

August 2021



Disaster Recovery and Resilience

Shared Inquiry Program 2020

REBUILDING REGIONAL HOUSING MARKETS

DISCUSSION PAPER
SIP.2020.6



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REFERENCE

This report can be referenced as Hopkins, D. & Houghton, K. (2021). *Rebuilding Regional Housing Markets*. Canberra, The Regional Australia Institute.

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CONTENTS

Executive Summary	3
Introduction	4
This discussion paper	5
Two regional housing market examples.....	6
Cobargo and Winton: background.....	6
Barriers to rebuilding and recovery in Cobargo: affordability and access to finance.....	8
Cobargo housing cost structures.....	9
Barriers to rebuilding: affordability	10
Barriers to rebuilding: access to finance	11
Barriers to home building in Winton: access to finance.....	13
Winton housing cost structures	13
Winton affordability: some challenges but not acute	14
Key barrier to home building: access to finance	14
Conclusion	16
Appendix – cost structure estimates.....	0
References.....	0

EXECUTIVE SUMMARY

This discussion paper looks into barriers to housing construction in small regional towns. In particular it illustrates a (if not *the*) key structural barrier: constrained access to finance due to a significant difference between small towns' established housing values and new home building costs. The high cost of replacement building in small towns with low average property prices means that without adequate insurance residents who have lost their homes will be unlikely to be able to afford to rebuild.

There is complementarity here for remote towns, with the typical market value of existing housing stock often being out of step with the cost of construction.

The project tests the proposition of housing market failure in two places by considering rebuilding costs in relation to the current housing stock value and current average incomes in two small towns, Cobargo in Southeast NSW and Winton in Central West Queensland. Cobargo is a bushfire affected town and Winton a remote town.

The analysis shows that in Cobargo – insurance aside – there is limited financial capacity to rebuild at contemporary costs and if even if there is such capacity (among a minority of households), a tight credit environment could well undo the ability of such households from building.

In the case of Winton, where the existing stock has not expanded (in fact has shrunk) and also deteriorated over a long period (against a backdrop of drought-related economic weakness), the threat is more of a slow burn. The underinvestment in housing in Winton shares one common driver with Cobargo – the high equity required to obtain mortgage finance.

The scenarios explored in this Discussion Paper could apply to many regional places, and point to market failures that many regional areas may face in responding to any increases in demand. These commonly relate to: a mismatch between the costs of construction and renovation compared to the value of the existing stock, access to finance, and perhaps also access to skilled labour.

These failures existed prior to COVID. The resulting shortfalls in the quantity and quality of many regions' housing stocks (despite underlying demand) already represented key barriers to regional economic growth and development. Housing deficiencies have hampered the ability of regional businesses to expand their operations – inadequate local housing is a key constraint on businesses attracting new staff to enable such expansion.

INTRODUCTION

Australian regional housing markets in recent years have demonstrated a roller coaster ride – with sharp peaks and troughs in particular places as well as great geographical differences between regions with rising prices and others with declining values. In regions, many remote, affected by the mining construction boom of the early 2000s, investment and home values saw dramatic peaks around 2011. In other regions investment and home values have been quite flat, or even declining. In some regions new housing is required to meet rapid growth in populations, while in other regions the housing stock is deteriorating through lack of investment.

The existing research on regional housing markets – domestic and international – is slim. While there have been many media articles through 2020 and 2021 about regional market expectations and performance, there has been little recent Australian research into understanding regional housing investment. There was research published ten years ago through AHURI which considered the drivers of demand and supply of regional housing, with a focus on the affordability of housing in regions¹, but nothing recently. Looking internationally suggests that these regional housing market failures are not unique to Australia, with similar market failures reported in northern Scandinavia².

Natural disasters in remote places compound the consequences of this market failure. In many more rural and remote places, the cost of housing has been low, as have average incomes. For many of these places the housing market was in an equilibrium which balanced the low cost of housing and the low average incomes. This equilibrium has been shattered in the aftermath of a natural disaster, as the cost of replacement housing stock is well above the ability of residents to repay. This Discussion Paper explores this disequilibrium through developing scenarios of replacement housing cost in two regional places.

Insurance is the key buffer for people living in low cost/low income places when disaster strikes. But the cost of insurance means that not all homeowners are insured to cover full replacement, and renters have no insurance options on the home itself. The level of insurance in bushfire affected communities was discussed by the 2020 Royal Commission into National Natural Disaster Arrangements.

