Home ownership and housing affordability

(Article published on Pearls and Irritations, a blog specializing in public policy issues curated by John Menadue, former Secretary of the Departments of Prime Minister& Cabinet, Immigration & Ethnic Affairs, and Trade, Ambassador to Japan and CEO of Qantas).

Once upon a time, from the late 1950s until the mid-1980s, Australia had one of the highest rates of home ownership in the world. That hadn't always been the case. From the time of federation until after the end of World War II, the proportion of Australians owning their own homes had been fairly steady at just over 50%. But between the Censuses of 1947 and 1961, Australia's home ownership rate rose by more than 17 percentage points, from 52.6% to 69.9%. By the 1966 Census, it had reached 72.5%. As John Howard has observed, this "was a measure of the success [Sir Robert] Menzies had in delivering a sense of prosperity and stability to middle-class Australians [and] one of the explanations for his continued political success".

The unprecedented expansion in home ownership during the Menzies years is all the more remarkable for having occurred in the face of a large and sustained increase in Australia's population, averaging 2.2% per annum between 1949 and 1966 - and in particular, in the population of Australia's capital cities, which grew by an average of 3.4% per annum over this period. That's twice the rate at which the population of our capital cities has growth over the past seventeen years.

It occurred because governments – Commonwealth and State – paid at least as much attention to expanding the supply of housing as they did to supporting the demand for it.

Successive Commonwealth Governments assisted would-be home buyers by providing access to finance directly through the War Service Home Loans Scheme and, after 1956, indirectly through building societies as part of the Commonwealth-State Housing Agreement.

But they also sought actively and directly to boost the supply of housing, both by building dwellings themselves (for rent and for sale) as well as by encouraging and facilitating the construction of new dwellings by the private sector. Between the 1947 and 1966 Censuses, Australia's population grew by 53% - but the stock of housing increased by 67%. Largely because supply outpaced demand, housing prices actually declined relative to incomes during this period: John Howard notes that the number of weeks' work at an average wage required to purchase a median-priced house in an Australian capital city declined from 301 in 1950 to 200 in 1955, and remained at that level through to 1970.

The 1966 Census represented the high water mark for home ownership in Australia. Since then, the home ownership rate has gradually drifted down to 67.0% at the most recent Census in 2011 – the lowest at any Census since 1954, and lower than all but eight of 35 OECD countries according to the Reserve Bank (the 2016 Census results, to be released on 27th June will likely show a further decline, based on findings from the ABS' biennial Survey of Income and Housing).

Moreover, the 5.5 percentage point decline in the aggregate home ownership rate since 1966 conceals much larger declines in home ownership, not only among the archetypal first home buyers in their mid-to-late 20s or early 30s, but among people up to their mid-50s.

In particular, since 1991 the home ownership rate among people aged 25-34 has fallen by 9 percentage points, to 47% (having fallen by 5 pc points over the preceding 10 years); among people aged 35-44 by 10 pc points, to 64%; and among people aged 45-54 by 8 pc points, to 73%. But the effects of these quite large declines has been largely offset by the increase in the proportion of the population aged 55 and over, among whom the home ownership rate dropped by only 5 pc points between 1991 and 2011.

The decline in home ownership rates reflects a combination of demographic, social and economic factors – not all of which should be seen as cause for regret, or needing remediation. The decline in home ownership among 25-34 year olds, for example, began in the early 1980s, and reflects (among other things) a gradual reversal of the immediate post-war decline in the age of first marriage and parenting, and an increase in the length of time spent in formal education compared with previous generations. There is no reason why government policy should seek to counter these trends.

However, it seems unarguable that the larger part of the decline in home ownership, especially among people aged between 35 and 55, since the early 1990s is the direct result of the ongoing deterioration in housing affordability – best summarized by the rise in average capital city dwelling prices from between 2 and 3 times average household disposable income in the 1980s to around 5 times average household disposable income since the early 2000s, the reverse of the trend which John Howard found so admirable about the Menzies era.

Fundamentally, this rise in the price of capital city housing relative to incomes is the result of the demand for housing rising at a much faster rate than the supply of it, over an extended period.

The demand for housing has been materially boosted by Australia's relatively high immigration intake, especially since the turn of the century – which has been both a result of and a contributor to our economic performance; and by the substantial decline in interest rates since the early 1990s – which for most of this period was also regarded as a measure of successful economic policies (until more recently when it has become an indicator of the failure of other measures aimed at boosting economic growth).

