the established areas of Sydney, but this achievement has been at the cost of increased traffic congestion, a decline in the amount of open space per resident and the loss of much of the suburban built heritage. Many of Sydney's residents are unhappy about these developments. Not surprisingly the policy of urban consolidation is a hot political issue in Sydney.

In its 2010 planning statement for Sydney, the Labor Government announced that it intended to reduce the share of housing in established areas to 70 per cent (rather than the 80 per cent or more that occurred during the 2000s). The newly elected Liberal Government seems to support this policy and 'appears committed to further increases in land supply'.<sup>145</sup> University of NSW academic Alan Peters thinks there is now plenty of land available on the fringe which is zoned for the purpose and serviced with trunk infrastructure. He believes that the slow pace of lot production may be attributed to its remote location.<sup>146</sup> Perhaps. An alternative explanation is the very high price developers have paid for zoned land on the Sydney fringe. This reflects the competition for the limited amount of such land available in the past. As a consequence, developers have to target the more affluent trade-up buyers in order to make a profit. According to the Urbis survey, in 2010, the cost of the raw land component for fringe housing in Sydney was \$135,000 (compared with \$55,000 in Melbourne). No wonder the sale price of houses on the fringe of Sydney was put at \$570,000<sup>147</sup> and no wonder the pace of development has been slow.

### **The consequences of Sydney's housing crisis**

There is much that could be written on this subject, including the extraordinary spatial differentiation on class and ethnic criteria which now afflicts Sydney. We confine ourselves to a few comments where there appears to be a direct link with the outcomes described above. These comments should be read as potential warning signs for those who think that Melbourne's housing boom can go on forever.

#### *Lower household formation*

It is widely asserted by housing economists that not enough houses are being built in Australia to meet their estimates of projected demand. Since these projections are based on past household formation rates as applied to projected population growth, the implication is that household

formation rates must be slowing because the population has grown as expected. This is a tricky issue, which the Australian government's National Housing Supply Council has wrestled with. The Council, like many private sector housing economists, has reported a substantial gap between its estimates of demand for housing and recent supply in parts of Australia. The Council's demand projections are 'unconstrained' in the sense that 'they do not account for how a shortfall in available housing may affect the formation of new households'. The Council acknowledges that, as a consequence of the shortfall, households may not form at the expected rate.<sup>148</sup> This could occur where young people stay longer in the parental home or where young people enter group households (and live in such households longer than in the past).

The aggregate data strongly suggest that this is occurring in Sydney. Sydney grew by 499,073 between mid-2001 and mid-2011 and Melbourne by 665,807 over the same period. During this time, as Table 8.1 indicates, there were 225,986 dwelling approvals in Sydney and 344,969 in Melbourne. For Sydney this means that there was one building approval for every extra 2.2 persons over the decade. For Melbourne the parallel figure was one building approval for every additional 1.9 persons. The likely explanation is that household formation has been delayed in Sydney, because potential households have not been able to afford the product which builders or developers have been able to put on to the market.

### *Decline in home ownership*

Households in Sydney have, to some extent, adapted to the sustained high price of housing available by devoting more of their incomes to housing. However, there is a limit to this process and it appears to be showing up in the data on housing tenure. Over the past couple of decades there has been an incremental decline in the share of households who own or are purchasing their dwellings in Sydney.

The result, as Table 8.2 indicates, is that a far higher proportion of young adults living in Sydney were renting their housing in 2006 than was the case in Melbourne and the rest of Australia. At this time, some 35.5 per cent of those aged 35-44 in Sydney were renting, compared with 27.1 per cent in Melbourne. Of those who are purchasing or who own their dwelling, it is increasingly likely to be a unit or apartment. By 2006, 63.6 per cent of dwellings in Sydney were detached houses compared with 73.1 per cent in Melbourne.<sup>149</sup>

**Table 8.2: Housing tenure of Melbourne and Sydney households by age of reference person, 2006**

Age of reference person	Number of households		Per cent of households <sup>^</sup>							
			Owned/being purchased/ rent buy scheme		Rented/rent free		Other tenure type*		Total	
	Sydney	Melb.	Sydney	Melb.	Sydney	Melb.	Sydney	Melb.	Sydney	Melb.
15-24	56,910	55,580	23.3	24.2	76.3	75.3	0.4	0.5	100.0	100.0
25-34	247,365	221,198	45.0	52.7	54.7	47.0	0.3	0.3	100.0	100.0
35-44	312,572	283,326	64.2	72.5	35.5	27.1	0.3	0.4	100.0	100.0
45-54	293,631	260,869	73.8	80.3	25.9	19.3	0.3	0.4	100.0	100.0
55-64	226,614	200,628	79.5	84.8	20.0	14.8	0.4	0.4	100.0	100.0
65+	286,432	261,694	81.4	86.1	16.2	12.2	2.4	1.8	100.0	100.0
Total	1,423,524	1,283,295	67.0	73.2	32.3	26.2	0.8	0.7	100.0	100.0

<sup>^</sup> (excludes those where tenure was not stated)

\* Other tenure type includes 'Being occupied under a life tenure scheme' which refers to households or individuals who have a 'life tenure' contract to live in the dwelling but usually do not have any equity in the dwelling — a common arrangement in retirement villages.

Source: ABS customised Census 2006 table supplied to CPUR

### *Slowing population growth*

Will people continue to flock to a city where the ratio of the median price of a dwelling to median family income is one of the highest in the world? Since Sydney's population increased by nearly 500,000 over the past decade, and most of this growth was attributable to net overseas migration, it is plain that people are still being attracted to Sydney. Sydney will continue to play an important settlement role in part because it contains large communities from Asia and the Middle East. Migrants from these countries constitute the bulk of Australia's current net migration intake. They tend to settle in locations where there are already large concentrations of co-ethnics.

Nonetheless, Sydney is not attracting as high a share of Australia's migrant intake as in the past. Sydney's share has fallen from nearly 40 per cent in the 1990s to around 30 per cent currently. The price of housing may be one of the reasons for this outcome.

