



Housing affordability: re-imagining the Australian Dream

**Brendan Coates, Fellow, Grattan Institute
Policy at the Pub, Melbourne
21 February 2018**

Housing affordability

What problem are we trying to fix?

- **Housing prices** have risen a long way as interest rates fell
- **Paying the mortgage** is not particularly difficult relative to history, but new borrowers take on more risk for longer, and accumulating a deposit is harder
- **Home ownership** is declining, especially among the young and poor
- **Lower income households** especially are spending more of their budget on housing
- **Wealth inequality** is increasing between generations, and within generations
- Economic growth at risk because **jobs are not accessible**

Rising house prices reflect both demand and supply

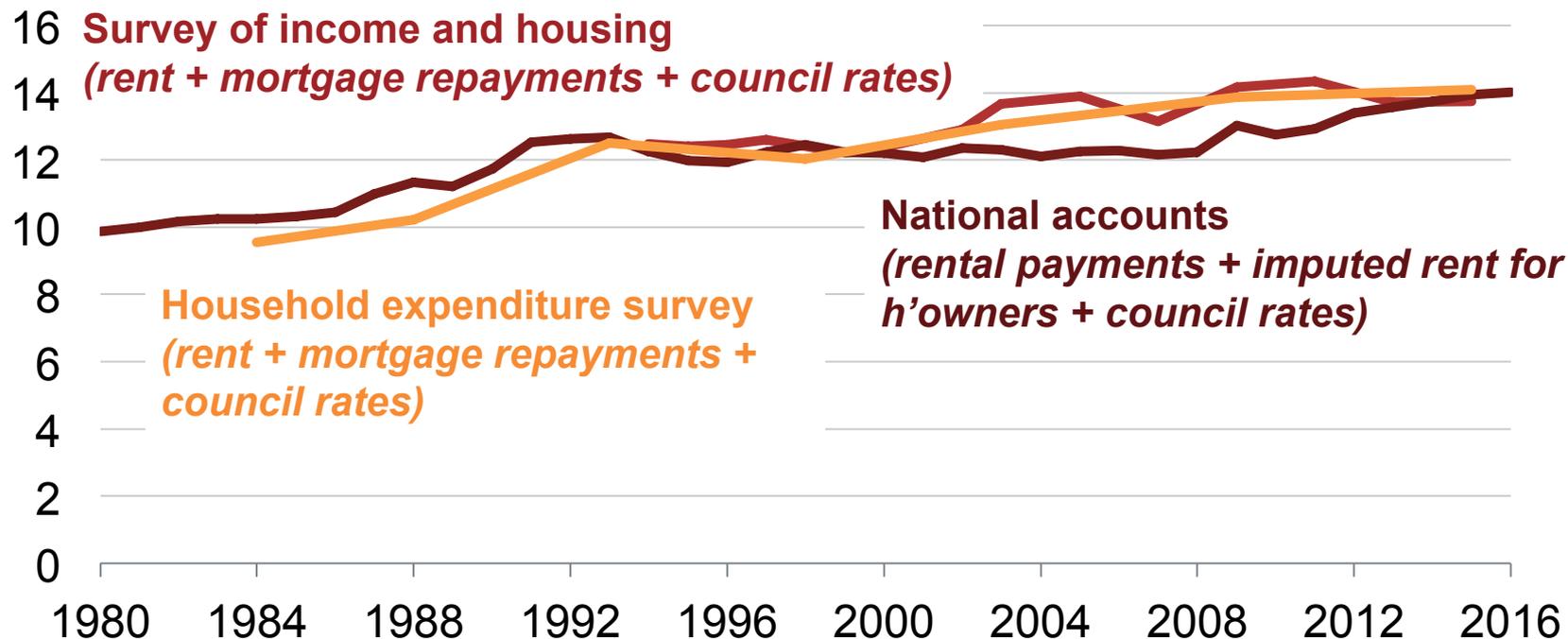
- Macro: rising incomes, falling interest rates, strong immigration, sluggish building
- Policy: land use planning rules; negative gearing; CGT discount; pension assets test; progressive land taxes; stamp duties; infrastructure choices
- Supply constraints, especially in inner and middle ring– less so in Sydney in last few years

Policies that would help require some tough calls

- Governments have favoured policies that appear to fix the problem, but don't
- Need action on both demand and supply policy levers
- Also need rental reforms – flat rate land tax; Tenancy Act reforms

Across all measures, spending on housing as a share of income has increased

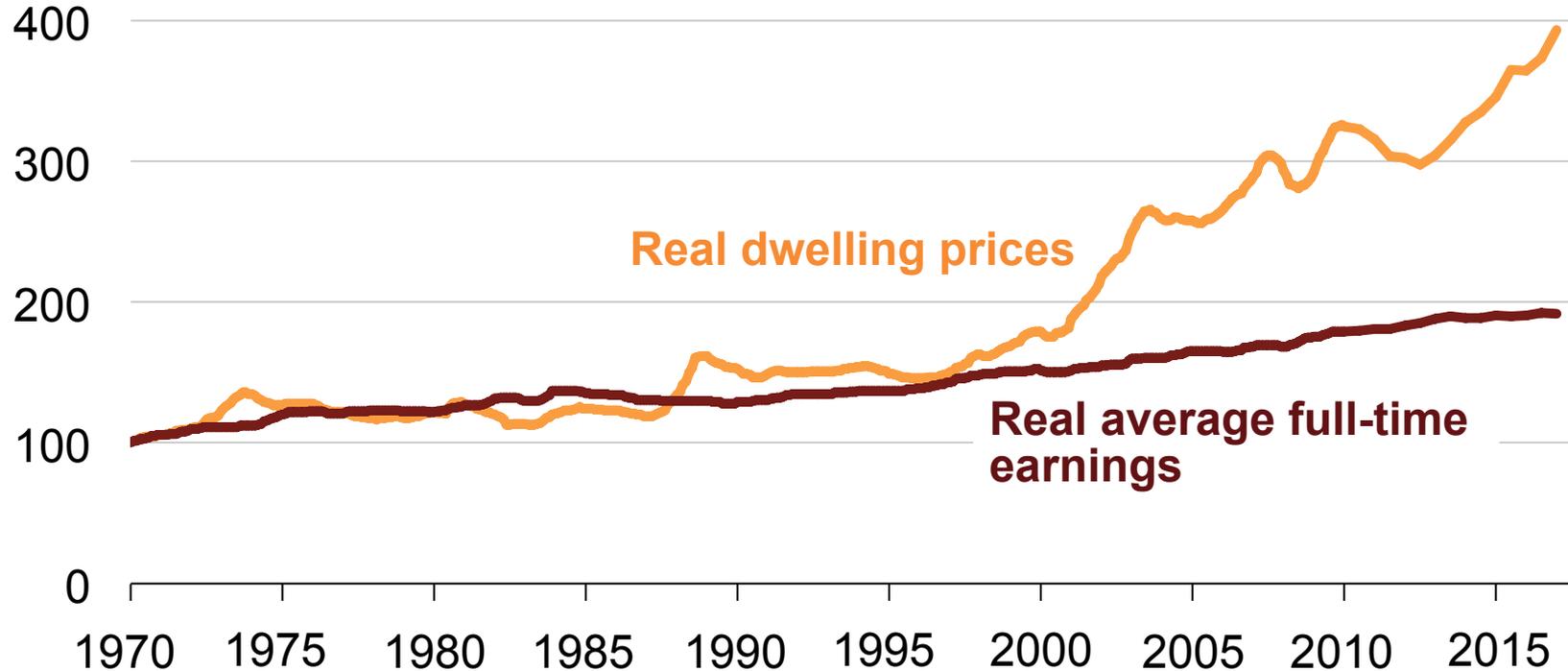
Housing costs as a share of gross household income, per cent



Notes: National accounts: Rent paid by households to the owners of dwellings, plus imputed value of housing services accruing to owner-occupiers (both their principal residence and any additional residence) and water and sewerage services, as share of gross disposable income (aggregate measure, nominal); Survey of Income and Housing: Mean household rent, mortgage and rates (general and water) payments as share of mean gross household income; Household Expenditure Survey: Mean household rent, mortgage (principal plus interest) and rates payments as share of mean gross household income.
Source: ABS; Grattan analysis

House prices have outstripped incomes since about 2000

Real dwelling prices and full-time weekly earnings, index: 1970 = 100

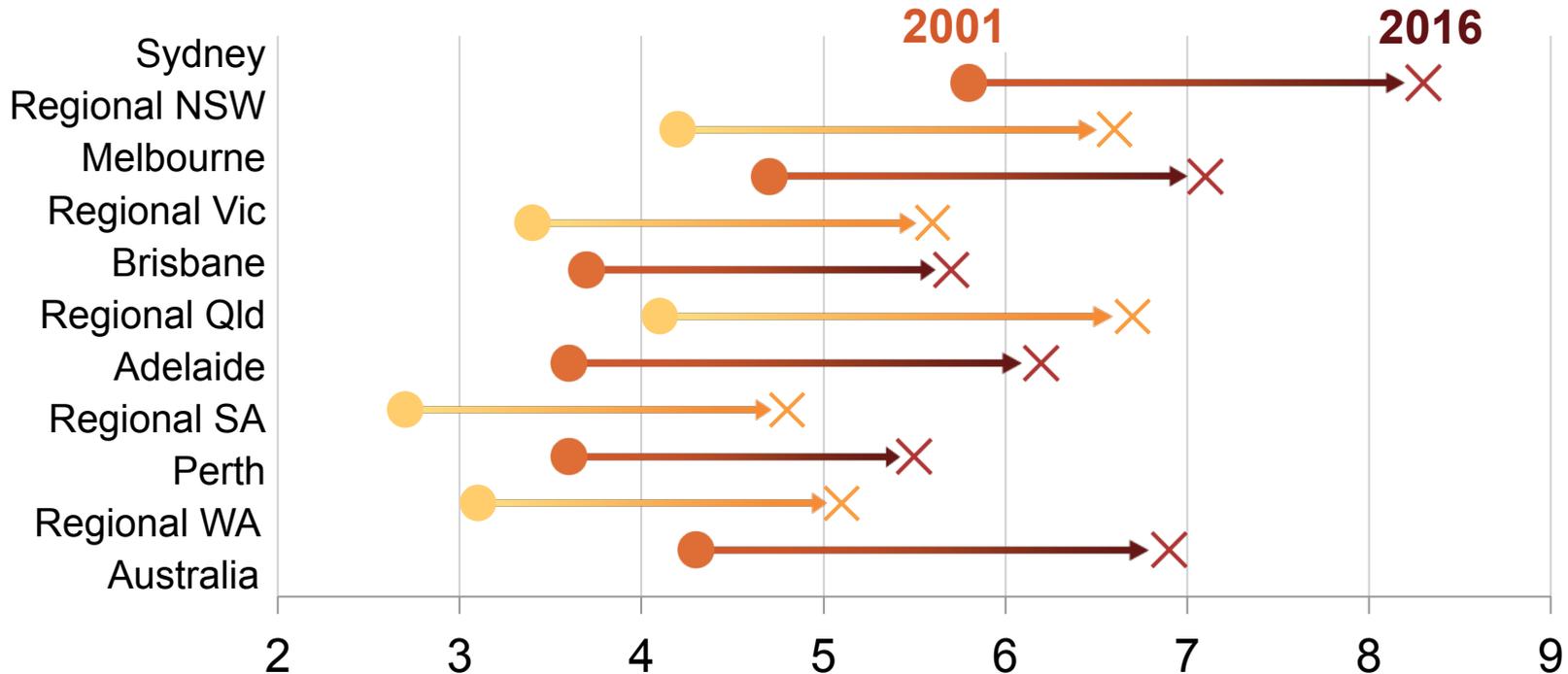


Notes: Data for 1970 to 2010 is from Yates (2011) 'Housing in Australia in the 2000s: On the Agenda Too Late? The Australian Economy in the 2000s'. Data from 2010 is six-monthly growth in ABS 6416.0 residential property price index, deflated by the CPI. Earnings data is from ABS 6302.0, deflated by CPI.

Source: Yates (2011); Grattan Institute, Renovating Housing Policy; ABS.