¹ Beer et al (2011) *The drivers of supply and demand in Australia's rural and regional centres*, AHURI Report 165

² Eliassen et al (2020) *Rural housing challenges in the Nordic region*, NORDREGIO Report 2020:7

Maintaining adequate insurance coverage

20.15 For insurance to help people manage natural hazard risk most effectively, households and businesses need to maintain adequate insurance coverage.

20.16 In part due to increasing costs driven by rising risk and tax distortions, absence of (or insufficient) insurance has been raised as a growing concern by other inquiries, consumer groups, and the insurance industry. At present around 95 per cent of homes are insured for loss or damage, but we have not obtained rigorous estimates on underinsurance.

20.17 The National Insurance Project Final Report to the Australia-New Zealand Emergency Management Committee in 2020 estimated that gaps in coverage are significant for contents insurance (among renters) and business interruption cover. It noted that up to 15 per cent of businesses do not have insurance for interruption to business caused by natural hazards.

Royal Commission Chapter 20

THIS DISCUSSION PAPER

This discussion paper looks into barriers to housing construction in small regional towns. In particular it illustrates a (if not *the*) key structural barrier: constrained access to finance due to a significant difference between small towns' established housing values and new home building costs.

The work also tests the assumption that many inland small towns have a delicate balance between low incomes and low cost of housing which is disrupted by disaster as high contemporary (re)building costs may be beyond the reach of affected residents.

There is complementarity here for remote towns, with the typical market value of existing housing stock often being out of step with the cost of construction.

The project tests the proposition of housing market failure in two places by considering rebuilding costs in relation to the current housing stock value and current average incomes in two small towns – one bushfire affected town and one remote town. This work will connect disaster recovery with policy discussions in 2021 on more general market failures in regional housing markets.

TWO REGIONAL HOUSING MARKET EXAMPLES

Cobargo and Winton have been chosen as two very different regional housing markets that also share some very important characteristics that represent structural barriers to home building.

These two examples highlight that while regional Australia is diverse, there are important shared characteristics that result in locals facing significant barriers to home building in their towns.

Importantly from this exercise, those key characteristics appear to be these towns' small and steady (if not declining) populations coupled with a low-priced existing housing stock. These two features tend to result in significantly constrained access to finance for local households seeking to build.

The situation in Cobargo has the added layer of the local incomes being quite low – making the town especially vulnerable in the face of a disaster that has widespread impact on the local housing stock – most local households simply cannot afford to rebuild their homes at current build prices.

In analysing the barriers to home building in these two different settings, this paper aims to be instructive for a wide range of small towns that may face similar barriers to disaster recovery or home building more generally.

COBARGO AND WINTON: BACKGROUND

Both Cobargo and Winton are relatively small regional towns with above-median-aged populations that have shrunk (Winton more significantly) between the 2011 and 2016 censuses, whose residents earn below-(national) median incomes. Both towns also have seen their stock of dwellings shrink over this period.

Table 1 Population trends

Intercensal population growth			
	2006	2011	2016
Cobargo			
Persons	426	441	388
Intercensal change (no.)		15	-53
Intercensal change (%)		3.5	-12.0
Winton			
Persons	981	954	875
Intercensal change (no.)		-27	-79
Intercensal change (%)		-2.8	-8.3