The housing cost factor appears to be significant for the movements of residents between Sydney and the rest of Australia. In the period 1996 to 2001 Sydney was estimated to have lost a net of 59,828 residents to elsewhere in NSW and interstate, or an average of 12,000 a year.<sup>150</sup> In the 2000s the net losses have been much higher. According to the ABS, they were more than 40,000 a year between 2002 and 2007.<sup>151</sup>

Most of those leaving Sydney are Australian-born residents, and of the former migrants who are leaving, most are from English-speaking countries. The out-migrants are predominantly moving to the coastal areas of NSW and South-east Queensland. Most of those leaving are not in the retirement ages. Their departure may be a product of Sydney's high housing costs as well as job opportunities elsewhere. The fact that net departures from Melbourne have been just a few thousand a year suggests that (at least until recently) Sydney's high housing prices were influential.

## Chapter Nine: Summary

### Prologue

This report has been about outcomes. It has examined why the planners have not achieved the core aspiration of *Melbourne 2030*: the provision of affordable housing in and around activity centres. It has also explored why dwelling prices have escalated so dramatically during the 2000s.

We have not offered firm judgements about what will happen in Melbourne as a result of the failure of *Melbourne 2030*, or what the solutions might be. Perhaps households with young children will cop living in tiny apartments or on small lots on the fringe. Maybe people will continue to flock to Melbourne despite the cost of housing. It is equally possible that Melbourne will follow the Sydney pathway with new households having no choice but to adjust to apartment-living as renters, with fewer people moving into the city and more people moving out, and with an end to the dwelling construction boom.

All this is up in the air. The Victorian Coalition Government has appointed a Ministerial Advisory Committee on Metropolitan Planning Capacity. The good news is that the government has acknowledged that *Melbourne 2030* is a failure. The bad news is that there is no sign that the planning bureaucrats and the urbanists who have been the chief advocates of the compact city strategy appreciate the hurdles confronting their proposals. These include that most of the growth in households needing accommodation over the next decade or so will be families with children or about to have children, and that apartments suitable for such families cannot be built at a price that is affordable to any more than a fraction of these families.

For their part, those with development interests continue to focus on removing the alleged planning obstacles to medium- and high-density development. This is despite the remarkable extension of development rights in inner and suburban Melbourne since *Melbourne 2030* was legislated in 2002.

If these are the views that are brought to the Ministerial Advisory Committee table, then the outlook is for more of the same failed policies and a greater chance that Melbourne will go down the Sydney pathway.

### The current housing situation in Melbourne

By 2011, Melbourne's housing prices were such that the majority of new households could not afford to purchase a dwelling in most of the city's suburbs and many renters were being forced into outer suburbs to find housing they could afford. One of the best known compact city advocates, Marcus Spiller, in a careful statistical study, concluded that in 1994-95 a household on a median income could afford a \$170,000 home. Such a household could purchase a median-priced house in 75 per cent of Melbourne's suburbs. By 2009-10, the equivalent household could afford a \$382,000 home. At this price their options were limited to just 25 per cent of Melbourne's suburbs, many of which were more than 35 kilometres from the CBD. Spiller notes that the only way to avoid this spatial banishment was 'to seriously compromise on space and house quality.'<sup>152</sup>

Equally momentous, even if a household is prepared to move to the fringe, some 45 kilometres from the CBD in the case of the nearest development frontier to the south-east, it will no longer find relatively cheap family-friendly housing. Only if the household is prepared to accept a 'serious

compromise' in the size of the land and floor space of the dwelling relative to the traditional detached suburban house, is it likely to find an affordable house.

Melbourne is becoming like Sydney. By the third quarter of 2011, Melbourne ranked just behind Sydney as one of the most unaffordable housing markets in the world. The multiple between the median house price (\$567,000) and median household income (\$67,700) in Melbourne was 8.4. Sydney's multiple was 9.2 (median house price \$637,000 and median household income \$69,400).<sup>153</sup>

Sydney is caught in a trap of its own making. The NSW Government made a commitment to turning Sydney into a compact city as far back as the 1980s. During the 1990s, it put strategies in place to promote infill of all types, from walk-up flats to medium- and high-density apartment blocks. This policy was put to the test during the 2000s. It did not work. The volume of new housing in established areas of Sydney fell during the 2000s relative to the 1990s, despite population growth continuing at a similar level to that of the 1990s. The main reason was the high costs that developers faced in producing infill accommodation. Meanwhile, as planned, the number of new dwellings on the fringe fell relative to the 1990s.

The result was a scarcity of housing, which was manifested in sustained competition for the available housing stock. Sydney started the 2000s with dwelling prices way above the level of other Australian metropolises and a well deserved reputation for being Australia's most unaffordable city. This situation did not change through the 2000s, despite the expectations of 'bubble theorists' like Steve Keen and Ross Garnaut (see Appendix) that prices would collapse. The continuing scarcity of housing was the main factor preventing any such collapse.

What about Melbourne? Melbourne started the 2000s in much better shape than Sydney. Housing was relatively affordable (Figure 1.4). Fringe development was far stronger than in Sydney. Then *Melbourne 2030*, with its commitment to making Melbourne a compact city, was legislated in 2002. As in Sydney, *Melbourne 2030* allocated development rights in activity centres across the city in order to facilitate the production of apartment-style living. *Melbourne 2030* also constrained fringe development by the establishment of an Urban Growth Boundary (UGB).

Yet, unlike Sydney, Melbourne's dwelling industry flourished. It took the form of infill (units and semi-detached dwellings on land previously occupied by detached houses), of high-rise inner-city apartments at the end of 2000s, and a surge in the production of detached housing on the fringe. The Victorian Government soon backed off on corralling growth within a tight UGB. In 2010, it rezoned enough land on the fringe to ensure that whatever the outer-suburban demand, there would be no lack of zoned land capable of meeting it. Our estimate is that, after taking demolitions into account, about 50 per cent of the net growth in new dwellings in Melbourne since 2002 has occurred on the fringe.

There were 344,969 building approvals in Melbourne for the decade 2001-02 to 2010-11 and just 225,986 in Sydney. Over this decade, Melbourne's share of building approvals in Australia was 21 per cent (see Table 8.1), yet Melbourne's share of Australia's population increased only marginally to 18.3 per cent by 2011.

Notwithstanding this remarkable record of building, housing prices in Melbourne increased sharply during the 2000s, while affordability moved in the reverse direction. A variety of factors was



involved including speculative expectations of capital gains and ready access to housing finance (see Appendix). But, above all, the boom was sustained by strong demand for housing due to rapid expansion in household growth. Record high net overseas migration was an important contributor to this demand. The result was that competition for established housing increased, pushing up prices, which in turn prompted more households to look to the fringe as an affordable alternative.