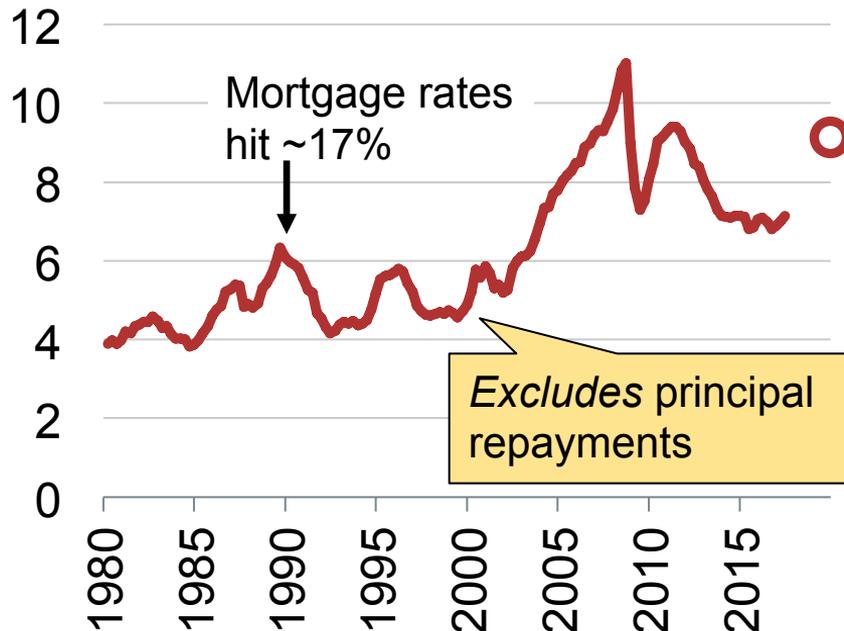
House price to income ratios have jumped in cities AND regions

Ratio of median dwelling price to median annual gross household income

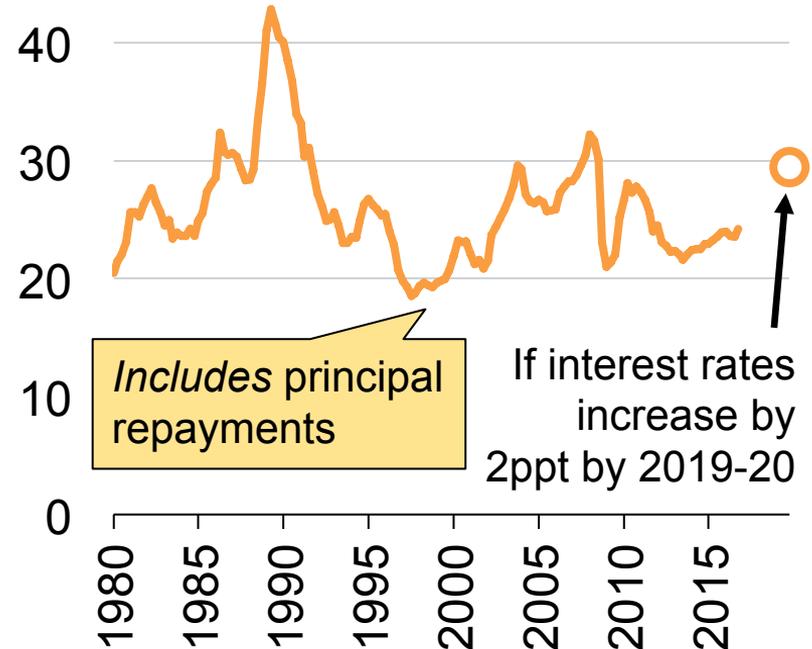


Mortgages servicing costs are well below peaks – provided interest rates don't rise

Mortgage interest payments as a share of total household disposable income



Interest payments on **new mortgage** as a share of mean h/h disposable income

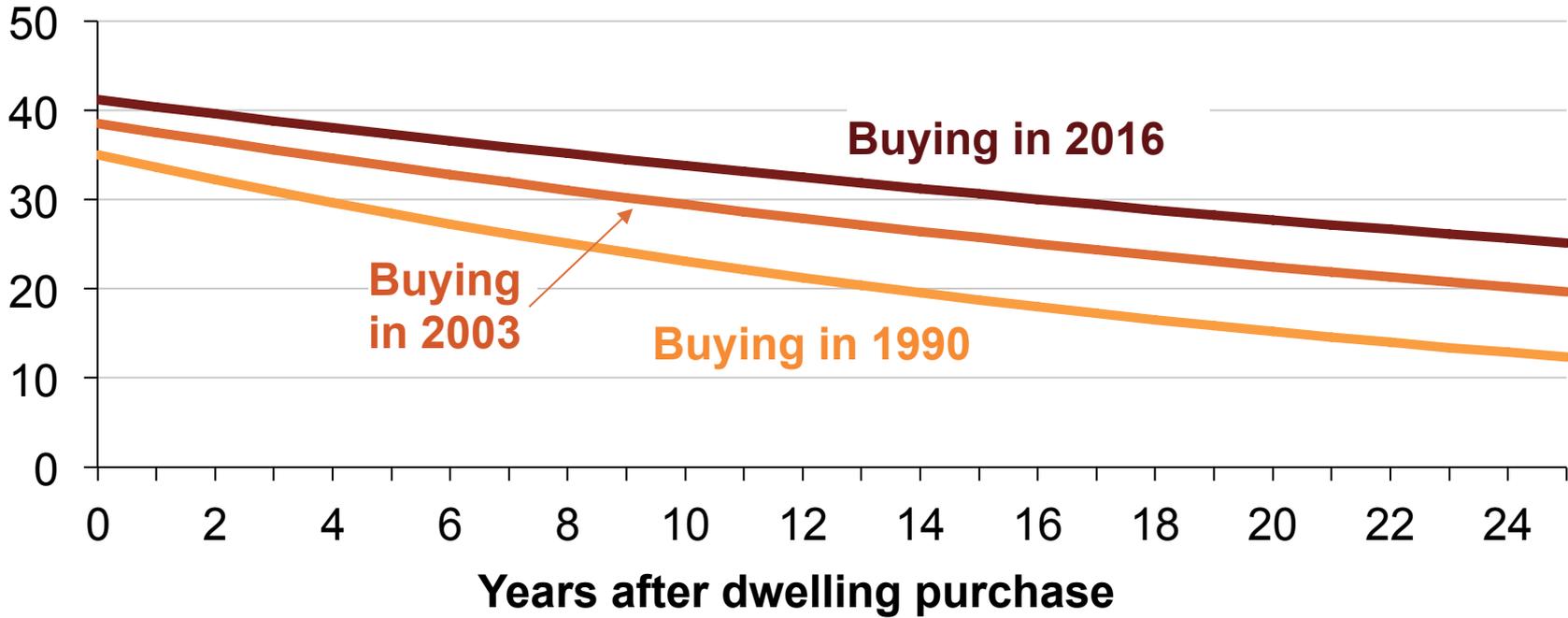


Note: Projection is for December 2019, if mortgage rates increase by ~2ppt and incomes grow at 3%. RHS assumes first home buyer mortgage is 80% LVR on the average Australian residential dwelling price, using house price index changes from BIS prior to 2011. Mean income is gross disposable income from National Accounts measure of income (based on ABS), which includes superannuation income and imputed rent, and before interest payments. Applies then current Interest rates, using standard mortgage rates until 2004, then discounted. Future scenario assumes house prices and incomes grow at 3% a year.

Source: RBA Statistical Tables, E2: Household finances – selected ratios; ABS; Grattan analysis..

A home is harder to pay off given larger loans and low wages growth

Mortgage repayments on an average house as a proportion of median household income, assuming 20% deposit, 25 year principal and interest loan

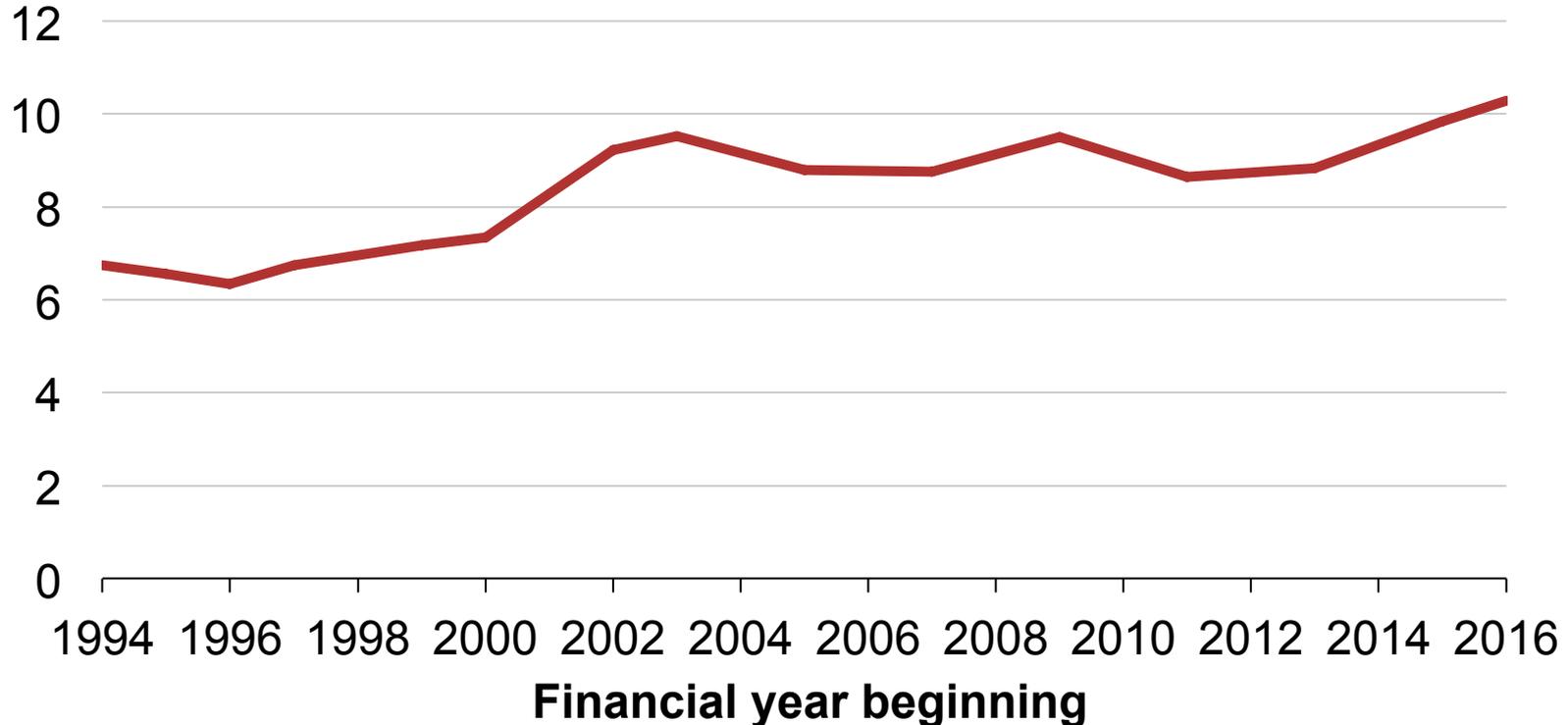


Notes: 2016 average dwelling price is \$644,000; 2003 house price is \$317,000, 1990 house price is \$140,000. Mortgage repayments on an average house (20% deposit), 25 year principal and interest loan. Average wages and interest rates over life of loan. Current wage growth and interest rates projected forwards. .

Source: ABS; RBA; Grattan analysis; CoreLogic Australia (2016).

It is harder to save a 20% deposit – although banks are now more flexible on deposit size

Years to save a deposit for average residential dwelling

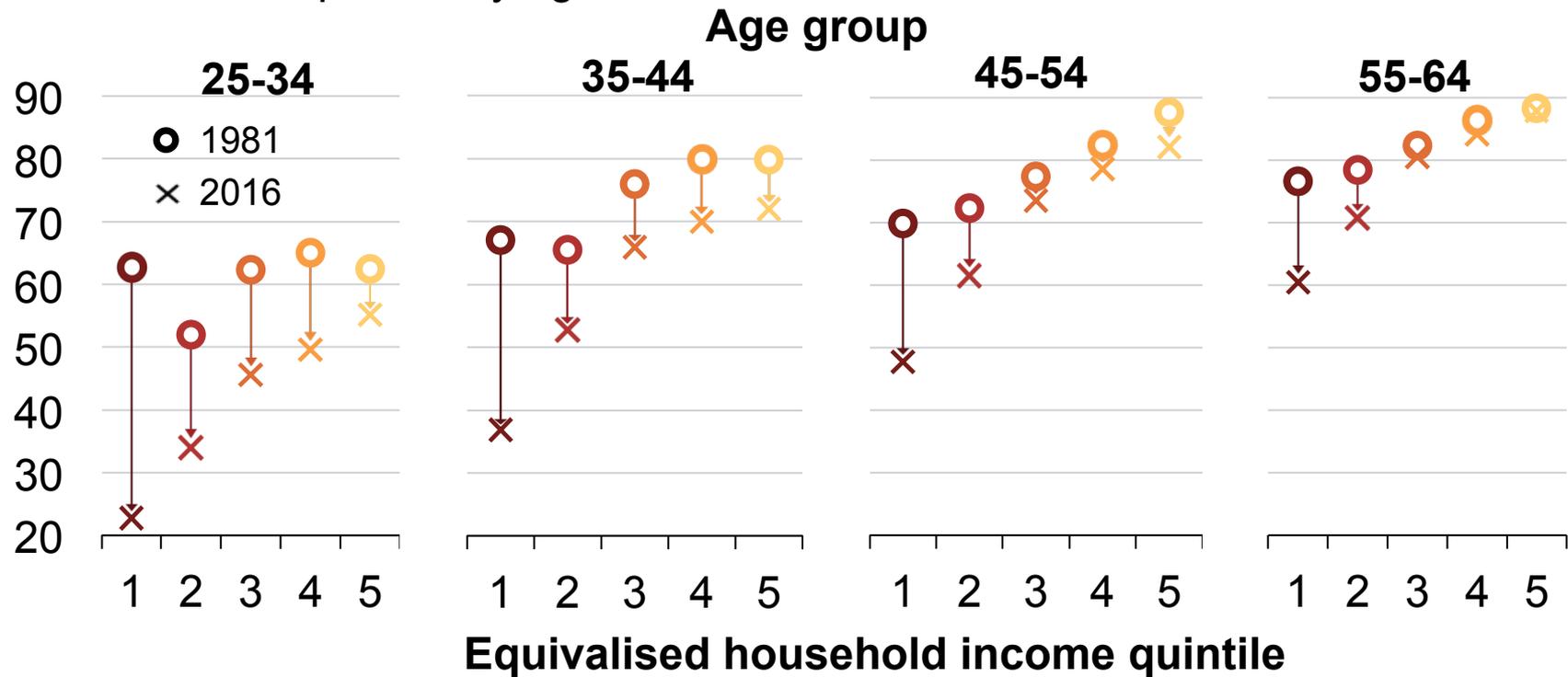


Notes: House price is average residential dwelling price from ABS 6416.0. Assumes deposit is formed by saving 15 per cent of gross household income, projected forwards by average growth in the wage price index.