Source: ABS

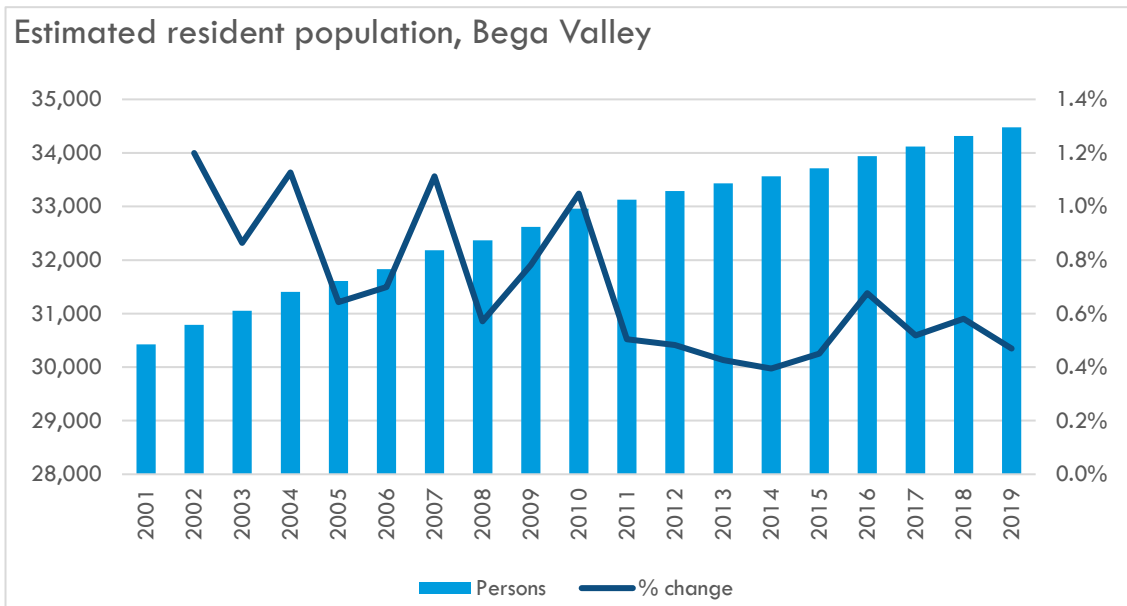
Table 2 Housing stock

Intercensal housing stock*			
	2006	2011	2016
Cobargo			
Number of dwellings	184	197	191
Intercensal change (no.)		13	-6
Intercensal change (%)		7.1	-3.0
Winton			
Number of dwellings	452	472	451
Intercensal change (no.)		20	-21
Intercensal change (%)		4.4	-4.4

*Excludes caravans, cabins and houseboats, improvised homes, tents and sleepers out and not stated. Number of dwellings in 2006 is an RAI estimate of census-enumerated occupied dwellings plus an RAI estimate of unoccupied dwellings.

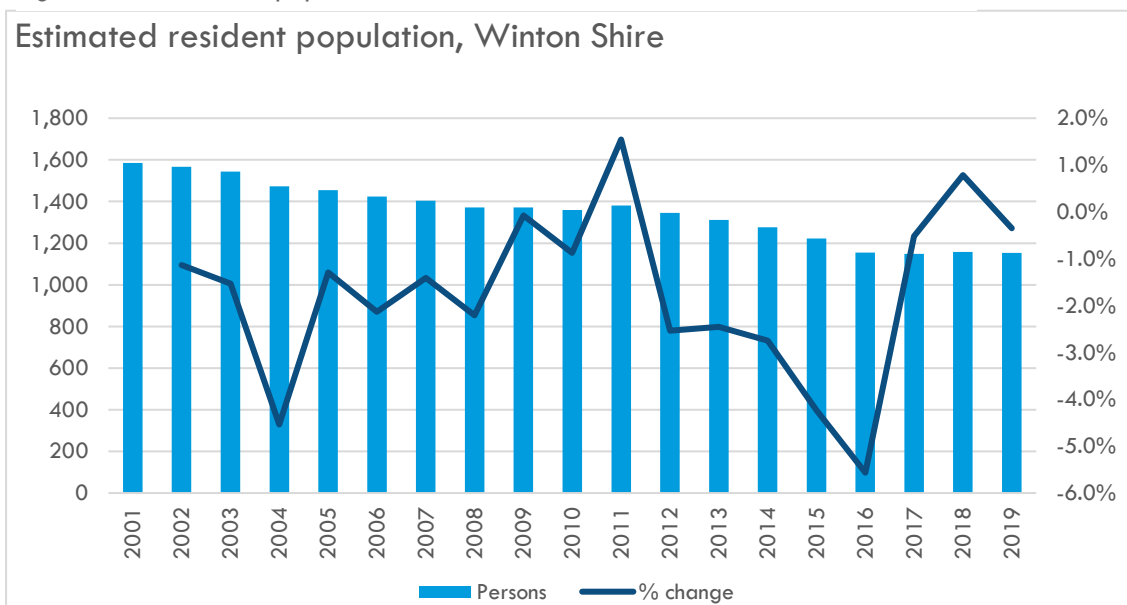
Cobargo is a small village in the Bega Valley Shire in Southeast NSW – a popular tourism, agriculture, forestry and fishing region with a resident population of around 34,000 people. While Cobargo has seen no overall population growth in recent years, the Shire itself has been growing steadily in population – at a rate of around 0.4%-0.6% per year.

Figure 1 Bega Valley Shire population trends



Winton is more remote, in the large and low population density Winton Shire in central west Queensland. Winton town's population of 875 at the 2016 Census made up 77% of the Shire's population at the same time. The Shire's population has declined slowly for the last 20 years.

Figure 2 Winton Shire population trends



BARRIERS TO REBUILDING AND RECOVERY IN COBARGO: AFFORDABILITY AND ACCESS TO FINANCE

The 2019-20 Black Summer bushfires had a major impact on Cobargo. Many shops were burnt on the main street, and in the village and surrounding areas properties were lost. It was one of the hardest hit communities in southern NSW, with 70 homes lost, five facilities destroyed, 168 outbuildings lost and a further 33 homes damaged³.