By the end of the 2000s, the capacity of developers to provide for demand on the fringe had collapsed, with a resultant surge in fringe house and land prices. As a consequence, the fringe ceased to provide the safety valve in Melbourne's housing market that it did during most of the 2000s. Meanwhile the price of infill also escalated, limiting its capacity to provide the needed housing stock. Also, the medium density option at the centre of the *Melbourne 2030* strategy fell way short of its advocates' expectations. The only success story has been the remarkable surge in high-rise apartment construction. For reasons summarized below, this is unlikely to continue.

If the situation on the fringe does not improve and the medium-density strategy continues to fail, Melbourne faces the same fate as Sydney. The result in Sydney during the 2000s was a low volume of dwelling construction, sustained competition for housing, no relief from the affordability crisis already evident by the early 2000s, lower proportions of households able to purchase housing, a slowdown in household formation and an exodus from the city.

### **The demography of household growth in Melbourne**

An appreciation of the prospects for high- and medium-density housing, infill and fringe housing depends on an understanding of the numbers and characteristics of the households that will be entering the housing market. It is widely believed that most of the growth in households in the next decade or so will be amongst one- and two-person households. This is correct for Melbourne. However, it does not follow, as is universally asserted by compact-city advocates and even by building and property industry analysts, that housing policy should be focussed on the production of small units or apartments suitable for such households.

This proposition is incorrect because most of the growth in one- and two-person households over the decade to 2021 will be amongst older people aged 55 plus and particularly those aged 65-74 (see Table 4.1, Chapter Four). These households already occupy housing. They do not have to move and, according to our analysis in Chapter Four, are unlikely to do so in large numbers in the near future.

The demand for housing over the next decade will primarily stem from the new households that form and enter the housing market for the first time. Their numbers were set out in Tables 4.1 and 4.2 in Chapter Four and are summarised in Table 9.1. If household formation rates remain the same as in the recent past, most of the growth in new households over the next decade will be in the 25-34 year old age group. There will be 244,111 households in this age group by 2021 (very few of whom were in separate households as of 2011), as well as another 69,954 in the 15-24 year old age group and another 77,578 aged 35-44. Since they are new households, all will be looking for housing, whether as renters or purchasers. These new households include recently arrived immigrants. The latter share the same motivation as newly formed households deriving from the resident population: they need to find accommodation.

Not only will few of the older householders move, there will also be few permanent exits from their ranks (such as through death and movement into institutional accommodation). There are relatively few frail-aged people in Melbourne because of the low numbers of births in the World War 2 and pre-war era. Thus the number vacating existing houses will be small relative to the number of new households looking for accommodation. There will be a total of 405,022 new households over the decade 2011 to 2021 but only 138,531 exits. As a result, there will be a need for some 266,000 new dwellings to accommodate the new households.

**Table 9.1: Estimation of the contribution of household formation and dissolution to the number of households, by age group, Melbourne 2011-2021**

	Age group								Total
	15 – 24	25 – 34	35 – 44	45 – 54	55 – 64	65 – 74	75 – 84	85 +	
Net change from household formation/dissolution^	69,954	242,111	77,578	15,379	-10,633	-10,848	-21,239	-95,811	266,492
	Net gain in households 15-54 = 405,022				Net loss in households 55+ = 138,531				

Note: Any discrepancies in the summations displayed in the table arise because the numbers displayed here are the rounded version of the numbers generated by the underlying mathematical process used in the model.

Source: Table 4.2 in Chapter Four

The majority of the new households will comprise families with children. They will be looking for family-friendly housing; that is, housing with several bedrooms and space for children to play both inside and outside the dwelling. Small apartments suitable for one- or two-person households will not fill the bill. A focus on such dwellings would only make sense if, in addition to the exits, large numbers of the baby-boomer and retired households vacated their (mainly) detached houses for apartment living. This, as noted above, is unlikely.

The Fact Sheet published as part of the Victorian Government's review of the Metropolitan Planning Strategy illustrates these misapprehensions. Residents have been invited to express their views and provided with Fact Sheets to help them do so. The Fact Sheet on housing states that:

Based on current trends, over the next 30-40 years the number of homes comprising couples with children is expected to decrease, while the number of one-person and couple only households is expected to increase.

At the same time, the type of housing people prefer is also changing. These changing preferences and household sizes mean Melbourne will require more diverse housing types, including medium and higher density housing close to infrastructure and in areas where people want to live.<sup>154</sup>

The Fact Sheet is in error. There will be an increase in couples with children. What the authors should have said was that the share of total households who are couple-with-children families will fall. Be that as it may, what matters for our analysis is that the Victorian Government is launching its important enquiry on the same misunderstanding that has afflicted most other analyses of Melbourne's housing situation. The emphasis is on housing diversity, notably medium- and high-density housing. It rests on the false premise that housing demand will come from one- and two-person households rather than from the new, younger households that will form during the next decade. As long as this misconception prevails it is unlikely that any useful planning alternative to *Melbourne 2030* will emerge.

### **The outlook for housing in Melbourne**

The Victorian Coalition Government is continuing with Labor's compact city strategy. It has flagged its intention to open up more inner-city locations for high-rise development and to promote

medium-density apartment and walk-up-apartment clusters in brownfill sites. Its objective appears to be to reassure its heartland electorate in the southern and eastern suburbs that Melbourne can have it both ways – continued strong population growth and the preservation of established suburbia. This has also been the message of transport corridor advocates such as Rob Adams who refers to these suburbs as the ‘green lungs’ of our metropolitan areas.<sup>155</sup> They will be saved, according to Adams, if most of Melbourne’s new housing is built along arterial roadways served by public transport.

High- and medium-density apartment developments will provide a niche for some single and couple families squeezed out of the inner-city zone infill market because it is becoming too expensive. For many singles and couples, apartments also serve as an entry point to the property market before they begin nesting. But it is a limited niche because of the costs of producing these apartments. The explosion of building approvals for high-rise apartments, detailed in Table 5.1 in Chapter Five, in 2019-10 and 2010-11 does not refute this proposition. The market for these apartments is investor driven. Whether they will satisfy the needs of people looking for accommodation rather than an investment has yet to be tested.

High-rise apartments cost \$8,000-plus per square metre (including the developer’s margin) to put onto the market, and medium-density apartments cost from \$5,750 to \$8,500 per square metre. As a consequence, a 110 square metre apartment (the minimum most families would expect if raising children) would range from around \$900,000 in the municipalities of Melbourne, Port Phillip, Stonnington, Boroondara and Yarra to around \$650,000 in Moonee Valley and Hobsons Bay.