Sources: ABS; RBA; Grattan analysis

Home ownership is falling particularly fast among younger low-income earners

Home ownership rates by age and income, 1981 and 2016

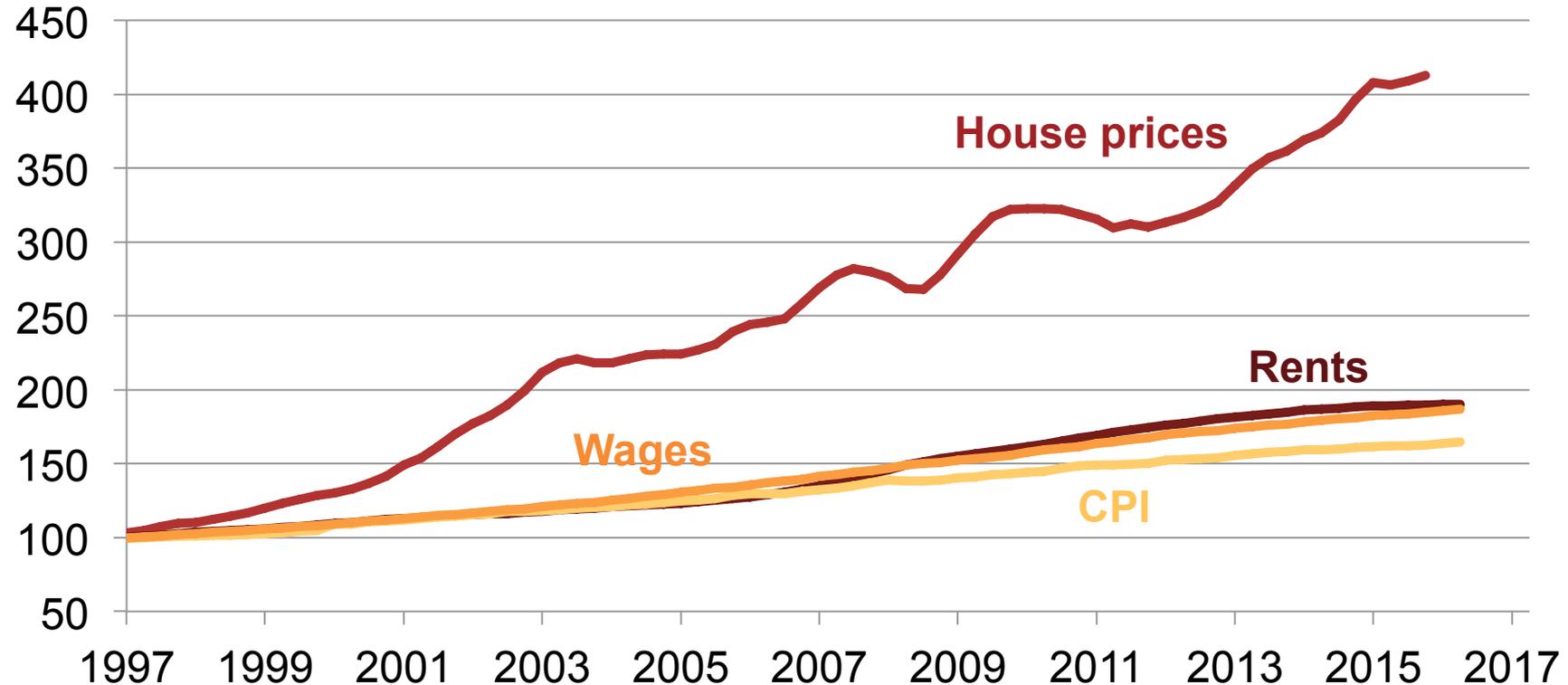


Notes: This graph updates Burke et al 2014 using Census data obtained from the ABS. Limitations in Census calculations of household incomes means that changes in home ownership rates by age and income are indicative and small changes in ownership rates should be ignored. Excludes households with tenancy not stated (for 2016) and incomes not stated. Uses age of household reference person and equivalised household income quintiles.

Source: ABS Census; Burke et al 2014 'Generational change in home purchase opportunity in Australia'; Grattan Institute

(Quality-adjusted) rents have grown in line with wages

Nominal, index, 1997 = 100



Housing is both an asset, and somewhere we live

“If housing is fairly valued – in the sense that the price of housing is equal to the present discounted value of the future rents – then the rise in prices implies an increase in the expected future cost of housing services.”

*Philip Lowe
Deputy Governor, Reserve Bank of Australia*



Who wins and loses from rising house prices?

Winners

- Australians that own their home and an investment property
- Older Australians that own their own home
- Younger Australians that own their home *probably win* (but not by much)

Losers

- Younger Australians that own a home, but will need a bigger one in future *probably lose*
- Renters

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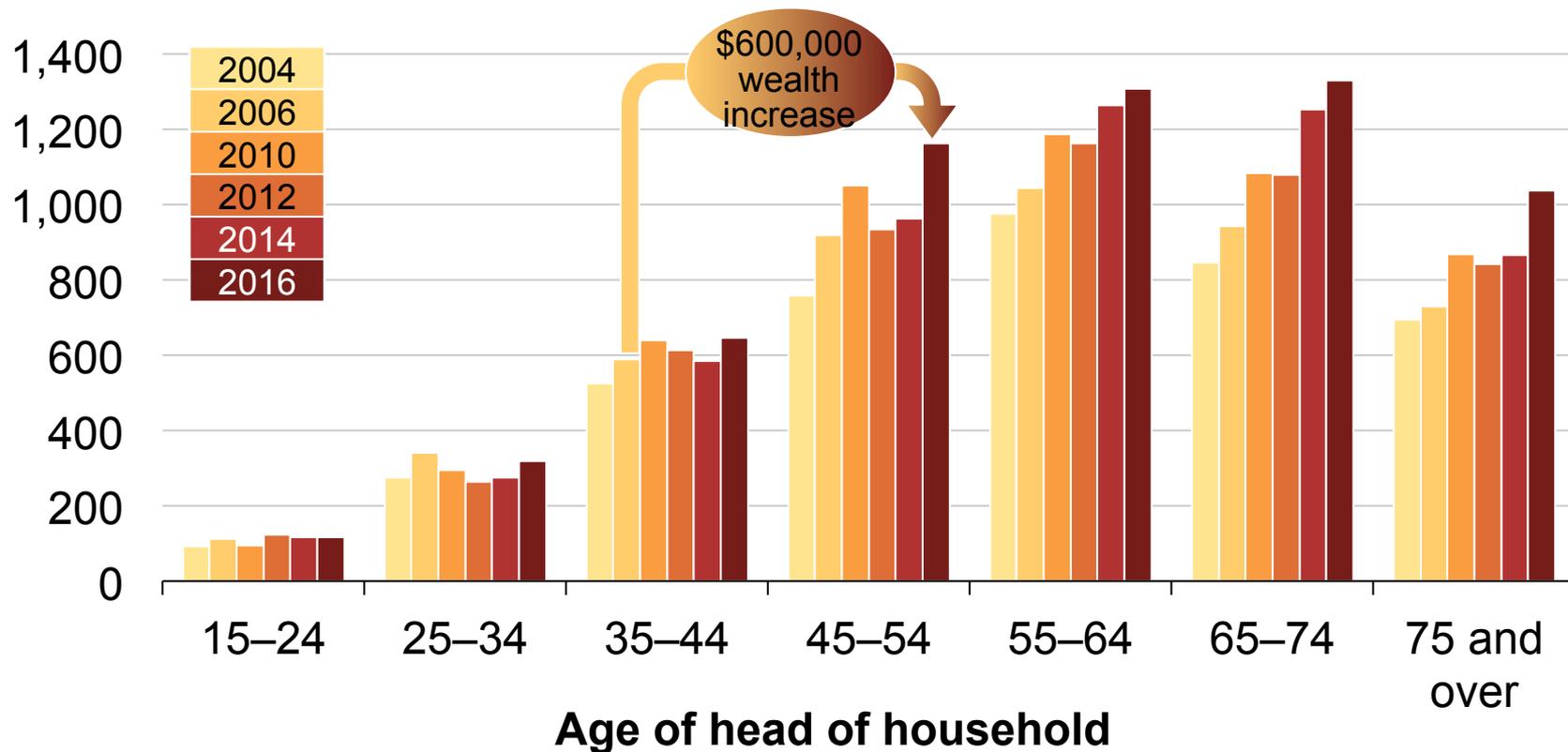
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In time their children will win (or lose) too

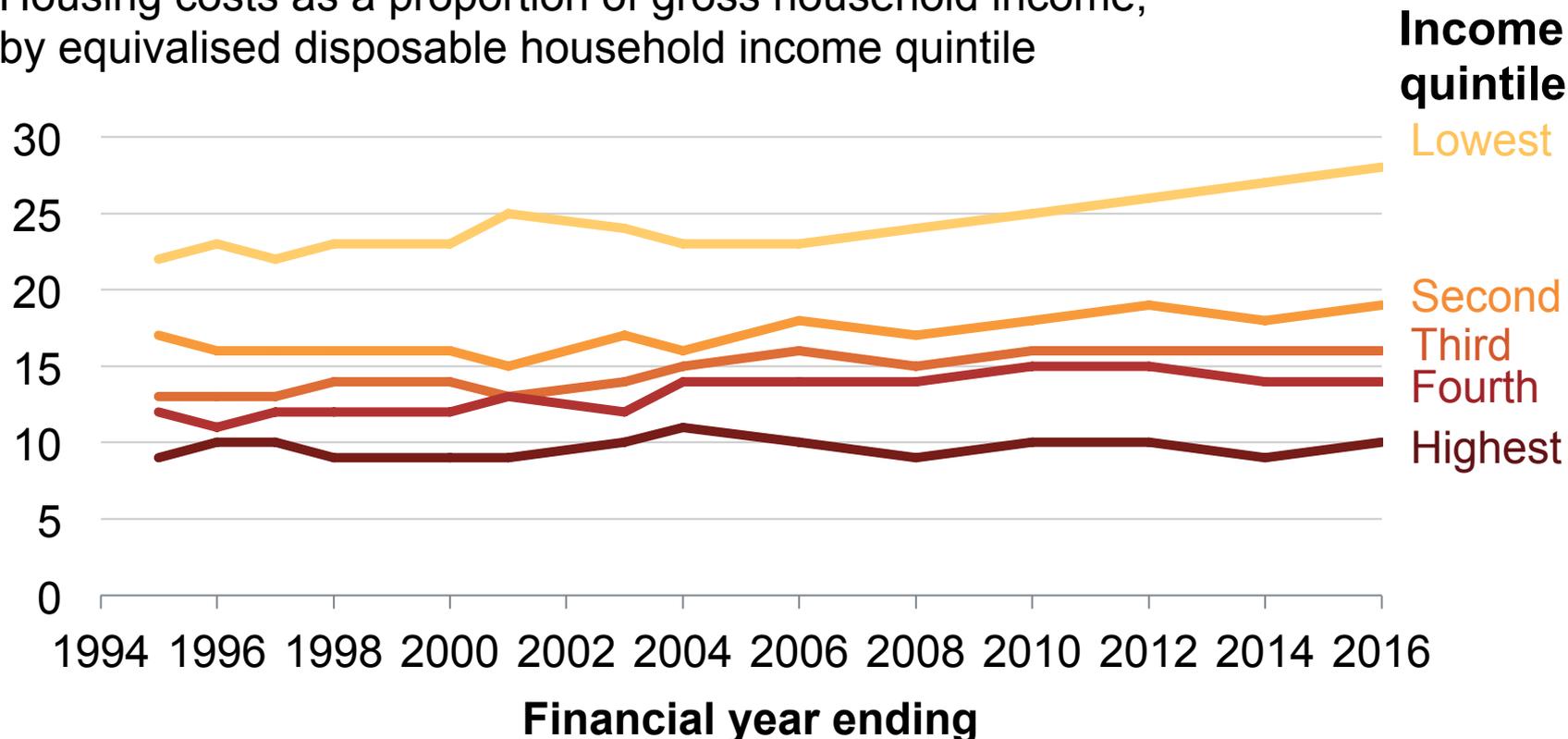
Older households became wealthy in ways that are unlikely to be repeated

Mean wealth per household, \$2015-16, thousands



Low income households have increased their spending on housing more

Housing costs as a proportion of gross household income, by equivalised disposable household income quintile

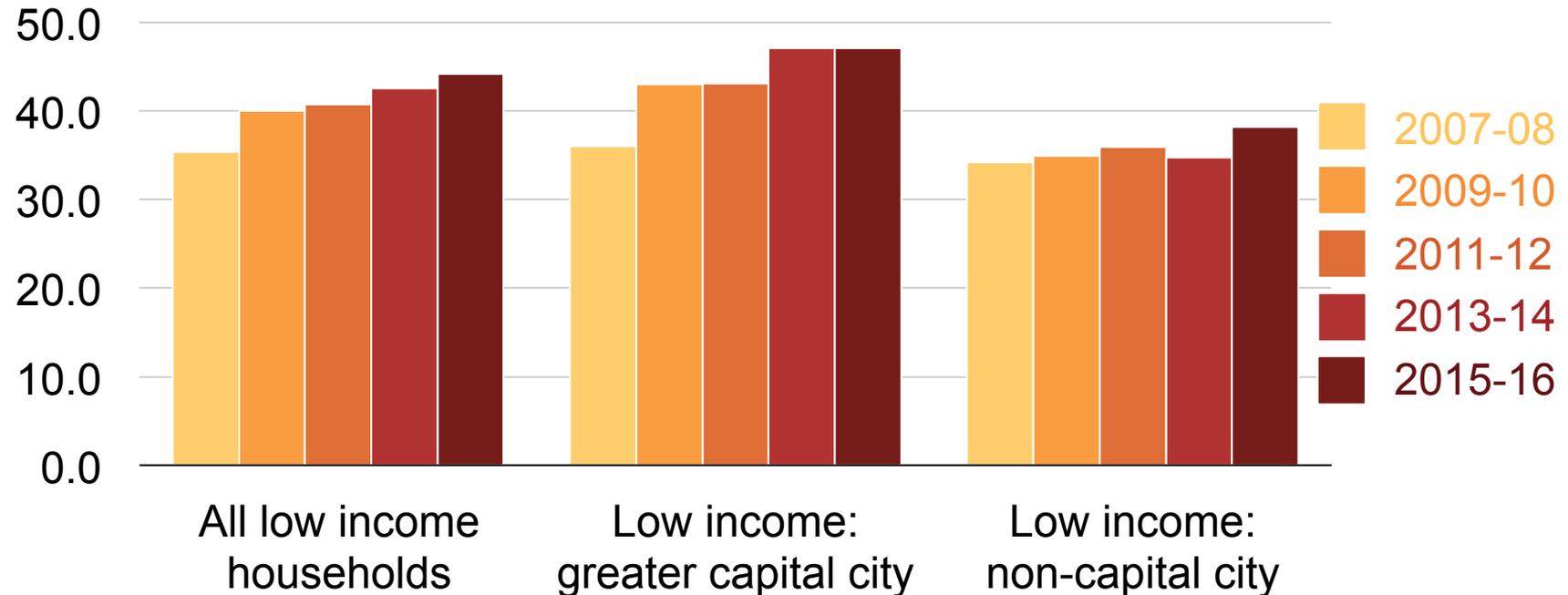


Notes: housing costs include rent, mortgage and rates (general and water) payments as share of gross household income for each quintile. Data interpolated for missing years