In the context of a disaster that has diminished the (already small) stock of housing, the most urgent challenge was simply meeting the basic housing needs of residents. A small town like Cobargo has very limited slack or spare capacity in its stock. A best-case estimate is that the town has capacity to house about 60 displaced persons – a situation where each of the roughly 30 unoccupied dwellings being used to house 2 people each (the town's average household size).

Residents of the area had reportedly been living in makeshift housing for many months after the 2019-20 bushfires⁴.

Longer term, without external support the town faces an 'existential threat' if housing – its very fabric – isn't rebuilt. The following analysis illustrates the barriers to building in Cobargo and therefore how this threat is not implausible, with the likelihood that many of the existing residents not being able to afford to rebuild, or to buy back into a rebuilt village. The analysis does not take into account insurance coverage and levels of insurance – clearly for existing homeowners with a high level of cover most of the costs of rebuilding should be covered. But as the Royal Commission pointed out, there is a prevalence of underinsurance in regional towns, and the insurance issue does not help renters in the Cobargo market either.

³ <https://knowledge.aidr.org.au/resources/black-summer-bushfires-nsw-2019-20/>

⁴ <https://www.abc.net.au/news/2021-01-03/black-summer-remembered-south-coast-nsw-bushfires/13011334>

COBARGO HOUSING COST STRUCTURES

Table 3 below uses building approvals data from the wider Bega Valley Shire to estimate the cost to construct an average new house in Cobargo in 2019. Vacant residential land lots advertised for sale in the 18 months to the end of 2019 were used to estimate the (serviced) land component of the overall cost of a new house and land package. This is likely to be an underestimate as the approval value doesn't account for any variations that typically take place after an approval has been granted (and the value of the approval lodged with local authorities).

Table 3 Estimated housing costs in Cobargo

Cobargo estimated cost structures⁵		
House + Land (established)	\$	382,500
House (+ utilities and infrastructure connections) \$		287,900
Land (unimproved) \$		94,600
House + Land (new)	\$	526,899
House only \$		411,661
Land (+ utilities and infrastructure connections) \$		115,237
Difference (new vs established)	\$	144,399

Sources: ABS building approvals, NSW Valuer General, Allhomes.com.au, Domain.com.au

These estimates are used in the following analysis to illustrate the barriers to rebuilding in Cobargo, two particular barriers that go to:

- straight-forward issues of **(un)affordability of rebuilding for individual Cobargo households**, and
- **limited access to finance** peculiar to small regional settings where a new home build is significantly more costly than local established housing.

⁵ See appendix for how estimates have been derived.

BARRIERS TO REBUILDING: AFFORDABILITY

Prior to the Black Summer Bushfires, Cobargo had struck a delicate balance between the low incomes of the town and its low housing costs, such that the overwhelming majority of residents were living free from housing stress (a situation where housing costs consume more than 30 per cent of incomes).

Census 2016 data highlights this balance – the median weekly personal income of working-age residents was \$430, well below the national median of \$662. For households, the local median income was \$701 per week, less than half the national median weekly income of \$1,438. In a setting of high home ownership rates – a large majority (70.8 per cent) of Cobargo households owned their homes, many of whom owned their homes outright – these low incomes hadn't put residents under housing stress. Only 2 per cent of local mortgage-paying households were in a situation of mortgage stress, while 12.7 per cent of renting households were in a situation of rental stress.

Table 4⁶ below highlights how the estimated cost to build a new home in Cobargo is beyond what is affordable for the majority of local residents. Servicing a typical mortgage for a new build requires two local median incomes (or would account for 61 per cent of the local median income).

Table 4 Cobargo housing affordability

Cobargo affordability - established vs new housing		
	Established house & land	New house & land
Price, \$	382,500	526,899
Loan size, \$	344,250	474,209
Monthly repayments, \$	1,759	2,423
Monthly incomes, \$	3,940	3,940
Share of income on mortgage repayments	45%	61%
Number of incomes to comfortably service a mortgage	1.5	2.0

The difference in affordability between new and established housing highlighted by the table above is unlikely to be as acute as what many residents needing to rebuild are facing. The difference is likely to be much larger - many of the owner-occupier households who lost their homes in the bushfires will likely have had much smaller mortgage repayments than what is listed in table 4 above – reflecting lower established house prices at the time of purchase in previous years. Up until 2018 Cobargo's median house prices were below \$300,000.