These prices are well beyond the means of most couples and, in any case, for this price they can purchase far more spacious infill housing with some private outdoor space in the middle zone of the city.

As a consequence there is no affordable family-friendly housing being built in either high- or medium-density apartment blocks in the core or inner zones of Melbourne. Developers cannot even contemplate such housing in the middle or outer zone because households can buy much larger detached housing for the same price. Rather, as the costs of putting such projects on the market have increased, the trend is towards the construction of smaller and smaller apartments. These are now typically below 40 square metres for one-bedroom and below 70 square metres for two-bedroom apartments in both high-rise and medium-density developments.

There is no ready solution to this impasse. As detailed in Chapter Five, the costs of producing high- and medium-density apartments have risen for a range of reasons including planning delays and construction costs. The labour costs of construction are an important component of this increase. One ingredient is competition for construction labour. This has been a chronic problem in Melbourne, partly because employment in construction has increased from 110,750 in 2000 to 191,750 in 2011.

There appears to be no realistic prospect of any change in these circumstances. New households that cannot afford established houses or infill in the inner zone will have to look for alternatives. Infill is likely to spread into outer-suburban areas as it becomes more expensive in areas close to the city. The other option is detached housing in the outer or fringe zones.

Since scarcity is the key factor which props up Melbourne (and Sydney's) established area dwelling price regime, if there was a slowdown in population growth, this would take some of the pressure off. About 64 per cent of Melbourne's population gain is likely to come from net overseas migration over the decade 2011 to 2021, even assuming our low (relative to the Victorian State Government) assumptions about this migration level. The share of household growth will be well under the 64 per cent level. Nevertheless, a further decline in immigration levels to Melbourne would be the most sure-fire way of ameliorating the housing price crisis.

### *The fringe safety valve*

The crucial importance of the fringe housing market becomes clearer in this context. When, from about 2006, the price of established housing took off, the fringe market provided an important alternative for first-home buyers who were priced out of established areas. By 2009-10, there were 16,810 building approvals in fringe locations. Around half of these houses were sold to first-home buyers.

First the Labor Government, and now the Coalition Government, have pinned their hopes on keeping the Melbourne growth story alive through fringe development.

The core of this strategy is to get as much land as possible ready for subdivision. The GAA has made progress towards this end. This is a Houston-style solution based on the assumption that the more that land is made available for subdivision, the more it will encourage developers to put it on the market. However, the GAA departs from the Houston model in that it has ensured that each precinct is pre-planned to provide space for community functions and to make developers pay for some of the required facilities.

We doubt that the PSP process will allow the fringe to serve as a safety valve as in the past. The GAA has no power to ensure that landholders who possess the land rezoned within the UGB do sell it to developers. Once developers obtain the land, the GAA has no power to ensure that they proceed rapidly to subdivide it.

A more serious concern is that it is now difficult to produce lots for less than \$200,000 each. When translated into house and land packages, a 190 square metre three-bedroom house with a two-car garage on a 350 square block costs around \$400,000.<sup>156</sup> A similar house on a 450 square metre block costs well over \$400,000. This is well beyond the budget of most first-home buyers. It is not a consequence of escalating construction costs. The building industry on the fringe is highly competitive and union free.

Rather it is a consequence of government inaction and action. As to inaction, the main component of fringe costs is the cost of the raw land developers must procure. The original landowners have been able to sell land zoned within the much expanded UGB for whatever the market will bear. Neither the Labor Government nor the Coalition Government has required these landowners to make any contribution or 'betterment tax' to the subsequent costs of developing the land. They pocket the profit with all the subsequent costs falling on the developer, who subsequently seeks to pass them on to the consumer. The result is that the raw land component per block is between \$38,000 and \$94,000 per block.

Then there are the costs of government action. Developers have to provide a wider range of local infrastructure, including telecommunications, than in the past. Currently this adds about \$50,000 per block.

In addition, they must allocate ten per cent of their land for public open space. The PSP Development Contribution Plan requirement also adds around \$20,000 per block. With land tax and various other planning costs, plus GST, this adds to a total of \$40,000 to \$50,000 per block. None of these impositions is unreasonable. They are a step forward in the provision of better-planned and better-served fringe communities.

Finally there are finance and marketing costs and the developer's profit margin. Depending on the price of the raw land, these costs can add to near \$200,000. This means that the era of cheap land on the fringe is over.

As a consequence, the development industry may move in the Sydney direction, where almost all development on the fringe is for blocks at least 500 square metres in size and the great majority of the buyers are trade-up customers.

There is another possibility. This is that the industry will respond by providing small and therefore less expensive lots. In the March quarter 2012, 20 per cent of the lots being sold were less than 300 square metres. The houses being built on these lots are not family-friendly, in the sense that they offer little family-living space (other than tiny bedrooms), and have backyards which are barely large enough to accommodate standard children's play equipment and provide little room for canopy trees and shrubs. Yet they are priced at around \$350,000.

Maybe the current slowdown in the housing industry is a taste of things to come. Building approvals for Melbourne fell from 29,790 in the six months to December 2010 to 19,053 in the six months to December 2011. In fringe areas of Melbourne, the number of lots sold per month was 473 in the December quarter of 2011 and 638 in the March quarter of 2012. This is half the monthly levels recorded between 2007 and 2010.

Those tempted to rejoice that suburban sprawl will contract need to pause. The current situation has given an impetus to the pursuit of lower cost housing alternatives on the peri-urban frontier. This is evident in the Shires of Baw Baw, Mitchell and Macedon Ranges. Such development is occurring by default, in the sense that successive state governments have made no attempt to restrict it. The result is sprawl beyond the urban boundary.

Peri-urban location provides family-friendly housing at a cost way below that available within the UGB. However, the long commutes required into Melbourne will limit its appeal. This leaves the option of moving outside the ambit of Melbourne to a regional city or interstate. From the point of view of migrants considering a location in Melbourne, the temptation to look elsewhere interstate will also increase if solutions to Melbourne's affordability problems are not found.

#### *The bottom line*

Melbourne is at a critical juncture. The collapse in housing affordability means that the city's development industry has lost its comparative advantage relative to other Australian metropolises. The problem will not go away. Its origin lies in the high costs of development both in established

areas and on the fringe. Melbourne's housing boom of the 2000s will not be repeated unless solutions can be found to the cost issues. The low-hanging fruit of the 2000s in the form of relatively cheap infill and low cost outer-suburban development has largely been harvested.