But these are not the only factors which have inflated the demand for housing. Ever since the mid-1960s, when the Menzies Government introduced the Home Savings Grant Scheme at the suggestion of the New South Wales Young Liberals (whose President at the time was John Howard), policy responses to perceived difficulties in attaining home ownership have taken the form of measures which allow people to spend more on housing than they otherwise would – that is, on increasing the demand for housing – rather than, as they did prior to the mid-1960s, on increasing the supply of housing.

Nowhere has this been more apparent than with regard to the demand for housing as an investment asset, as distinct from a place of abode.

In the early 1990s, first home buyers and residential property investors each accounted for about 18% of total housing finance commitments (with the remaining 64% going to existing home owners 'trading up' to their second or subsequent home). By 2014-15 the share of housing finance commitments going to first home buyers had fallen to less than 10%, while the share going to investors had risen to more than 50%. Over the same period, the number of first home buyers as a proportion of the population aged between 20 and 64 fell from over 0.9% to less than 0.7%; while the proportion of taxpayers who are landlords rose from less than 10% to more than 15%.

There could be no more compelling evidence of the way in which first home buyers have been, in effect, 'squeezed out' of the housing market by investors – a clear case, if ever there were one, of 'supply [of rental housing] creating its own demand'.

While the decline in interest rates and an easing in the criteria used in making and pricing loans to investors have played a significant part in expanding the demand for residential property as an investment, policy decisions – in particular, the change to the capital gains tax regime in 1999 and the 2007 decision to allow self-managed superannuation funds to borrow in order to purchase property – have also played a key role.

This might not have been a problem if the majority of property investment were directed into new housing – thereby boosting supply. But since the early 2000s more than 90% of lending to property investors has been for the purchase of established housing (compared with less than 75% in the early 1990s). The overwhelming effect of this increase in the flow of funds into residential property investment has therefore been to inflate prices, rather than to boost the supply of housing.

Successive federal governments have long been aware of the role that property investors have played in pushing up prices. But the only investors they have been willing to deflect away from bidding up the price of existing housing towards increasing the supply of new housing have been foreign investors – and even then, regulations intended to enforce that objective have been at best only loosely enforced, until quite recently.

Meanwhile, state and local governments – particularly, though not exclusively, in New South Wales – have pursued policies which have had the effect of constraining supply (by preventing land which might otherwise have been used to provide new housing from being thus used, or adding to the cost and time involved in redeveloping established areas at higher densities) and/or adding to the cost of providing new housing (by funding the provision of urban infrastructure through 'up-front' charges on developers instead of, as had previously been more commonplace, through local government borrowings subsequently serviced and repaid out of increases in rate revenue).

In addition, under-investment by state governments in urban transport, both public transport and arterial roads, has (as the Governor of the Reserve Bank noted in

April), "pushed housing prices up", by adding to the premium attaching to housing from which employment and entertainment options are more readily accessible.

How concerned should we be about these developments?

There are at least four reasons for being concerned about the decline in home ownership rates, to the extent that it is involuntary rather than the result of 'lifestyle choices'.

First, to the extent that people still believe, as Menzies did, that "one of the best instincts in us is that which induces us to have one little piece of earth with a house and a garden which is ours, to which we can withdraw, in which we can be among our friends, into which no stranger may come against our will", then it should be troubling that a growing proportion of Australians are unable to realize those "best instincts".

Second, since Australia's retirement income system has long implicitly assumed that the vast majority of retirees will have close to zero housing costs, the fact that a diminishing proportion of Australians will own their own homes in retirement (combined with the fact that an increasing proportion of those who have attained home ownership by the time they reach retirement will need to use their superannuation savings, in whole or in part, to discharge their outstanding mortgage debt) means either that more Australians will experience greater insecurity in retirement, or there will be greater pressure to lift the rate of the age pension, or both.

Third, the inability of a growing proportion of Australians to attain home ownership is contributing to a widening in the inequality in the distribution of wealth between those who own property and those who don't (from an average of $517,000 per household in 2003-04 to $907,000 per household in 2013-14).

Fourth, to the extent that the principal source of finance for starting a small business is the ungeared equity in a home, the decline in home ownership rates (and the decline in outright ownership) should be a source of concern for those who believe, as the Liberal and National Parties do, that there is something inherently more noble about starting and running a small business than there is about working for a large one (or for a government agency).

To the extent that these concerns are widely shared, what can be done? Treasurer Scott Morrison is certainly right in emphasizing that "there are no single or easy solutions" – even though he (and others on his side of politics) tend to ignore this advice in emphasizing 'supply-side solutions' and decrying any suggestion of policy measures which are intended to dampen demand, especially from investors.