⁶ Affordability in this table is calculated using: RAI estimates of new and established housing in Cobargo (for more detail on these refer to the appendix), estimates of local median incomes during 2018-19 (based on ABS data showing local incomes in 2017-18), and assuming a 30-year loan that is worth 90 per cent of the cost of the home at a 4.57% interest rate (the average standard variable rate charged by bank lenders during 2020).

BARRIERS TO REBUILDING: ACCESS TO FINANCE

The minority of local households that do have adequate incomes to service a typical mortgage on a new build are still likely to run into significant barriers to finance. It is the town's size, demographics and housing (namely price-point) characteristics that result in local households being constrained in accessing finance, irrespective of their own individual financial capacity.

A small town with a low median house price is likely to have a housing market with relatively few transactions at a relatively low value.

While it is not unusual for new housing to be more costly than established housing, it becomes significant in a small town setting where the difference is large. In Cobargo that difference is estimated to be to the tune of \$144,399. Any local new home building project will have its value weighed down, often to the point where the project is valued at below cost. This is because valuers must assign projects a market value based on recent comparable sales.

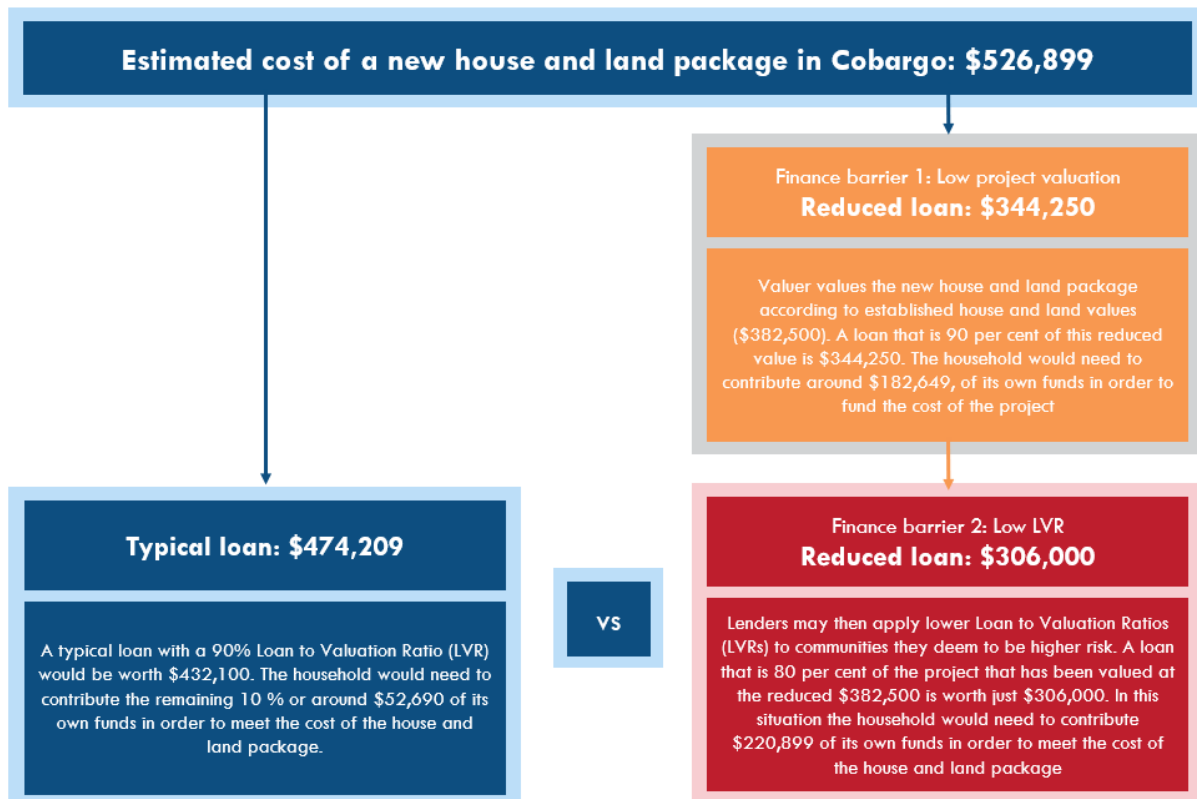
Additionally, the town's small (if not shrinking) population and relatively low incomes are likely to weigh on lenders' assessment of risk – the assets being less liquid than in metro and more populous (and growing) areas and prone to declining in capital value. Moreover since the GFC financial market regulation has tightened. In particular lending to borrowers in more risky markets is now more costly for banks because of the additional capital they are required to hold⁷.

As a result, banks tend to limit their exposure to (by limiting LVRs in) regional areas. This compares with more populous markets where borrowers can finance a larger share of the value of a property through a mortgage.