There is little recognition of these realities in the government, academic and property circles that dominate debate on the matter. We have seen no acknowledgment from compact city advocates about the failure of the medium-density option to provide affordable housing. The new Minister for Planning, Mathew Guy, talks about increased opportunities for high-rise towers in and around the CBD and for brownfill in inner-zone areas. This mirrors the opinion of the most prominent boosters of Melbourne's housing boom. For example, Bernard Salt has called for the extension of developer rights for high-rise projects in inner suburbia. He advocates the 'Manhattanisation' of Melbourne's inner suburbs.<sup>157</sup> This borders on fantasy given the precarious nature of the current crop of high-rise proposals and their irrelevance to the needs of most of the new households that will be entering the housing market.

The initiative most likely to deliver additional housing in a form, price and location that would meet new households' dwelling needs is an extension of infill opportunities. If developers could build banks of townhouses or walk-up flats to three levels throughout established suburbia, this would provide cheaper and far more spacious apartment living than the medium- or high-density options. But it would involve a breach of the tacit political quarantine of established suburbia from intensive development. Such development would violate Rescode since it would decisively change the neighbourhood character of the areas affected. We do not favour the extensive use of this option; however, if Melbourne is to accommodate the growth in households which has been projected, it may have to be pursued.

Perhaps the infill initiative would re-ignite the save our suburbs movement. Perhaps not. Suburbanites appear to have tolerated the impact of infill to date. Yet, they have seen much of the built suburban heritage demolished, their suburban streetscapes partly denuded of greenery and their streets congested by the extra traffic.

Why do they accept this? It is probably because so many benefit from growth. All those with a stake in the property market have seen their paper wealth boosted with the escalation of property prices during the 2000s. It is no surprise that property market reports always treat property price increases as good news. For example, Fairfax commentator Elizabeth Knight, reporting on housing price movements, writes that they have continued to fall in the March quarter of 2012, except in Darwin and Perth. She states that 'over the year house prices have dropped an *alarming* (our italics) 4.5 per cent'.<sup>158</sup>

To some extent suburbanites have been able to have it both ways. They secure the financial benefits of dwelling scarcity but without a major challenge to the suburban lifestyle. A more intrusive form of infill would challenge this arrangement and perhaps trigger the mobilisation of the electorate against any government responsible for it.

It is our hope that those contemplating what to do about Melbourne's affordability crisis will, after reflecting on this report, have a more realistic understanding of what is needed and what may or may not work.

## Appendix One: The causes of Melbourne's dwelling price surge

There are two main contending explanations for the surge in dwelling prices in Australia over the past decade. One is that the price rise has been fuelled by expectations of capital gains and facilitated by high levels of debt. In other words it is a speculative bubble, which could well burst, as has already occurred with the housing bubbles in the United States and Ireland. The other is that the price surge reflects the pressure of rapid increases in the number of households.

### The bubble explanation

The bubble thesis is based on the theory that house prices are ultimately grounded in the rental return they could achieve. When this return falls below current market interest rates, houses are considered to be overvalued. *The Economist* is famous for its annual reports on global house prices which employ this methodology. In recent years, Australia has hit the top rungs of overvalued housing. The magazine reported in mid-2010 that on its analysis of 'fair value' in housing, which is based on comparing the current ratio of house prices to rents to the long term average of this ratio. 'By this measure Australian property is the most overvalued of any of the 20 countries we track'.<sup>159</sup>

The bubble thesis has many prominent supporters in Australia. They include the redoubtable economist Ross Garnaut, who supports the Shiller thesis described below, and the prominent academic economist Steve Keen. Garnaut specifically takes issue with the population growth component of the scarcity thesis. Like Keen, Garnaut argues that the rate of building in Australia during the 1985 to 2009 period was sufficient to provide for the growing number of households over the same time.<sup>160</sup> Instead, both assert that the boom was driven by the flood of investment money available during the period of financial excess during the 2000s.<sup>161</sup> Keen has repeatedly prophesied a property bust. We are still waiting. Keen has recently had to walk up Mount Kosciusko after losing a bet with another economist on the issue.

The essence of a housing bubble is that, as long as those in the market believe that prices will continue to rise, they will continue to do so (even if overvalued by conventional criteria). In the US, reputable figures in the world of finance reassured the public that all is well. For example, Ben Bernanke, then Chairman of the Presidents' Council of Economic Advisers, said in 2005:

House prices have risen by nearly 25 per cent over the past two years. Although speculative activity has increased in some areas, at a national level these price increases largely reflect strong economic fundamentals, including robust growth in jobs and incomes, low mortgage rates, steady rates of household formation and factors that limit the expansion of housing supply in some areas.<sup>162</sup>

The work of Robert Shiller provides the best explication of the social processes which sustain expectations of continued price increases. Once a pattern of price rises in residential markets gets established, so Shiller argues, additional aspiring home owners and investors are attracted to join in. The former are fearful that if they do not they will miss their opportunity to achieve home ownership and the latter, beguiled by the prospects of capital gains, rush to join the party. Shiller describes various feedback loops which can intensify this process. These include media hype about price booms and 'new eras' which then add to the confidence of prospective buyers that housing investment is safe. Shiller likes the notion of 'information cascades' which occur 'when those in a group disregard their own independent, individually collected information (which might otherwise

encourage them not to subscribe to a boom or other mass belief) because they feel that everyone else simply couldn't be wrong'.<sup>163</sup>

In the US, the housing bubble was abetted by government policies which promoted lending to sub-prime mortgagees. Rajan argues convincingly that this policy reflects a structural feature of the US economy. This is that ordinary people have been the losers as far as growth in their incomes is concerned relative to elites (especially those in the finance industry). One way the US Government could and did respond to popular frustrations generated by this situation was to facilitate lending for housing purchases to lower income households. As Rajan puts it, 'As evidence mounted in the early 1990s that more and more Americans faced stagnant or declining incomes, the political establishment started looking for ways to help them with fast-acting measures – certainly faster than education reform, which would take decades to produce results. Affordable housing for low-income groups was the obvious answer.'<sup>164</sup> Both the Clinton administration in the late 1990s and the Bush administration in the early years of this century, increased funding for persons on low income to purchase housing. They also required the semi-government mortgage provider, Fannie Mae, to increase mortgage assistance to low income purchasers. This was the origin of the subprime mortgage phenomena which helped drive the increase in U.S. housing prices until the crash in 2007. The U.S. merchant banks did their bit as well, by inventing the financial instruments, including Collateral Debt Obligations (CDOs), which allowed the packaging and sale of these mortgages across the globe.