Source: ABS 4130.0 Housing Occupancy and Costs

Rental stress among low-income households is increasing in capital cities

Per cent of low-income renters with housing costs more than 30 per cent of gross household income

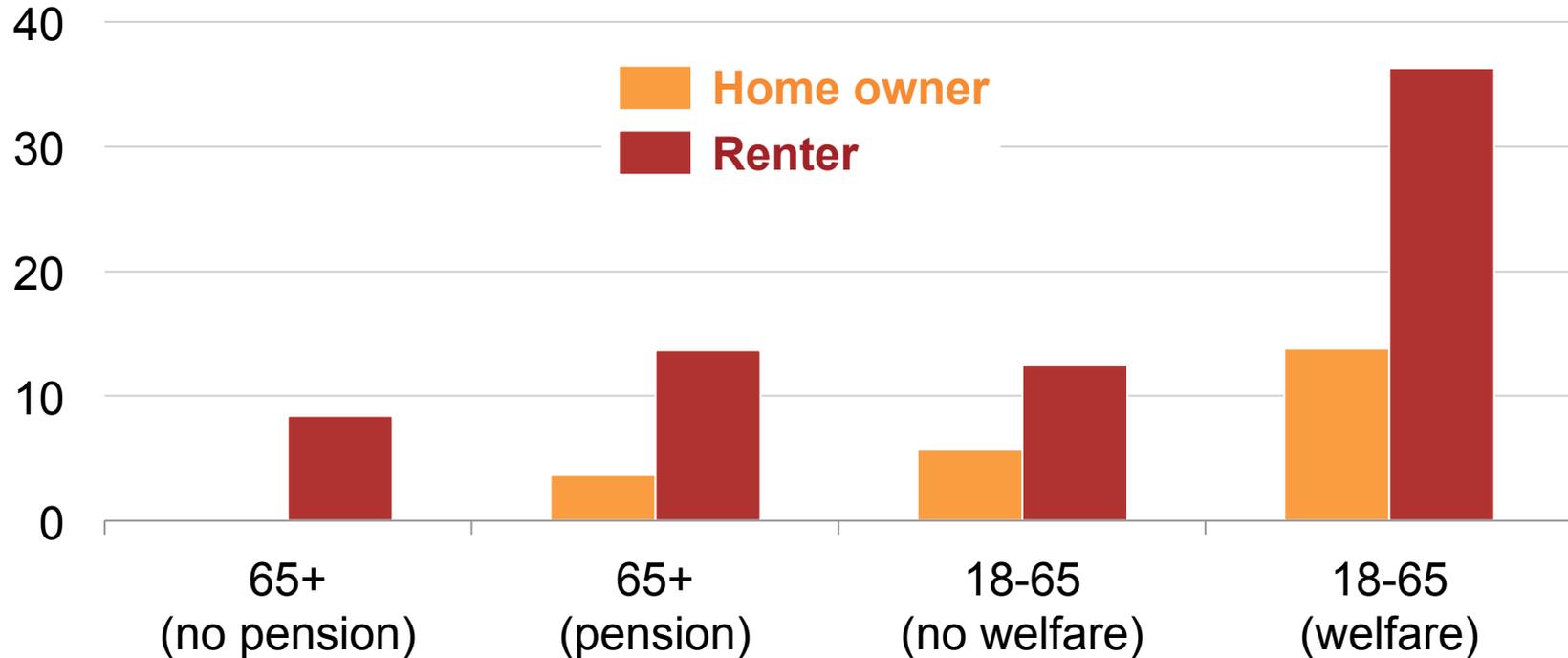


Notes: Low income households are defined as the 40 per cent of households with equivalised disposable household income (excluding Commonwealth Rent Assistance) at or below the 40th percentile.

Source: ABS 4130.0 - Housing Occupancy and Costs

Renters are much more vulnerable – particularly young people on welfare

Percentage of households facing at least one financial stress, 2015-2016

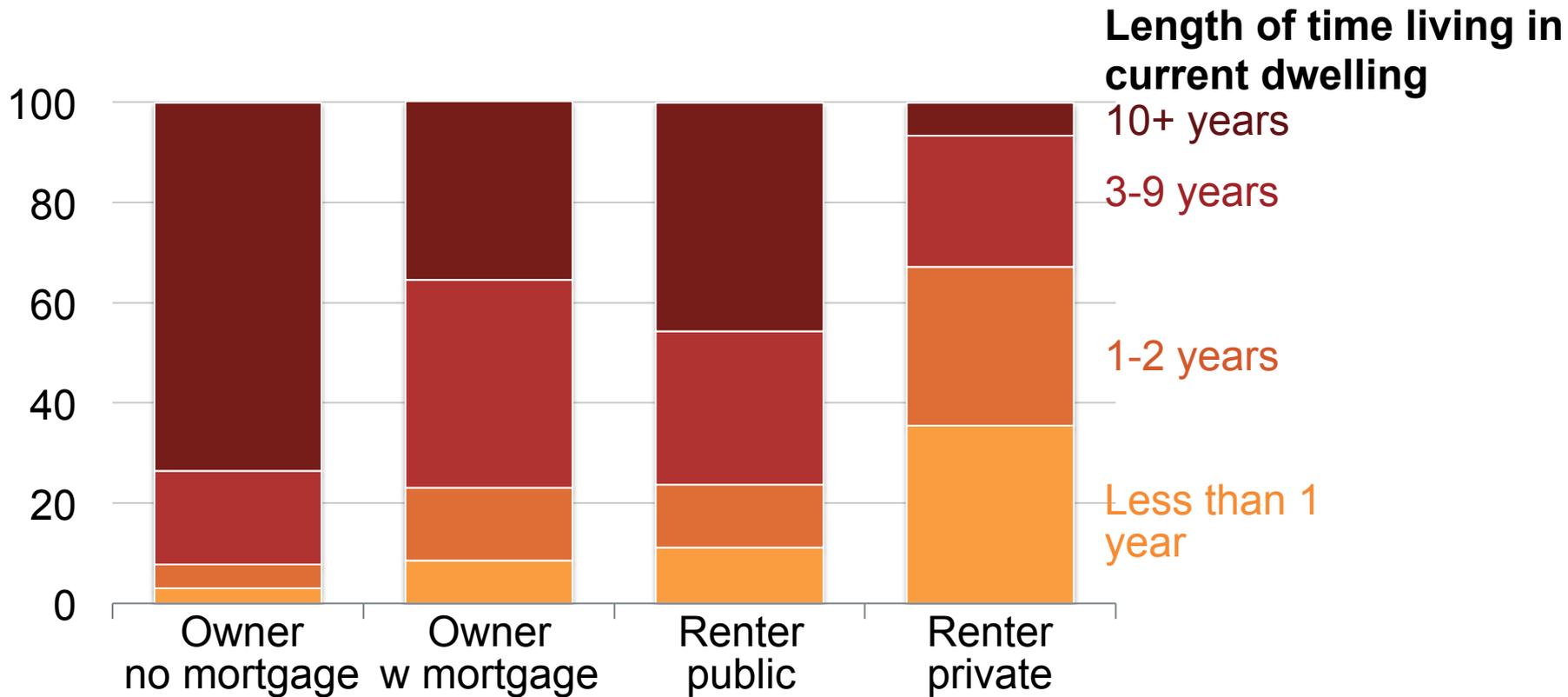


Notes: Financial stress defined as money shortage leading to 1) skipped meals; 2) not heating home; 3) failing to pay gas, electricity or telephone bills on time; or 4) failing to pay registration insurance on time. Pension recipients include everyone over the age of 65 who receives government benefits (excluding unemployment and student allowances). 'Welfare' includes every welfare type excluding parental benefits or the family tax benefits. Recipients of these benefits and no benefits are included in the 'no welfare' category.

Sources: ABS Household Expenditure Survey 2015-16, Grattan analysis.