The overall mechanics of these barriers to finance are illustrated in table 3 below – using the above estimate of the cost of a new house and land package in Cobargo.

⁷ <https://www.apra.gov.au/news-and-publications/apra-increases-capital-adequacy-requirements-for-residential-mortgages>

Figure 3 Barriers to finance in Cobargo



A typical loan – covering 90 per cent of the cost of the project – would be worth \$474,209. The household would have to finance the remaining \$52,690 with its own funds.

The first barrier is a low valuation. If the project is valued at Cobargo’s median established house price (\$382,500) rather than the build cost – then a typical loan on this value would only finance \$344,250 of the project, leaving the remaining \$182,649 to be financed from the household’s own funds.

The next barrier is lenders’ practices of lowering their exposure to small, regional and more remote areas, by applying lower loan to valuation ratios. This scenario considers a case where a lender only lends 80 per cent of the value of the project. A loan that is 80 per cent of the reduced-value project would be worth only \$306,000. The household would now have to fund \$220,899 – more than 40 per cent of the project cost – from its own finances for the home to be built.

The few households in Cobargo that would ordinarily have the means to service a mortgage on a new home build are likely to be priced out if they don’t have the personal funds to cover this large share of the build cost.

BARRIERS TO HOME BUILDING IN WINTON: ACCESS TO FINANCE

The barriers to home building in a very remote community like Winton are slightly different but nevertheless result in significant underinvestment relative to underlying demand.

The key differences between Winton and Cobargo lie in the towns' respective established housing prices, incomes, and remoteness.

Winton is obviously in a far more remote setting than Cobargo and its median house price is much lower – around \$120,000-\$130,000 for the last five years. Local incomes however are higher than in Cobargo, so issues of affordability aren't so acute for Winton. On some measures, local incomes are about on par with incomes nationally. Census 2016 data shows that the median weekly personal income of working-age residents was \$672, just higher than the national median of \$662. For households, the local median income was \$1,097 per week, about 24 per cent lower than the national median weekly income of \$1,438.

Given these incomes and low housing costs, the overwhelming majority of residents are free from housing stress – 96 per cent of local renters have rents that were less 30 per cent of incomes, while 98 per cent of owner-occupier households had mortgage payments below this 30 per cent threshold.

WINTON HOUSING COST STRUCTURES

Table 5 below uses local builder estimates on the cost to build an average home in the area. The Winton Shire Council also provided the rough sale price (which is just cost price) for vacant, serviced residential land in the town.

The table shows the massive gap between established housing and the cost to build new housing – an established home is estimated to be less than half the cost of a new house and land package (lower by 66.5 per cent or some \$292,500).

This significant difference between established housing prices and new home building costs is a key barrier to home building and overall levels of housing supply in Winton – the mechanics of which are illustrated further below.

Table 5 Estimated housing costs in Winton

Winton estimated cost structures⁸	
House + Land (established)	\$ 147,500
House (+ utilities and infrastructure connections) \$	130,000
Land (unimproved) \$	15,000
House + Land (new)	\$ 440,000
House only \$	400,000
Land (+ utilities and infrastructure connections) \$	40,000
Difference (new vs established)	\$ 292,500

Sources: ABS building approvals, QLD Valuer General, Allhomes.com.au, Domain.com.au

⁸ See appendix for how estimates have been derived

WINTON AFFORDABILITY: SOME CHALLENGES BUT NOT ACUTE

As noted above, incomes in Winton – on some measures – are on par with incomes nationally. Servicing a typical 90 per cent LVR mortgage on a new house and land package would consume 50 per cent of a median local income – which is more than the 30 per cent considered comfortable. However, the other perspective of affordability – the number of median incomes to service a mortgage – shows that it would take 1.7 incomes, which would be similar in many other housing markets across the country. In this respect, the issue of the affordability of new housing is not so acute in Winton.

Table 6 Winton housing affordability

Winton affordability - established vs new housing		
	Established house & land	New house & land
Price, \$	147,500	440,000
Loan size, \$	132,750	396,000
Monthly repayments, \$	678	2,023
Monthly incomes, \$	4,063	4,063
Share of income on mortgage repayments	17%	50%
Number of incomes to comfortably service a mortgage	0.6	1.7

KEY BARRIER TO HOME BUILDING: ACCESS TO FINANCE

In Winton the most significant barrier to homebuilding is limited access to finance. This very limited local access to finance is mainly due to the significant difference between established and new housing prices. The issue is further compounded by banks reduced lending in regional and remote settings.