The housing price boom in Australia since 2000 has some parallels with that in the US. Once underway, it was accompanied by apparently well-informed property and financial industry commentary that it reflected fundamental and enduring forces. In Australia's case, these mainly focussed on the impact of rapid population growth. But those doubting the bubble thesis note that Australian banks did not issue mortgages to sub-prime borrowers and that there was no parallel to the US situation where mortgagees could walk away from their mortgages (and forfeit their property in the process) if they thought their house was worth less than the loan they had taken out.

Another ingredient to the Australian housing market which is less evident in the US is the role of investors. There is no parallel to the subsidies which the Australian Government offers investors to purchase property via negative gearing tax concessions. In both the US and the United Kingdom, those owning rental property can only deduct their expenses (including interest payments on their rental property) from their rental income for taxation purposes. They cannot, as in Australia, deduct losses from their rental business against other sources of income, such as salary payments from an occupation unrelated to the rental business. Also, since September 1999, the capital gains tax levied on the sale of investment property held for at least a year was reduced to 50 per cent of the nominal gain on its sale.

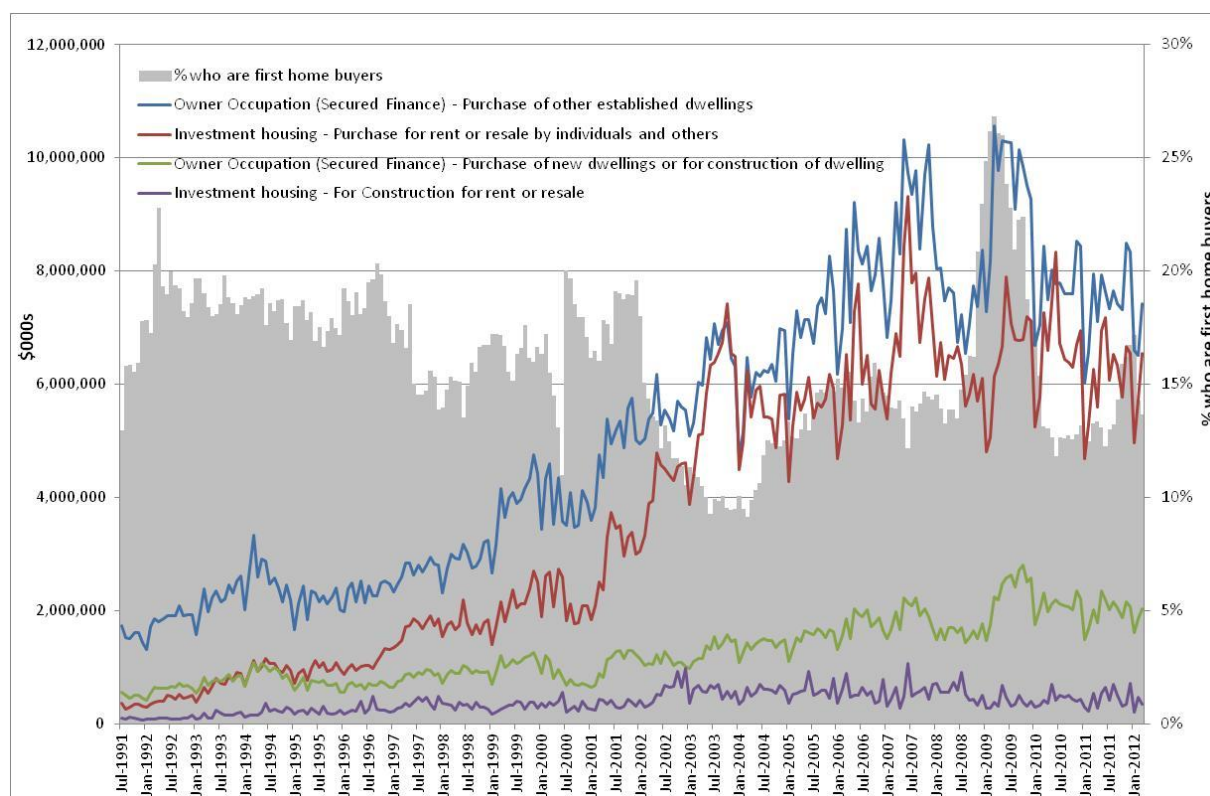
Perhaps the investor phenomenon adds an element of fragility to Australia's dwelling market. We were initially attracted to this idea, because of the scale of investor activity in the Australian housing market. According to the Taxation Department statistics, by 2008-09 there were 320,625 taxable individuals in Victoria (1.7 million for Australia as a whole) who reported rental income, almost all losses. For Victoria, this number represented 14.2 per cent of all taxable individuals. Though most of these taxpayers owned one rental property, nearly 30 per cent owned two or more.



According to the Household, Income and Labour Dynamics in Australia Survey (HILDA), nearly 20 per cent of individuals in Australia aged 45-64 receive income from a rental property.<sup>165</sup> It is often said that property is the superannuation of ‘mums and dads’ in Australia. The HILDA data suggest this is an exaggeration: 44 per cent of employed individuals who own a rental property were employed as managers and professionals (compared with 33 per cent of all employed persons who are managers or professionals<sup>166</sup>). The investor phenomenon in Australia is not a manifestation of high finance. Rather the huge army of rental investors is a product of multiple individual decisions, some looking for a long-term rental return, yet almost all expecting that in the process the income tax deductions flowing from negative gearing will help pay for their investment and that it will eventually deliver rich capital gains.

As Figure A.1 indicates, investors across Australia have surged into the housing market since 2002. Unfortunately parallel data are not available at the state level or for the role of overseas investors. In the case of purchases of established dwellings (that is, not new or to-be-constructed dwellings), their share of housing finance commitments rose sharply after 2001. This is consistent with the hypothesis that they were attracted to the strong prospects of capital gain during the period. At times the level of their commitment was as almost as high as that of owner occupiers. However, following the GFC, investor activity dropped off sharply. Yet Australian housing prices did not collapse in 2008. After a brief relapse in early 2009, they surged again through 2009 and 2010 (see Figure 1.4) before beginning to deflate in 2011.