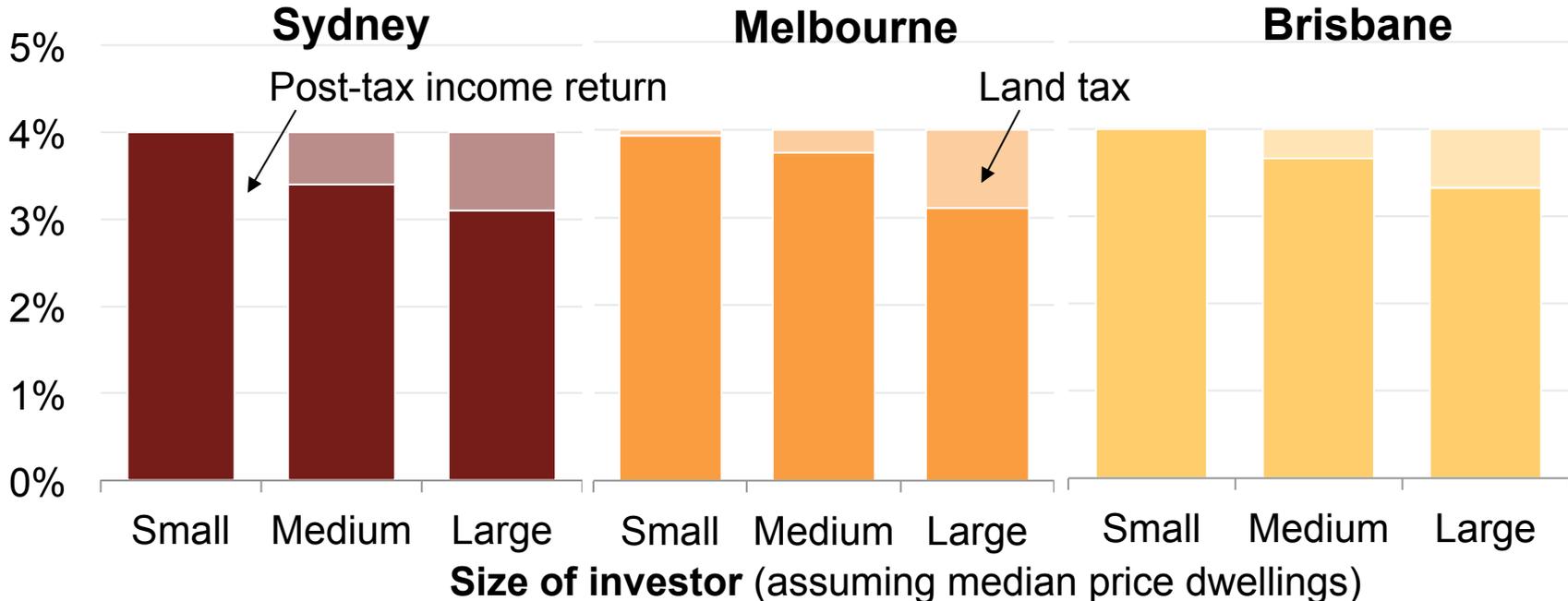
Renters move more often than owners

Proportion of category, by length of time living in current dwelling



Land taxes discourage large residential investors

Land tax paid and post-tax income return, % of asset value

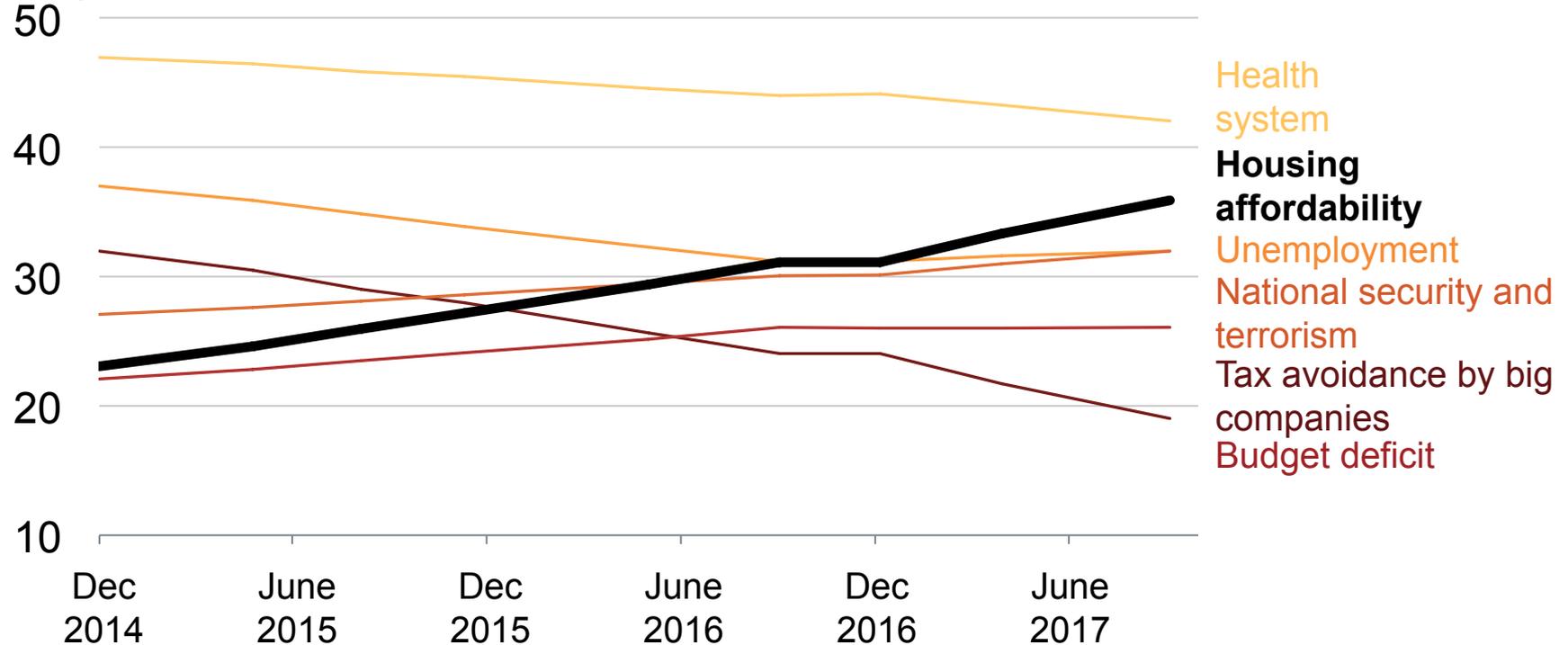


Notes: Assumes a small investor owns one property, a medium investor owns five properties and a large investor owns 25 properties. Sydney example based on \$880,000 median-priced dwelling. Melbourne example based on \$720,000 median priced Melbourne dwelling. Brisbane example based on \$490,000 median-priced Brisbane dwelling and 'large investor' is subject to land tax regime for resident individuals. For all three cities, assumes 4 per cent gross rental return and land value is assumed to be half the value of the property. Ignores deductibility of land tax costs against income in personal and corporate income tax returns.

Sources: NSW Office of State Revenue (2018), State Revenue Office Victoria (2017a), Queensland Office of State Revenue (2018), and ABS (2017c); Grattan analysis.

People are increasingly concerned about housing affordability

Per cent of responses to question, “What are the three most important issues for government?”



Notes: Top six concerns in 2017 shown. Some questions change slightly across surveys.
Sources: AHURI (2017) and Essential (2017).

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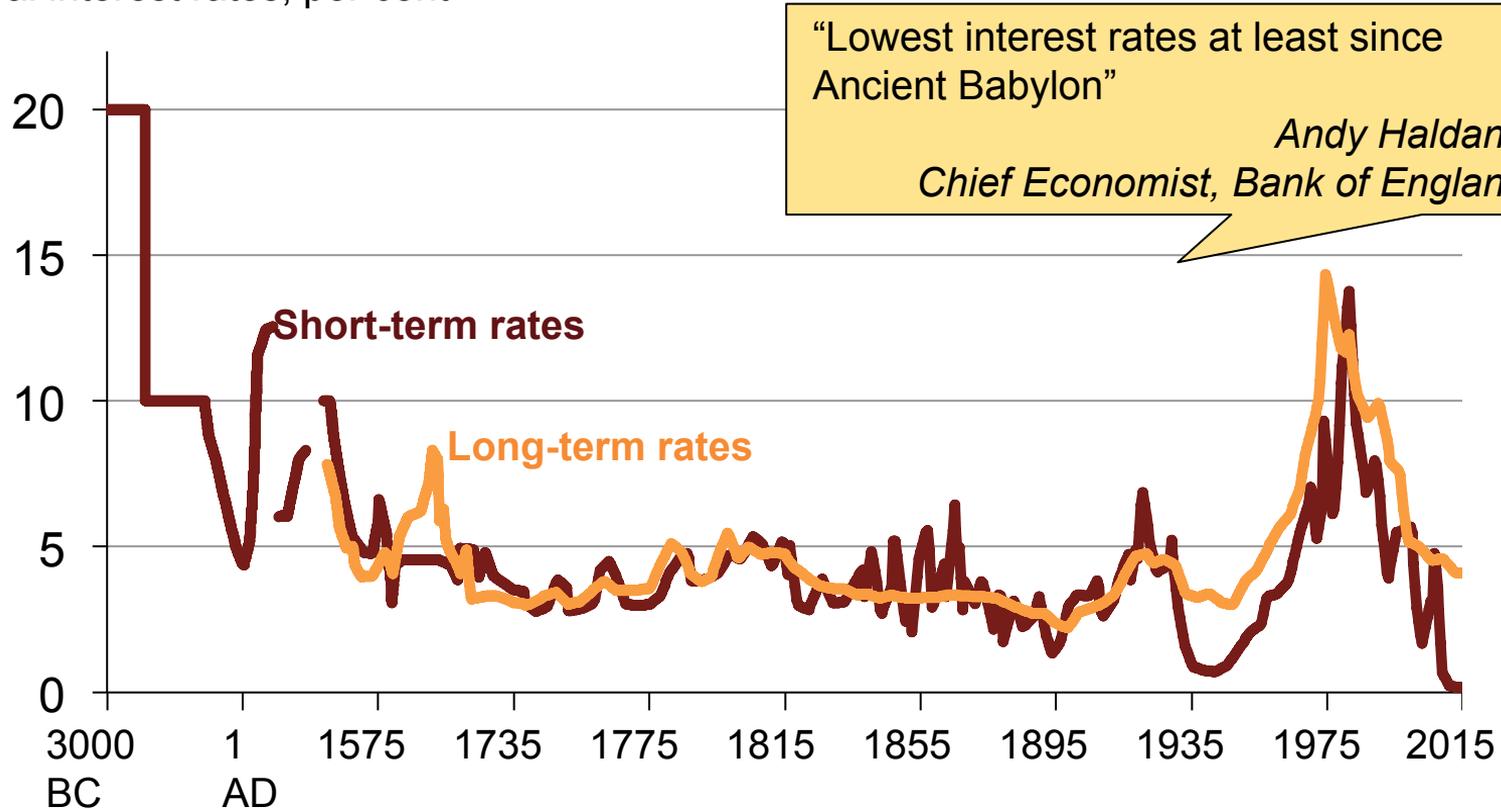
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Policies that would help require some tough calls

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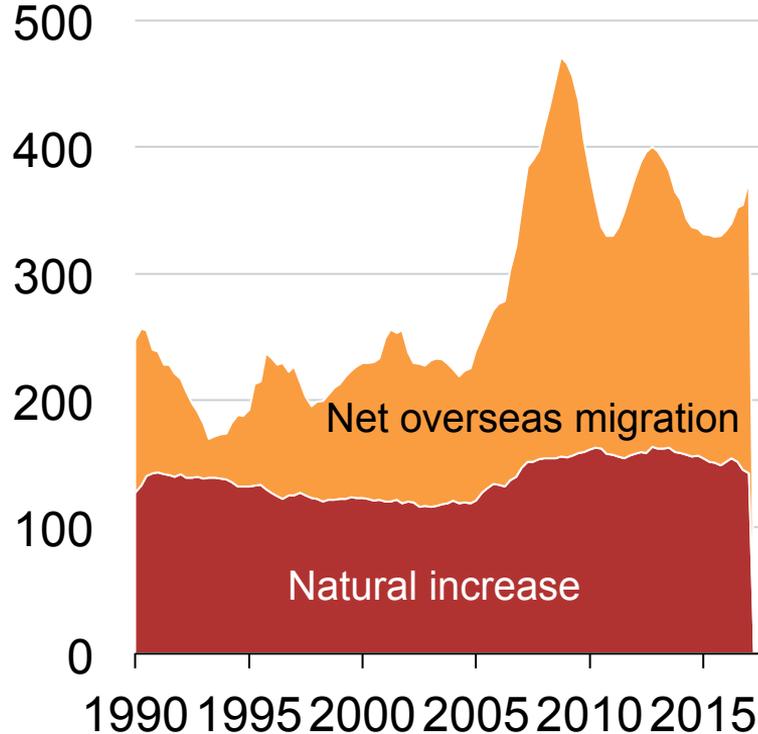
Interest rates are very low by historic standards

Global interest rates, per cent

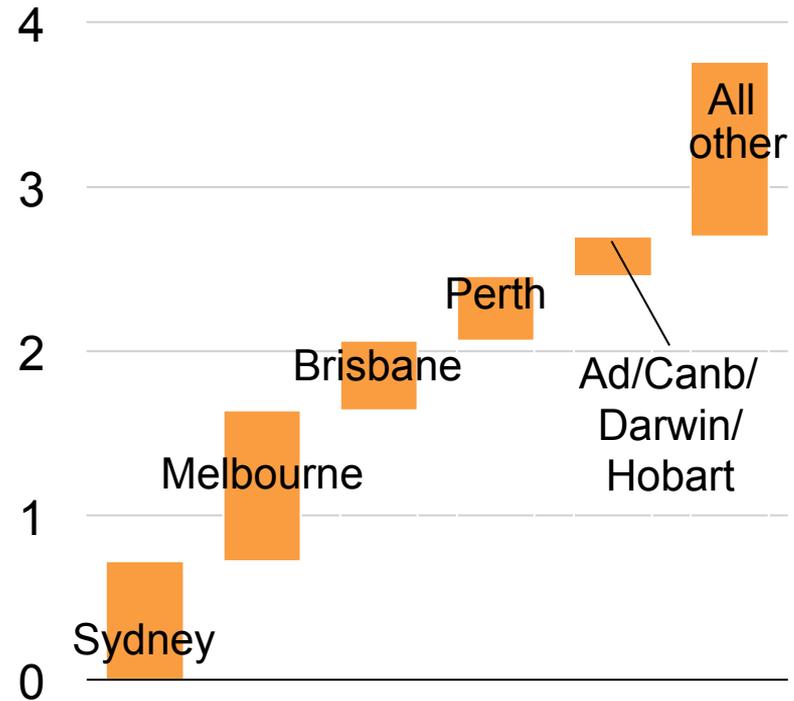


Migration was much higher 2006-2016, and so capital city populations jumped

Annual resident population growth, 000s



Total population growth, 2006 to 2016, millions

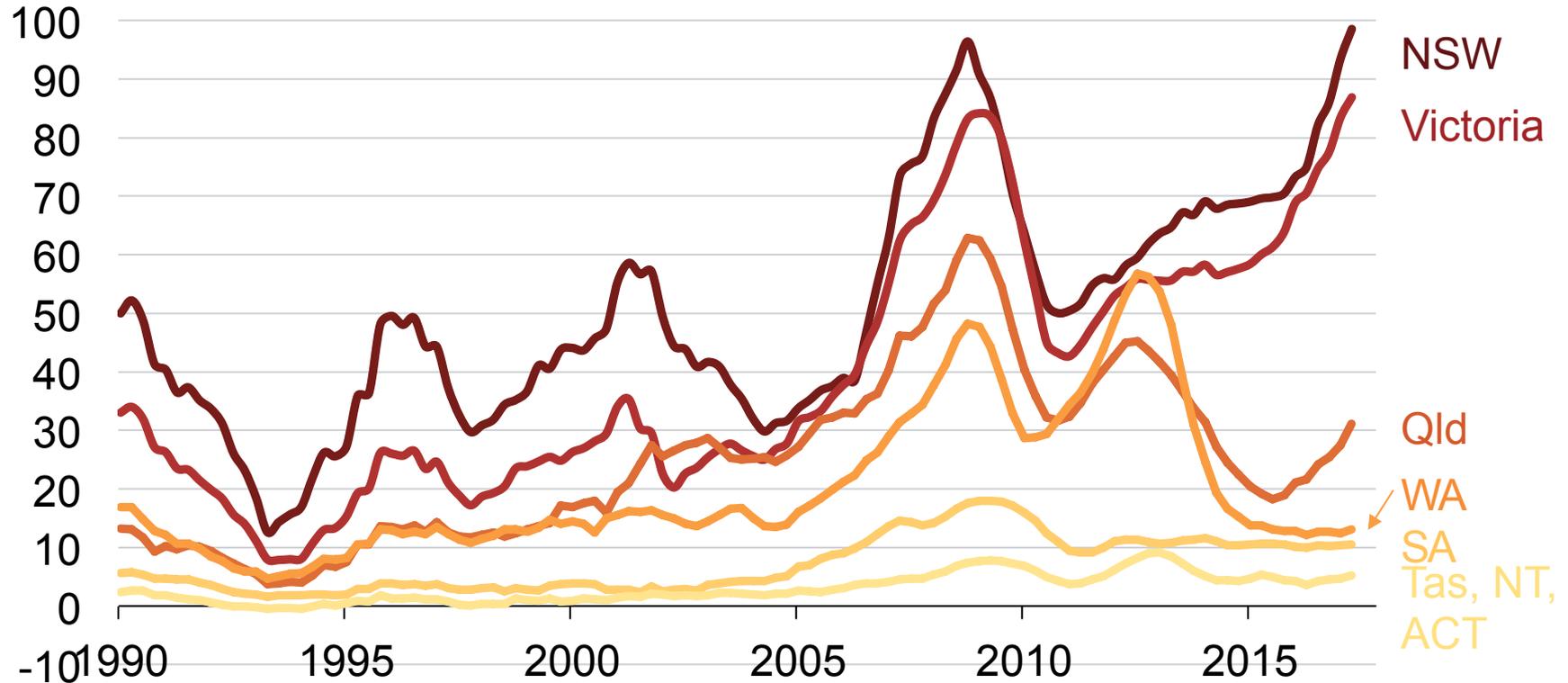


Notes: for left-hand side, series break in 2006 when 'net overseas migration' definition was changed