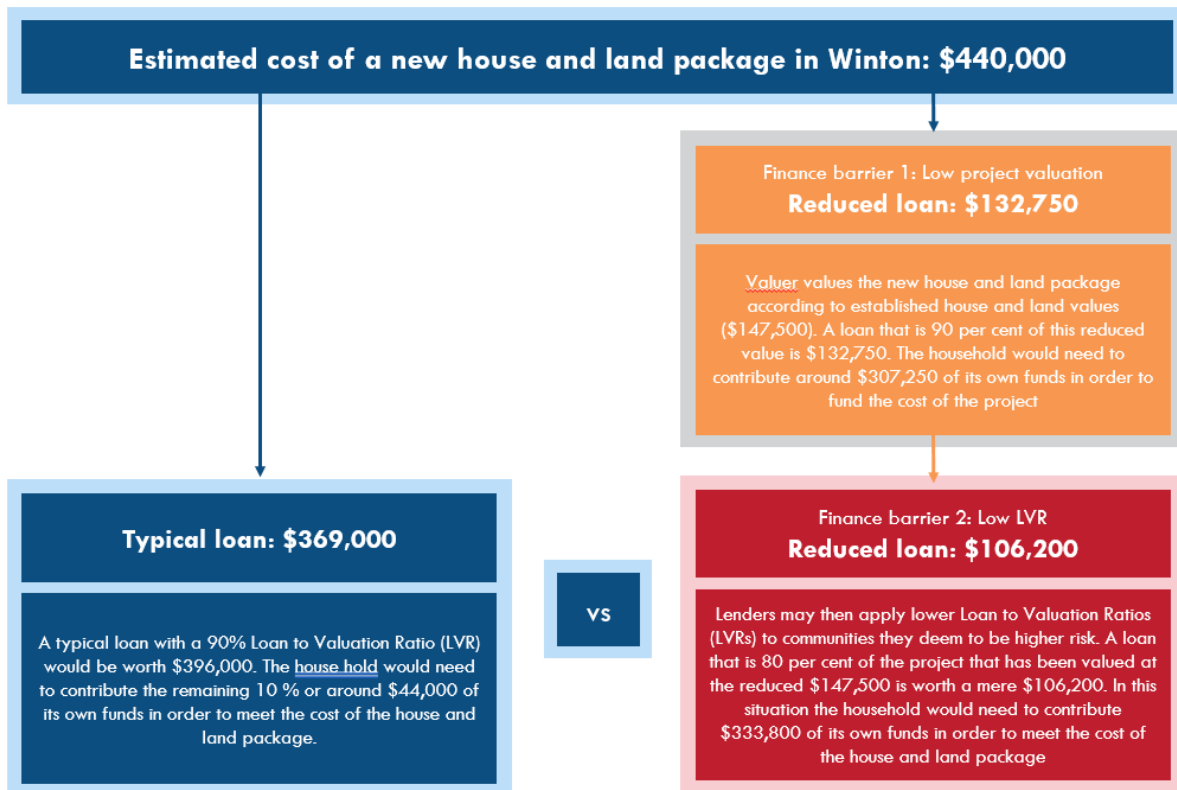
The table below (using the above estimates of new and established housing costs) illustrates how it is that this gap significantly weighs on locals' access to finance for new housing.

It shows how a local household considering a new build at the above estimated cost is likely to face their project being valued significantly below cost (and in line with the low established housing values).

Even if this household was able to obtain a loan for 90 per cent of the ascribed value of the project, the low *ascribed*-value (\$147,500 in this instance) would mean that this loan would only be worth \$132,750. The household would need to source \$307,250 from its own funds to cover the cost of the project.

The effect of a low LVR (80 per cent in this instance – though local feedback suggests LVRs are often lower) would be to reduce the loan amount down to a mere \$106,200. The split of funding ends up looking like the reverse of what is typical, with the majority of the cost needing to be covered by the household and only a small portion funded by a loan.

Table 7 Barriers to finance in Winton



Finally in more remote settings there are additional barriers to home building on the supply side of the market – particularly in accessing skill trade labour.

Firstly, given that the home building workforce is engaged on a contracting and sub-contracting basis (rather than an employment and project basis) – a large enough pool of work needs to be available to sustain such a local workforce. In remote settings, this pool is likely to highly dispersed over large distances.

Also, the residential building industry in these more remote settings would also be competing against non-residential building and construction industries (non-residential building, mining and engineering construction) to source skilled trade labour.

Finally, it is also likely that the barriers to accessing skilled trade labour are self-fulfilling – attracting and retaining a local skilled trade labour force to build homes locally is difficult, partly because of the difficulty in housing such a labour force in the first instance.