**Figure A.1: Housing finance commitments, owner occupation and investment housing, established and new dwellings, Australia, July 1991-March 2012 (original)**



Notes: Excludes alterations and additions. Investment housing excludes revolving credit. Purchase of new dwellings by owner occupiers includes refinancing across lending institutions.

Source: Australia Bureau of Statistics, Housing Finance, Australia, Cat. No 5609.0, Tables 9a and 11

This is the strongest piece of evidence prompting scepticism that Australia's housing boom can be interpreted as a bubble. The market was saved by a surge of first-home buyers entering the housing market following the introduction of the Federal Government's First Home Owners Grant Boost in October 2008. This provided an extra \$14,000 to first-home owners who bought or built a new home and an extra \$7,000 for those buying an established home. This inducement continued to 30 September 2010 after which the amount was reduced to \$7,000 for new home buyers until 31 December 2010 (at which point the Boost ended). In 2009-10, according to the Victorian Government, some 17,228 new home owners in Victoria received the Boost for the purchase of new homes.<sup>167</sup> This is nearly a third of the total number of dwellings completed in Victoria in this year.

The rush into dwelling purchases as a result of this inducement reflects the extent of unmet demand from prospective home owners at the time. They had been squeezed by the escalation of dwelling prices and high interest rates prior to 2008. The combination of the Boost and the Reserve Bank's contraction in interest rates brought them flooding back into the market.

A closer look at the pattern of investor involvement in the housing market adds further doubts to the notion that investors add fragility to the housing market. In the case of Melbourne, investors have been most active in the core and inner areas and in the semi-detached and unit market. Table A.1 shows that only 14 per cent of all dwellings in the outer area were privately rented, compared with 44 per cent in the core area, 24 per cent in the inner area and 18 per cent in the middle area.

Regardless of location, rental rates among detached houses are significantly lower than amongst townhouses and flats. Only 13 per cent of houses were privately rented in 2006 in Melbourne, compared with 33 per cent of semi-detached houses and 51 per cent of flats. High rental rates in the core reflect the preponderance of flats or apartments in this area.

This rental information is derived from the 2006 Census so may not be an accurate guide to investor activity since. Nevertheless, it suggests that investors have not been a major factor in the escalation of the price of houses in Melbourne since the year 2000. In the case of other dwellings, any assessment of the role of investors in price escalation must take account of their contribution to the supply of such dwellings. The housing finance data shown in Figure A.1 do not help in this regard because they do not indicate how many investors bought new semi-detached houses or flats. Nevertheless, the important role of investors in this market is an inducement for builders or developers to construct such dwellings. As Table A.1 shows, this role is especially important for flats, units and apartments. As of 2006, 51 per cent of these dwellings were being rented in Melbourne.

Overseas buyers have also played a role in the inner-city apartment markets. Their off-the-plan purchases of high-rise apartments appear to be a major contributor to the extraordinary surge in approvals for these projects over the past two years in Melbourne (See Table 5.1, Chapter Five). Unfortunately, most of the information on the scale of this involvement is anecdotal. We do, however, have the oft-repeated evidence from Harry Triguboff, the chief of Meriton apartments, one of the biggest of the apartment building businesses (in Sydney), that 'most of his customers were from China'.<sup>168</sup> But these overseas buyers, like domestic investors, also contribute to the supply of dwellings, since in their absence many of Triguboff's projects would literally not have got off the ground.

**Table A.1: Occupied Private Dwellings (OPD) by tenure type and landlord type and dwelling structure, Melbourne by zone, regional Victoria and Victoria, 2006**

Location*	Separate house	Semi-detached\ row or terrace house\ townhouse etc.	Flat\ unit or apartment	Total (includes other/not stated)
<i>Number of occupied private dwellings(OPD)</i>				
Core - high density	25,596	31,688	70,224	128,404
Inner - predominantly detached housing	228,951	47,726	65,230	343,635
Middle – mainly detached housing	357,981	47,772	44,079	451,896
Outer - new housing areas	325,833	18,189	14,015	360,083
Melbourne	938,361	145,375	193,548	1,284,018
Regional Victoria	443,137	17,635	31,053	498,351
Victoria	1,381,498	163,010	224,601	1,782,369
<i>Number of OPD rented through a real estate agent or person not in the same household<sup>^</sup></i>				
Core - high density	5,043	11,447	39,664	56,600
Inner - predominantly detached housing	31,188	15,674	33,547	81,317
Middle – mainly detached housing	44,516	15,325	20,132	80,393
Outer - new housing areas	38,965	5,820	5,960	50,978
Melbourne	119,712	48,266	99,303	269,288
Regional Victoria	59,403	6,498	13,801	80,647
Victoria	179,115	54,764	113,104	349,935
<i>Per cent of OPD which are rented through a real estate agent or person not in the same household</i>				
Core - high density	20	36	56	44
Inner - predominantly detached housing	14	33	51	24
Middle – established	12	32	46	18
Outer - new housing areas	12	32	43	14
Melbourne	13	33	51	21
Regional Victoria	13	37	44	16
Victoria	13	34	50	20

\* Based on a best fit of Victorian postcodes to Statistical Local Areas which were aggregated to the indicated locations. Hence the data will not match the published Australian Bureau of Statistics' totals for Melbourne and Victoria.

<sup>^</sup> Because the data depicts the role of investors, dwellings rented from State Housing Authorities and other landlord types are not included in the table.

Source: Calculated from Australian Bureau of Statistic (ABS), Census 2006 Community Profile

These observations do not deny the role of investors in adding to the demand heat which has propelled the Australian housing boom. In some sections of the industry, notably the inner city small apartment sector the recent explosion of approvals is largely driven by overseas and domestic investors. Rather, our conclusion is that any analysis of the long term outlook for the housing market needs to be focussed more on fundamental structural issues. These are best understood through the prism of the scarcity hypothesis.