Source: ABS 3101.0 - Australian Demographic Statistics, December 2016; ABS 3218.0 Regional Population Growth, Australia, 2016

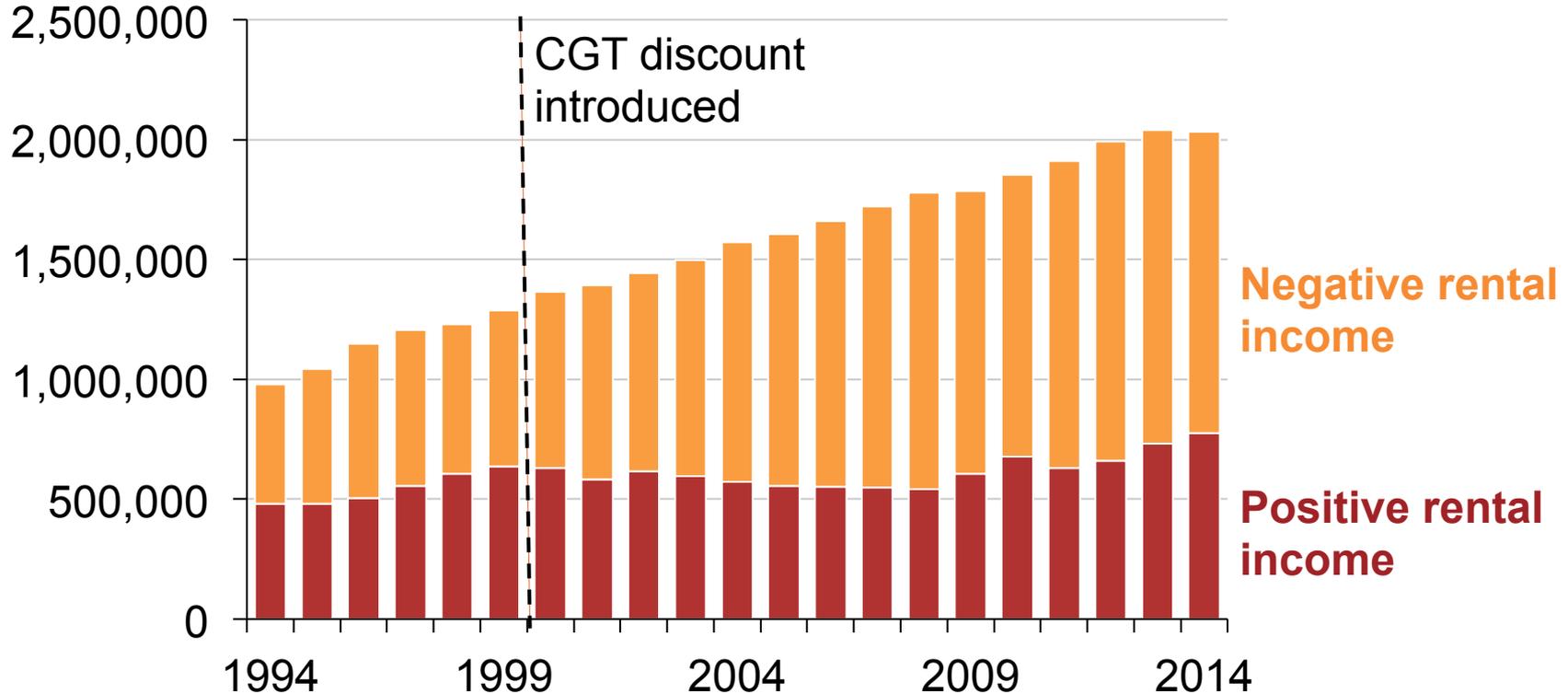
Net overseas migration into NSW and Victoria is at record levels

Net overseas migration, four-quarter rolling sum, thousands



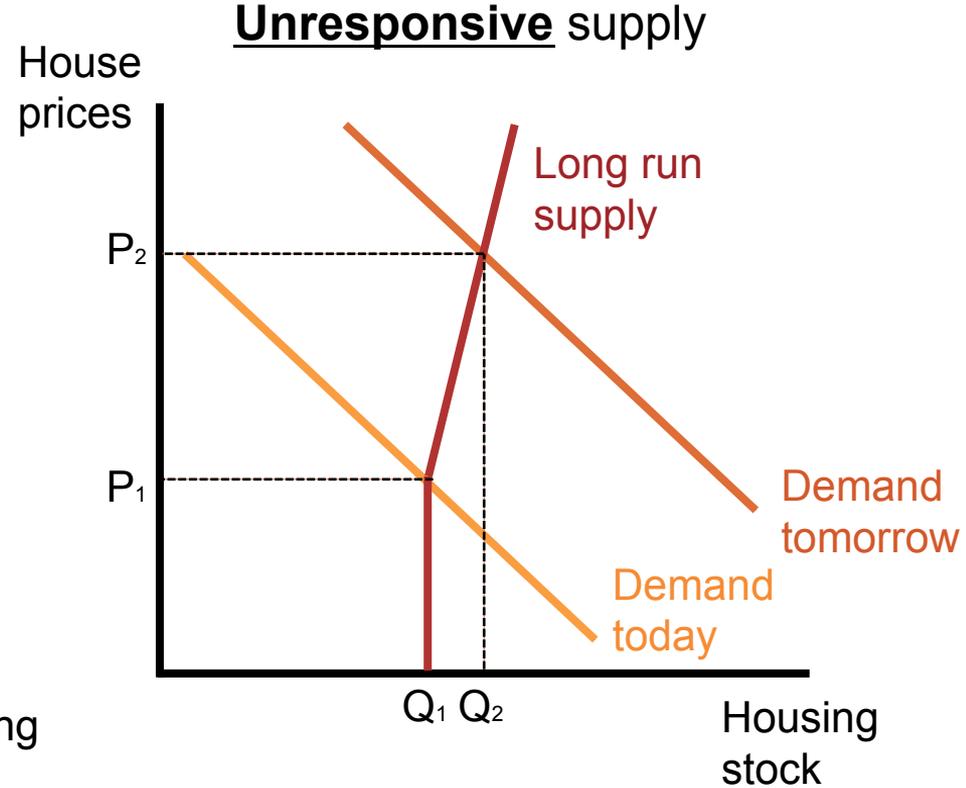
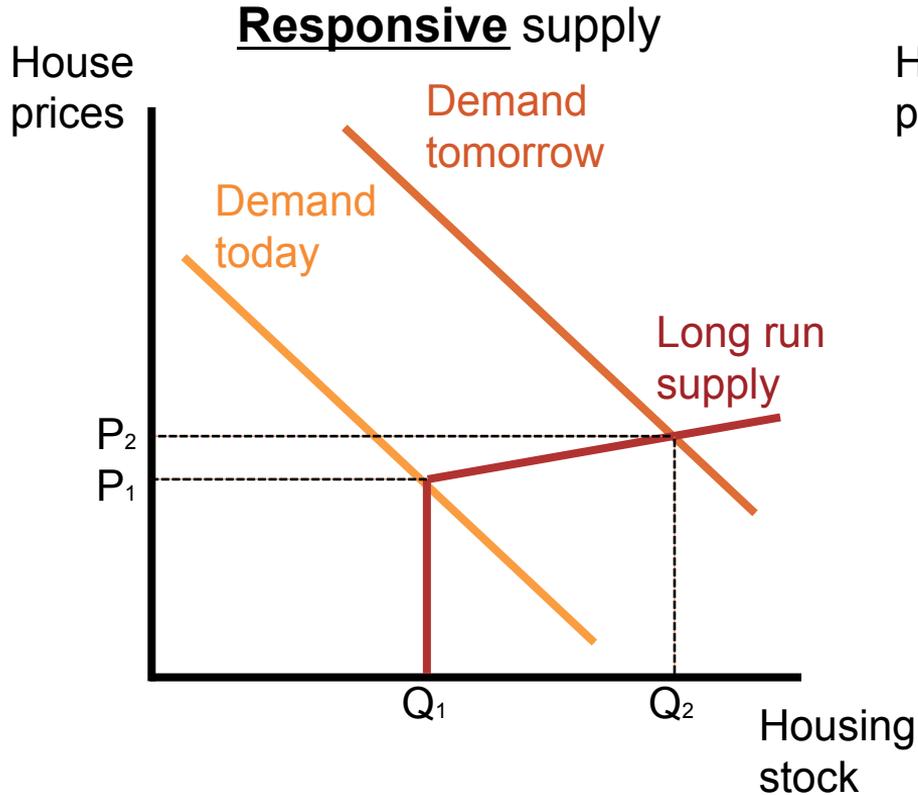
Almost all the net new property investors since 1999 have been negatively geared

Number of landlords



Notes: Total net rent is the sum of net rental losses and profits across all landlords as marked on their tax returns.
Source: Daley et al. (2016a); ATO, Tax stats 2013-14

A lot depends on how housing supply responds to rising demand



International literature says supply matters and restrictive planning increases prices

Housing prices reflect rising land values

Knoll, Schularick and Steger (2017) – rising land prices explain about 80% of the global house price boom since World War II in 14 advanced economies (including Australia).

Strict land use planning rules raise house prices

Glaeser and Gyourko (2018) – most US cities don't have a housing supply problem, but cities where house prices > social costs of building new housing (NYC, San Fran, LA, Boston) have most restrictive land use planning rules.

Hilber and Vermeulen (2016) – house prices in UK south-east would be 35% lower if as many planning permits issued as the north east.

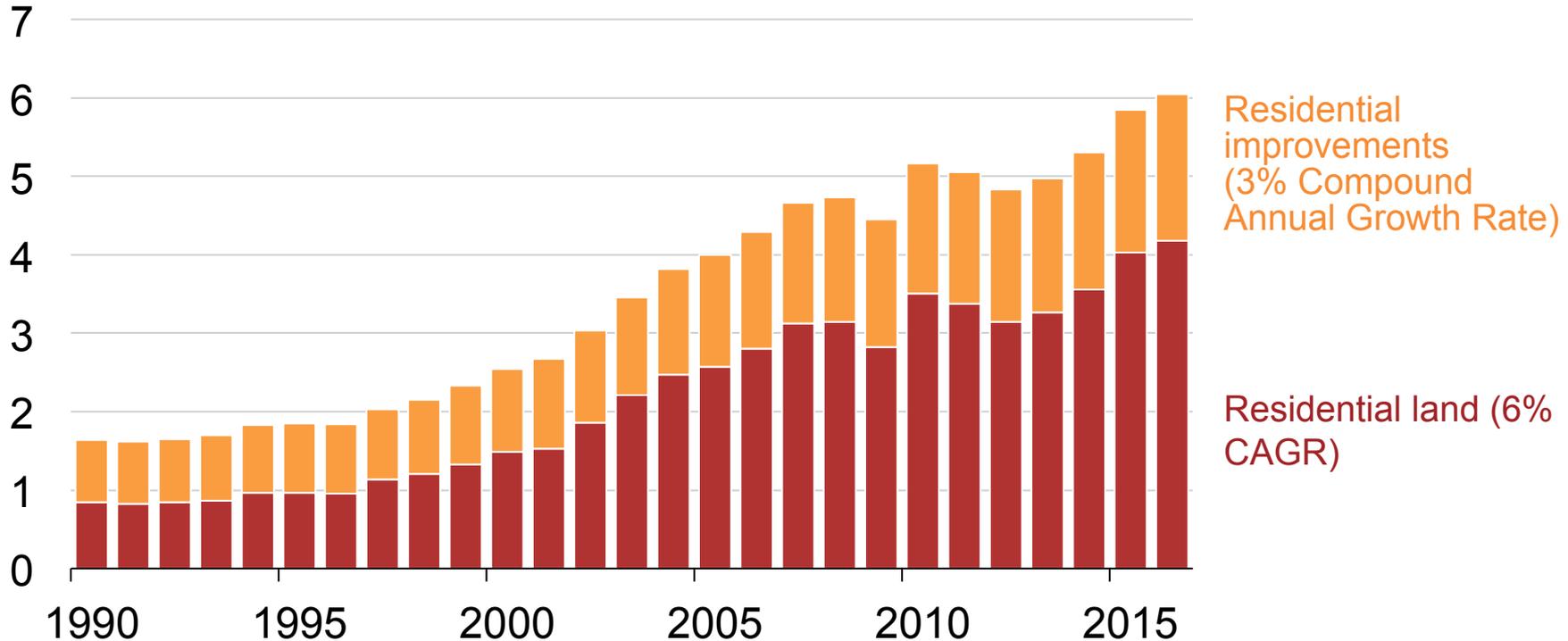
Saiz (2010) – both zoning regulations and geographic constraints affect housing supply, and geographically constrained cities have tighter zoning regulations.

Gyourko and Molloy (2015) – literature review finds “vast majority” of studies show areas with more regulation have higher house prices, less construction.

Lees (2017) – Land use regulation accounts for large share of the cost of homes in major New Zealand cities including Auckland (56%) and Wellington (48%).