CONCLUSION

These two examples of Cobargo and Winton show the very different barriers that small inland towns face in building and maintaining a sufficient and appropriate stock of housing.

Housing is a key part of the very fabric of a community. If it cannot be maintained and does not meet the community's needs, this represents an 'existential threat'.

In the instance of Cobargo, where a disaster has destroyed nearly half of the housing stock, the threat is immediate and urgent. The above analysis shows how – insurance aside – there is limited financial capacity to rebuild at contemporary costs and if even if there is such capacity (among a minority of households), a tight credit environment could well undo the ability of such households from building.

These are areas for further research – how governments can respond and assist communities to overcome these very particular barriers in order to sustain a town and its community in the event of a disaster.

In the instance of Winton, where the existing stock has not expanded (in fact has shrunk) and also deteriorated over a long period (against a backdrop of drought-related economic weakness), the 'existential threat' is more of a slow burn. While issues of affordability might not be so pressing, this highlights the need to further work to understand the lack of building in the area, despite a strong need (demand) for more and better housing.

The scenarios explored in this Discussion Paper could apply to many regional places, and point to market failures that many regional areas may face in responding to any increases in demand. These commonly relate to: a mismatch between the costs of construction and renovation compared to the value of the existing stock, access to finance, and perhaps also access to skilled labour.

These failures existed prior to COVID. The resulting shortfalls in the quantity and quality of many regions' housing stocks (despite underlying demand) already represented key barriers to regional economic growth and development. Housing deficiencies have hampered the ability of regional businesses to expand their operations – inadequate local housing is a key constraint on businesses attracting new staff to enable such expansion.

The great differences in housing market outcomes across regional Australia form a foundation for the RAI's Shared Inquiry Research Program for 2021. The importance of regional housing in 2021 has been highlighted by rapid increases in regional home values and rental costs, and tightening of available sale and rental stock in many places. Underpinning these market tightenings in early 2021 has been steady growth in demand for labour in most parts of regional Australia since May 2020 – with lack of suitable, quality housing being increasingly cited by employers as an important impediment to filling vacant positions.

While the tight regional housing market in early 2021 has gathered many media headlines, the underinvestment in housing in many regions goes back over many decades. Particularly in remote places where housing construction activity has been subdued for many years, housing deficiencies have hampered the ability of regional businesses to expand their operations – inadequate local housing is a key constraint on businesses attracting new staff to enable such expansion.

APPENDIX – COST STRUCTURE ESTIMATES

Estimated cost structures - new vs established housing

Cobargo

1. Established home

a	House & land package, \$	382,500	← Source: allhomes.com.au
b	Structures and improvements, \$	287,900	← b = a - c
c	Unimproved land, \$	94,600	← Source: nsw valuer general's office - https://www.valuergeneral.nsw.gov.au/land_value_summaries/lga.php?lga=018&base_date=01072020

2. New home

a	House & land package, \$	526,899	← a = b + c
b	House ONLY, \$	411,661	← source: ABS, average value of detached house approved for construction during 2016-2018
c	Serviced (but vacant) land, \$	115,237	← source: allhomes.com.au, RAI calculation. See box below

Difference (new vs established), \$ **144,399** -27.4%

Sources: allhomes.com.au, NSW Valuer General's Office, RAI calculations

Estimated Cobargo vacant land price:

\$110,000 for 1,222 sqm in 2019			
(council headworks for water and sewer still owing)	90	\$/sqm	source: https://www.realestate.com.au/sold/property-residential+land-nsw-cobargo-202410790
\$115,000 for 915 sqm in 2017			
	126	\$/sqm	source: https://www.allhomes.com.au/21-cobargo-bermagui-road-cobargo-nsw-2550
	1,069	average land size	
	108	average price per sqm	
	115,237	estimated vacant (connected) land price	

Estimated cost structures - new vs established housing

Winton

1. Established home

a	House & land package, \$	147,500	← Source: domain.com.au, RAI calculated median
b	Structures and improvements, \$	132,500	← b = a - c
c	Unimproved land, \$	15,000	← Source: QLD's valuer general's office - https://www.dnrme.qld.gov.au/_data/assets/pdf_file/0010/1475281/2020-property-market-movement-report.pdf

2. New home

a	House & land package, \$	440,000	← a = b + c
b	House ONLY, \$	400,000	← source: CWQ builder feedback - avg cost of construction = \$2000/sqm, avg house size = 200sqm
c	Serviced (but vacant) land, \$	40,000	← source: Winton Shire Council

Difference (new vs established), \$ **292,500**

Sources: domain.com.au, QLD Valuer General's Office, RAI calculations

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