### The scarcity hypothesis

The major Australian banks assert that Australia will not follow the US experience. Their main reason is that strong underlying growth in housing demand will continue due to rapid population growth. Two examples will illustrate. In April 2010, Paul Braddick, the ANZ Bank's main spokesman on these issues, asserted in a detailed analysis that 'Australian houses prices are not overvalued'. Braddick makes the point that household income has grown strongly during the 2000 to 2010 decade thus putting Australian households in a better position to manage increased payments for housing.<sup>169</sup> This is in sharp contrast to the US where households other than the rich have seen little growth in real household income over the past couple of decades.<sup>170</sup> Braddick sees no likelihood in any change to

this situation in Australia. He also argues that because of the underlying scarcity of housing and of continued population growth, the 'critical housing shortage' evident by 2010 will continue.<sup>171</sup>

A little later in 2010, the Commonwealth Bank (CBA) put out a similar report, which also debunked the bubble thesis. The CBA acknowledged that household debt in Australia as a percentage of disposable income had grown from less than 120 per cent in 2002 to around 170 per cent in 2009. By this time, this ratio was above most other developed countries, including the US where it was 130 per cent.<sup>172</sup> The CBA also acknowledged that housing-price-to-income ratios were high in Australia, but argued that when Sydney (6.2) and Melbourne (5.7) were compared with similar high-income coastal locations in the US, including San Francisco (7.0) and Los Angeles (5.7), they did not look excessive.<sup>173</sup> In any case, the CBA asserted that with continued rapid population growth, there should be no fears of a property bust.

One important source of evidence for the 'critical shortage' in housing referred to by Braddick and the CBA is the reports issued by the Commonwealth Government's National Housing Supply Council (discussed in Chapter Eight). The Council's dwelling demand projections (based on a one-to-one relationship between the expected growth in number of households to extra dwellings) indicate that demand greatly exceeds the recent annual level of dwelling construction in Australia. Thus the Council's conclusion in its 2010 report, that there is a 'growing shortfall between supply and demand'.<sup>174</sup>

The Deputy Governor the Reserve Bank, Rick Battelino, who also does not support the bubble thesis has focussed his explanation for the capacity of home purchasers to 'afford' the increased prices of the past decade around the strong growth in household income in Australia. He argues that though the share of household income devoted to mortgage payments increased during the boom years, households coped by using the growth in their income to meet the increased payments.<sup>175</sup>

In the light of this evidence, the position argued by Garnaut and by Keen that population growth is not a decisive factor in the price of housing in Australia seems implausible. The surge in net overseas migration has given a huge boost to household growth, especially in the main migrant settlement locations of Sydney and Melbourne. By 2008-09, when this surge peaked, both Melbourne and Sydney were experiencing annual growth in population of 80,000 to 90,000 a year, nearly double the level in the early 2000s. It is notable that in both cities there was a sharp increase in dwelling prices through the 2007 to 2009 period (see Figure 1.3). It is true that recently-arrived migrants mainly rent accommodation<sup>176</sup> but, nonetheless, they add to the overall scarcity of for such accommodation, thus enhancing the market for rental investors. To the extent that they do purchase housing, in the case of Melbourne, it has usually been in middle or outer-suburban areas. By doing so they add to demand in the markets that domestic first-home buyers are also seeking to enter.

Our demographic analysis of household growth in Chapter Four, however, shows that the main source of growth in demand for accommodation will come from new households in the 25-34 age group. Some of these will be migrants. But even if international migration to Melbourne diminishes, there will still be substantial growth in these new households. Their number over the next decade will greatly exceed the exits of older persons vacating their houses. This is because of the relatively small size of the older cohort.

The mechanism by which population growth underpins the housing market, especially in established suburbia, is well documented. One of the most important findings of the Productivity Commission's report on First Home Ownership in 2004 was that the surge in house prices up to that date was inversely related to distance from the centres of Sydney and Melbourne. The Commission concluded that 'This trend is consistent with rising house prices being primarily due to the inherent scarcity value of land in established areas, which has risen as demand has increased.'<sup>177</sup>

This relationship is very clear in Figures 1.1 and 1.2. The core, inner and middle zones of Melbourne offer proximity to high paying jobs in the core, access to prestigious public and private schools and superior civic amenities. They also offer easy access to the civic investments (Federation Square, the MCG, galleries and theatres) that successive state governments have lavished huge funds on in recent years. With rapid population growth (and income growth) competition for housing in these high-amenity areas will increase, especially given the difficulties developers are having producing affordable housing in these zones.

### **Summing up**

Nevertheless, one is left to wonder how long scarcity can lead to upward movements in dwelling prices without producing an affordable housing crisis and thus some price correction. There seems to be an unstated assumption amongst the commentators discussed above that the process of price escalation in the face of chronic supply shortages can go on forever.

However, as the CBA acknowledges, in order to enter the housing market during the recent boom, home buyers have had to take on extra debt. As a consequence, they had had to pay a greater share of their family income to meet loan repayment. In Victoria this share increased from around 25 per cent in 2000 and 2001 to 34 per cent by the March Quarter of 2011 and 35.9 per cent by the March Quarter 2011.<sup>178</sup> A recent Reserve Bank study provides further valuable evidence on this outcome. The study analyses the mortgage payments of households as reported in the ABS Household Expenditure Surveys of 2003-04 and 2009-10. It isolates household heads aged 15-39, thus giving a closer focus on the households most likely to have recently purchased a house. The study shows that the share of household expenditure spent on mortgage payments by the householders in this age group has increased by 4.2 percentage points to 29.3 per cent over the period of the two surveys.<sup>179</sup>

In this context it is not surprising that there has been a recent decline in demand for housing in Melbourne, including for new housing on the fringe. Melbourne is vulnerable because of the striking surge in dwelling prices in 2009 and 2010 (see Figure 1.4, Chapter One). In addition, the sustained high level of housing construction during the 2000s in Melbourne has produced a relative high ratio of dwellings to population by comparison with Sydney (Chapter Eight). The denting of consumer confidence prompted by the woes of the city's manufacturing and other industries vulnerable to the high Australia dollar, adds another note of concern.

But short of a prolonged recession and increased unemployment in which vulnerable home owners have to sell their properties, we do not think there will be any collapse in housing prices like that experienced in the United States or Ireland.

Rather the likely pattern is that Melbourne will follow Sydney. A combination of continued household growth and dwelling scarcity will see to this. In Sydney, developers have struggled to

produce dwellings at a price new households can afford. During the 2000s this led to a drop in housing production relative to the 1990s, yet population growth continued at a similar pace to the 1990s. The resulting scarcity of housing in Sydney has ensured that there was no housing bust. The same outcome is likely in Melbourne. The decline in housing affordability in Melbourne, which is the central finding of this study, will ensure continued housing scarcity in Melbourne. This will put a floor under the price of housing in Melbourne.

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