Housing prices increased mainly due to higher land values

Real market value of Australian property, \$2016, trillions

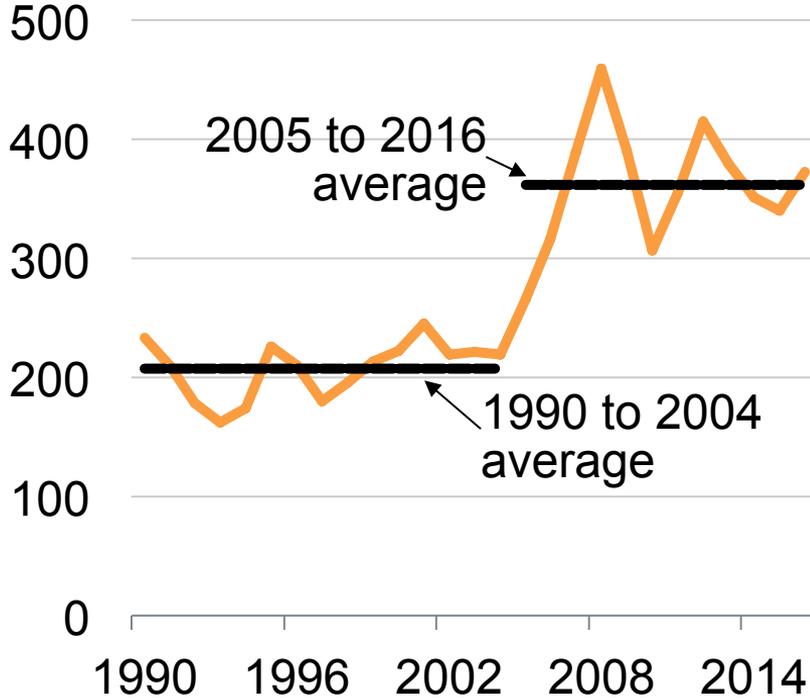


Notes: 'Residential improvements' consists of the value of the stock of dwelling construction; historical figures are deflated by the Consumer Price Index to \$2016.

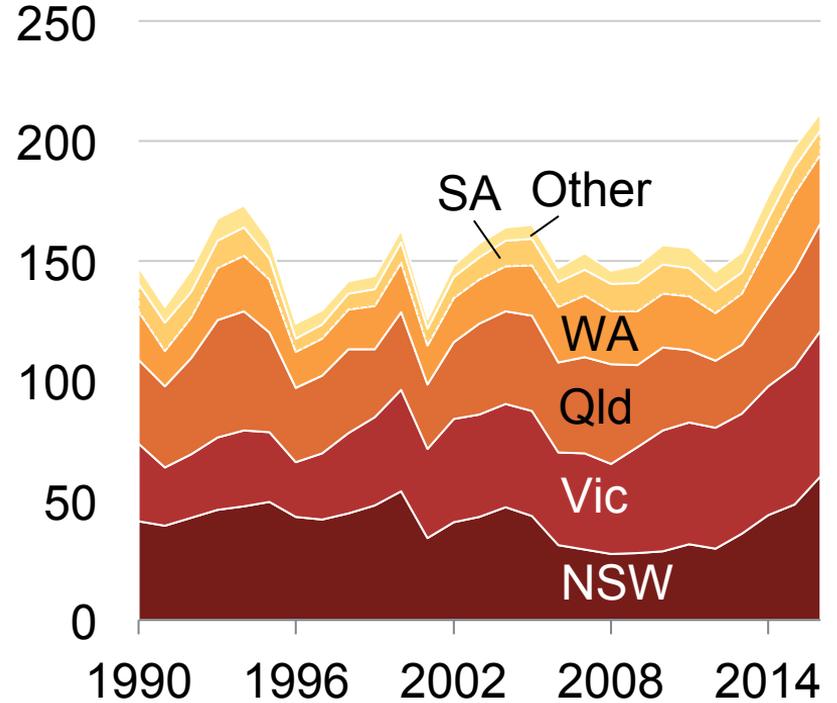
Source: ABS 5204.0; ABS 6401.0; Grattan analysis.

Population growth jumped, but construction did not

Population increase per year, '000

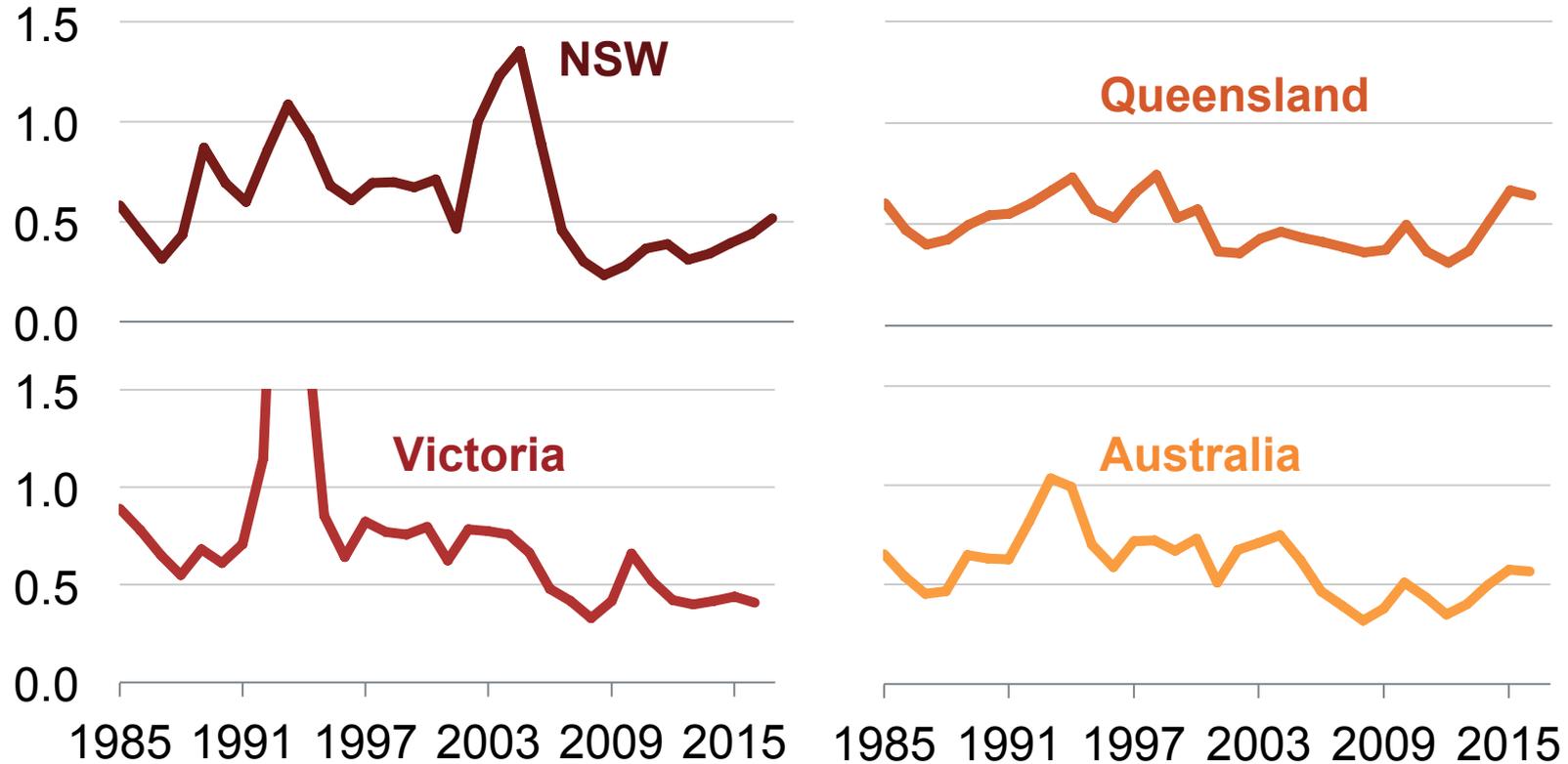


Dwellings completed per year, '000



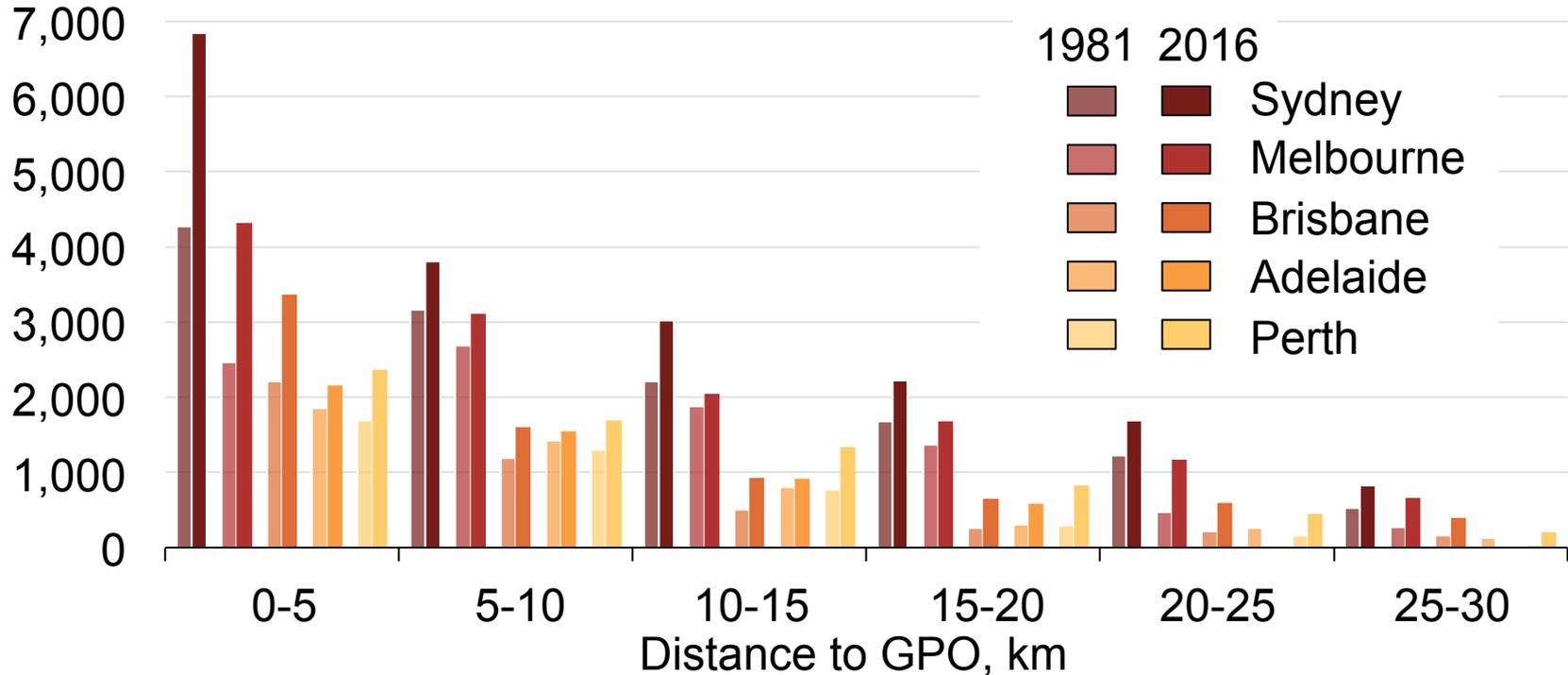
Housing construction lagged population growth between 2006 and 2016

Dwelling completions per additional person



Population density increased in the centre, but not much in the middle rings

Population density, 1981 and 2016, persons per square kilometre

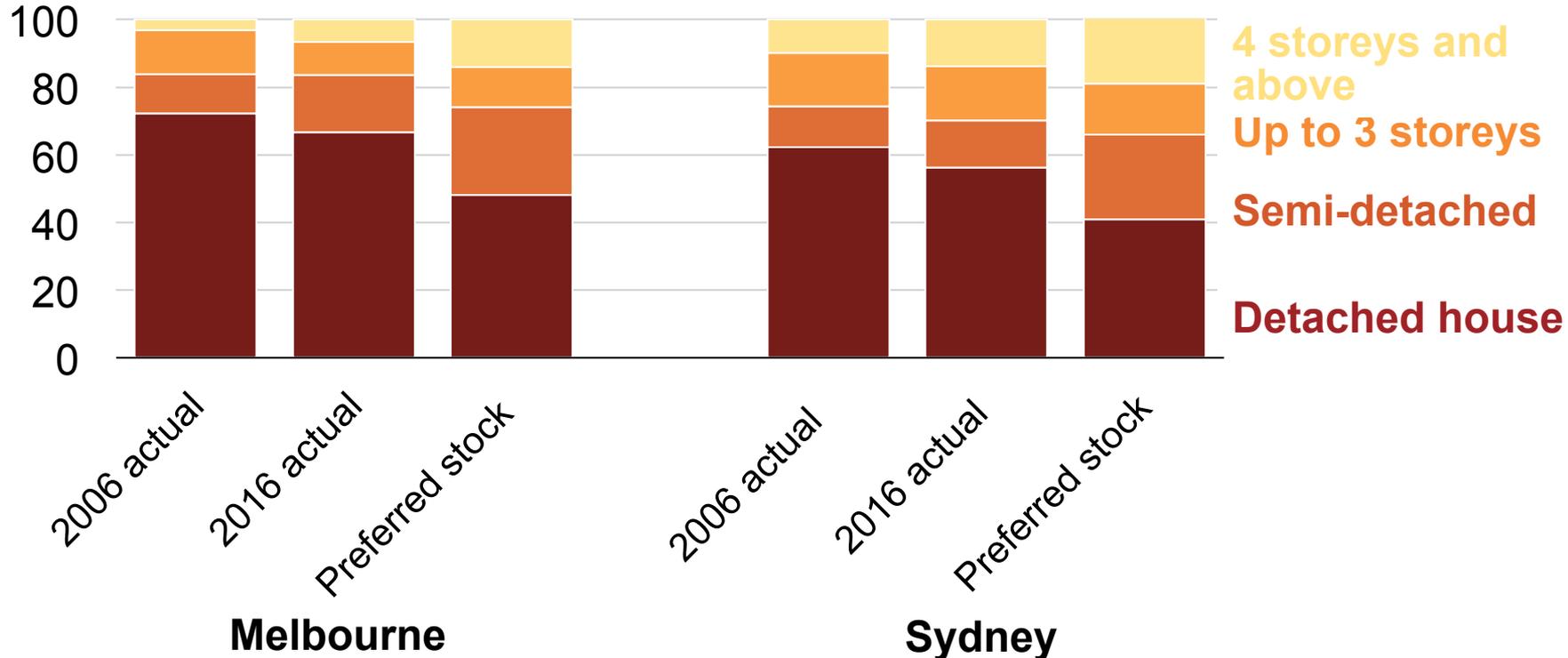


Notes: Coffee et al. (2016) updated using 2016 Census data, based on SA1 geographic units. Capital city boundaries in 2016 are Greater Capital City Statistical Areas. Population density for Adelaide in 2016 is only shown to 20km from GPO as Greater Capital City Statistical Area is significantly different to the 1980 Statistical Division boundary

Source: Coffee et al (2016); Census 2016; Grattan analysis.