But there is wisdom in the saying, attributed to (among others) Will Rogers and Denis Healey: "when you're in a hole, stop digging". In the context of Australian housing policy, what this means is that governments should:

- at the very least, don't adopt any more policies that would further inflate demand (as allowing people to draw down their superannuation savings in order to purchase a first home would do) or further constrain supply;

- retreat (gradually, if necessary) from existing policies which inflate demand or constrain supply; and
- pursue policies which would have the effect of increasing supply, but in so doing seek to ensure that the increased supply is of the *type* or *types* and in the *locations* that are in greatest demand.

It's worth emphasizing that a strategy which embraces all of these areas requires a sustained commitment from *all* levels of government – Commonwealth, state and local – working towards the *same* ultimate objectives, rather than (as so often in recent decades) at cross purposes.

More specifically, the Commonwealth Government should:

- reduce the competition prospective home-buyers face from domestic investors by modifying the way in which the income tax system treats investors' borrowing costs and/or the way it treats capital gains;
- reduce the competition prospective home-buyers face from domestic investors by requiring APRA further to lower its 'ceiling' on the rate of growth in aggregate lending to residential property investors, and/or further tightening the criteria used by mortgage lenders in making residential property investment lending decisions;
- reduce the competition prospective home-buyers face from foreign investors by further tightening FIRB rules governing the circumstances under which foreign investors are permitted to purchase established dwellings, and/or bringing real estate agents within the purview of anti-money laundering rules and AUSTRAC reporting requirements;
- add to housing supply by including owner-occupied housing in the assets test for the aged pension, while lifting the assets test thresholds to account for the inclusion of the family home, and pressuring State and Territory Governments to exempt pensioners from stamp duty when 'downsizing';
- provide grants or low-interest loans to State and Territory Governments for the construction of more new affordable rental dwellings, either by State and Territory housing authorities or community housing organizations (as previous federal governments have done);
- provide tax incentives for institutional or individual investment in new affordable rental housing (perhaps funded by reductions in existing tax incentives for speculative investment in established housing);
- provide support (in the form of loan guarantees or interest subsidies) for borrowings by community housing organizations and other not-for-profit providers of affordable rental housing; and
- use fiscal policy more actively, when economic conditions require measures aimed at boosting economic activity or employment, so as to reduce the need to rely predominantly on monetary policy (in the form of low interest rates) for that purpose.

State and Territory Governments can contribute towards enhancing people's capacity to become home-owners by:

- scaling back cash grants and tax exemptions or concessions for first-time buyers which simply allow buyers to pay more to vendors than they otherwise would;
- replacing stamp duties with a more broadly-based land tax (with no exemptions for owner-occupied land, but with appropriate transitional provisions to avoid 'double taxation' of recent purchasers) so as to eliminate the disincentives which stamp duties create for people to 'move home' as their needs change, as well as to provide State and Territory Governments with a more predictable and stable source of revenues;
- reducing up-front taxes and charges on land developers and builders for the provision of suburban infrastructure, permits and inspections (or simply revenue-raising) – whilst recouping revenue foregone through increased municipal rates or land tax, and working with the ACCC to ensure that reductions in up-front taxes and charges are passed on to new home buyers;
- reforming planning laws to reduce the scope for frivolous or vexatious objections to redevelopment of existing residential sites at higher densities; and
- increasing investment in urban transport infrastructure to improve access to and from new suburbs to places of employment, entertainment and recreation.

State and Territory Governments could also:

- improve the supply of affordable rental housing by building more of it themselves, or by funding community and not-for-profit housing providers to do so (including by transferring some of their existing housing stock to such organizations, allowing them to leverage it in ways that State and Territory Governments have become unwilling to do);
- make unused or under-utilized state-owned land available for the provision of more affordable rental housing; and
- provide support for borrowings by community and not-for-profit affordable housing providers in the same way as suggested for the Commonwealth above.

A program of measures along these lines shouldn't be beyond the range of what is politically possible. Indeed, most of it has been done before, in the 1950s and 60s – and the evidence from that period is that *it worked*, delivering affordable housing to a rising proportion of a population that was growing more rapidly than it is today. Moreover, the evidence strongly suggests that what governments have been doing (or failing to do) over the last years *hasn't worked* – unless you believe that it has been an unspoken, yet bipartisan, objective to transfer wealth to those who already own property from those who don't.

If governments continue to do what they've been doing, or failing to do, in the housing policy space for the last fifty years, then Australia is likely to become a very different, and less comfortable, place than most Australians have wanted it to be.