The housing stock is shifting in our capital cities, but there is still a way to go

Per cent of housing stock, actual and preferred

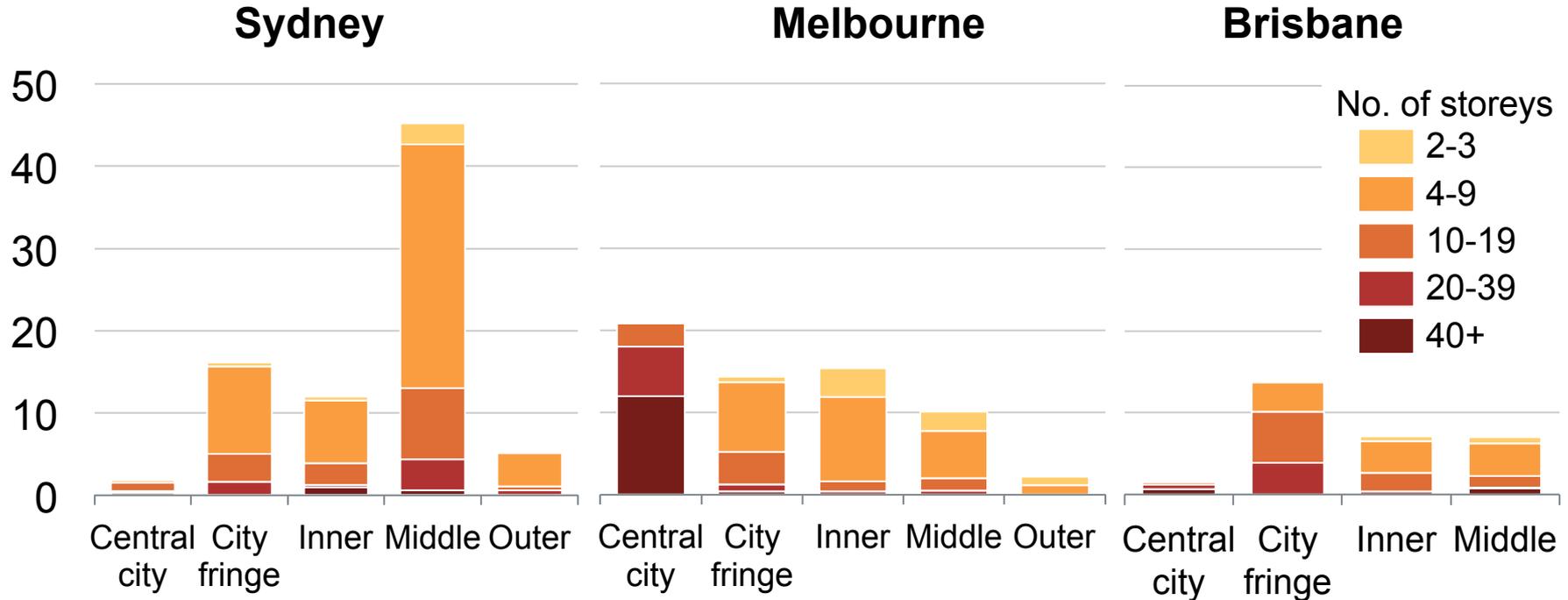


Notes: 'Preferred stock' is from the survey of 700 residents about housing preferences from Grattan's 2011 report, The housing we'd choose. Data may not sum to 100 due to rounding. Excludes dwellings listed as 'Not stated' and 'Other dwellings', such as caravans.

Source: Census; Housing we'd choose; Grattan analysis.

Melbourne supply is dominated by CBD high rise; Sydney by middle ring low rise

Apartment completions, 2014-2017, thousands

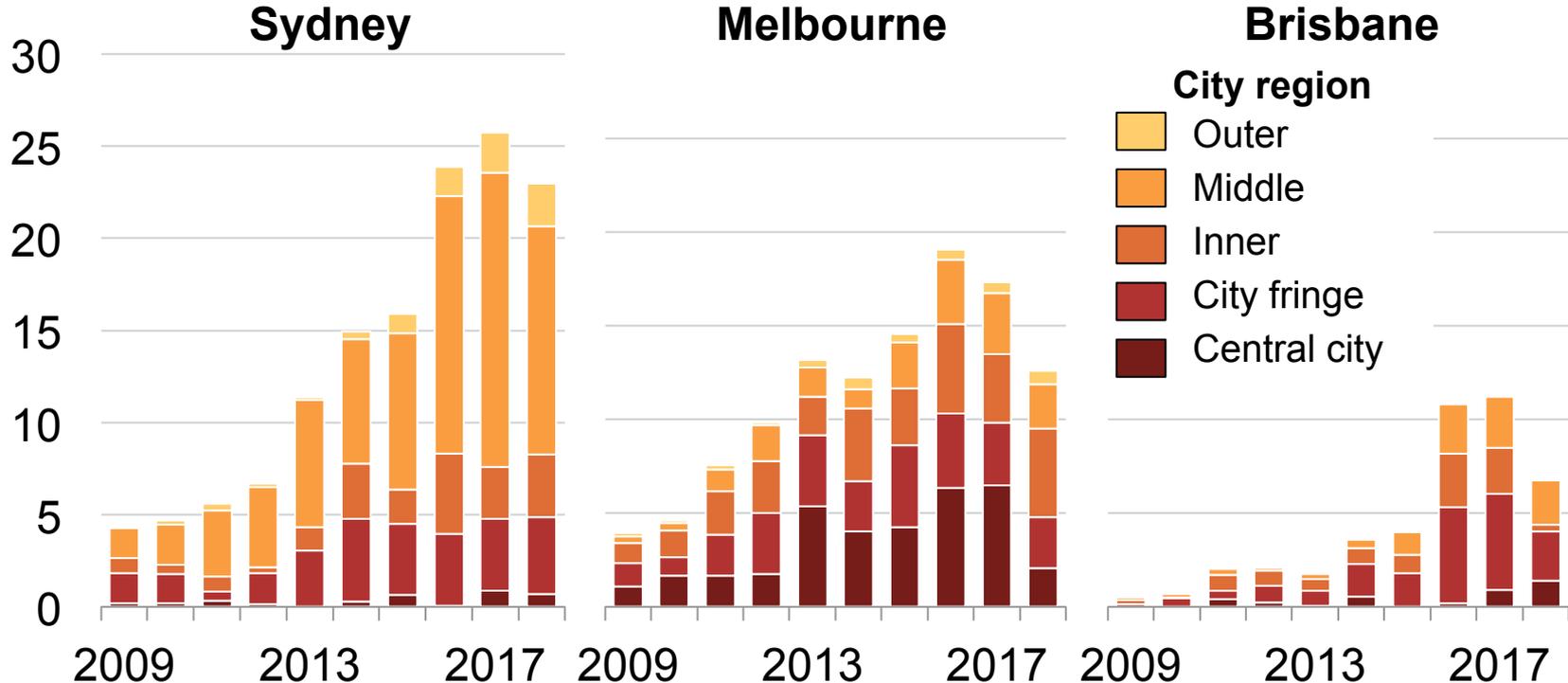


Notes: The Central city region = CBD and approximately 0-2 km from the CBD. City fringe region = approximately 2-5km from the CBD. Inner region = approximately 5-10km from each CBD. Middle region = approximately 10-35km from each CBD. Outer region = approximately 35km+ from the CBD. Middle Brisbane is work in progress, Outer Brisbane is not tracked.

Source: Charter Keck Cramer

Apartment supply jumped in Sydney in 2013 and 2015

Apartment completions and expected completions, thousands

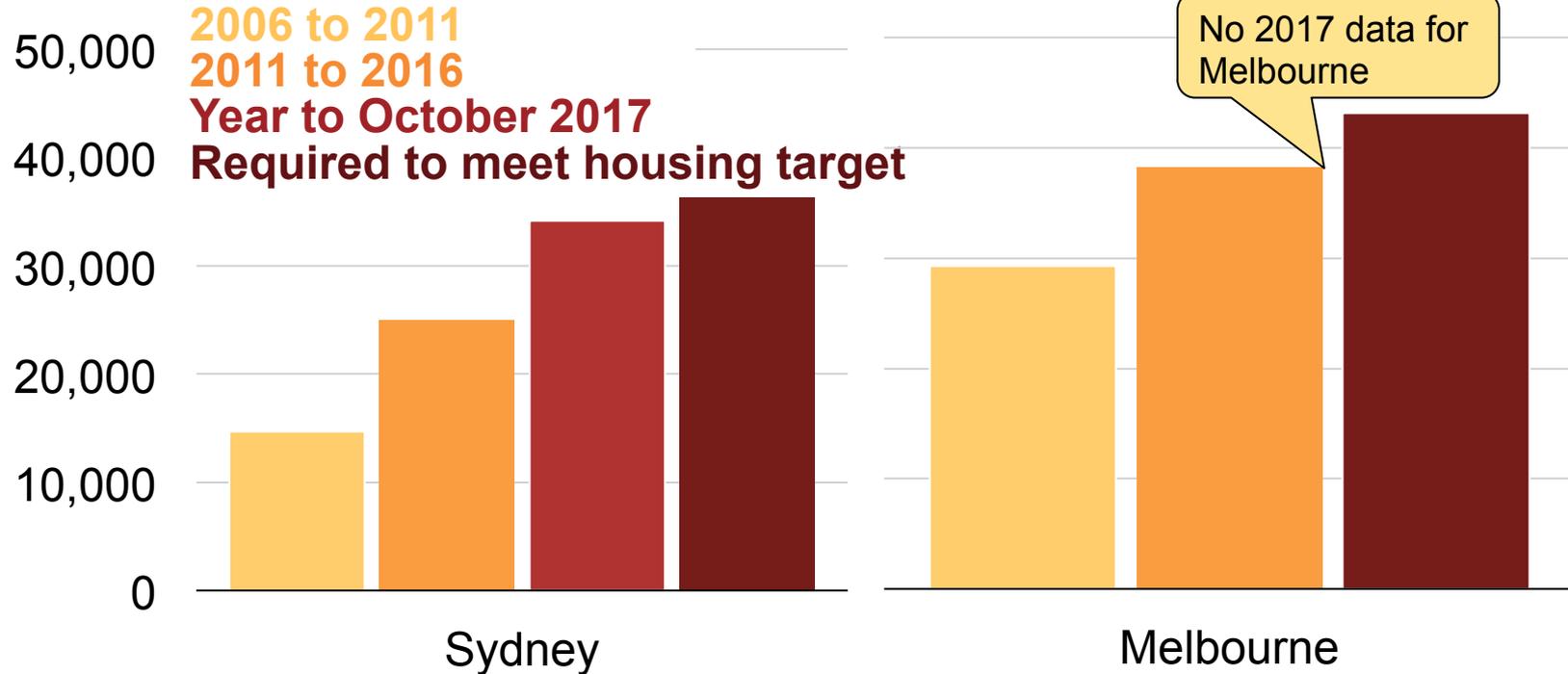


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Housing construction will need to keep increasing to meet city plan housing targets

Average annual net housing construction

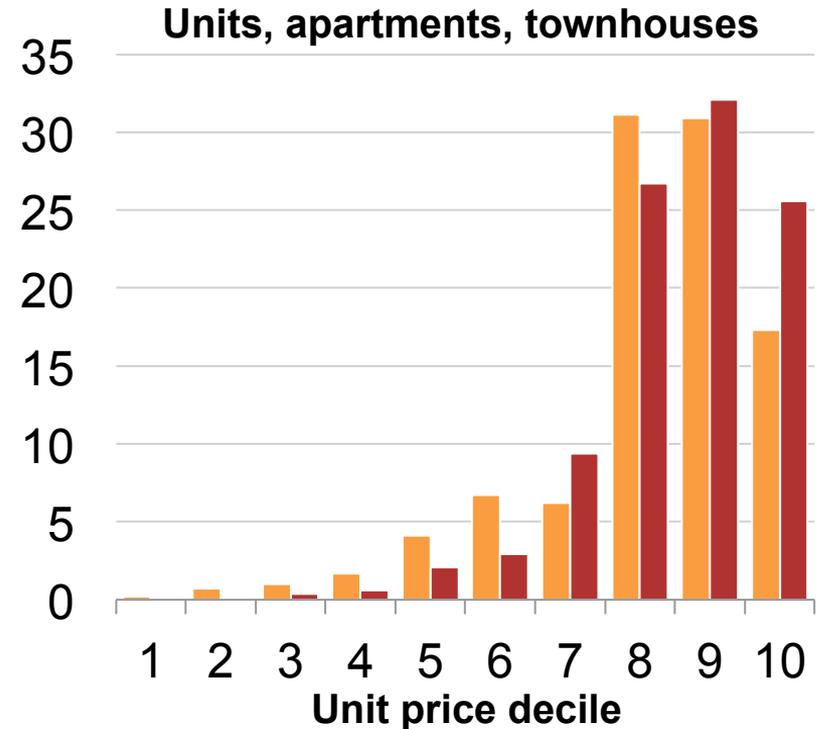
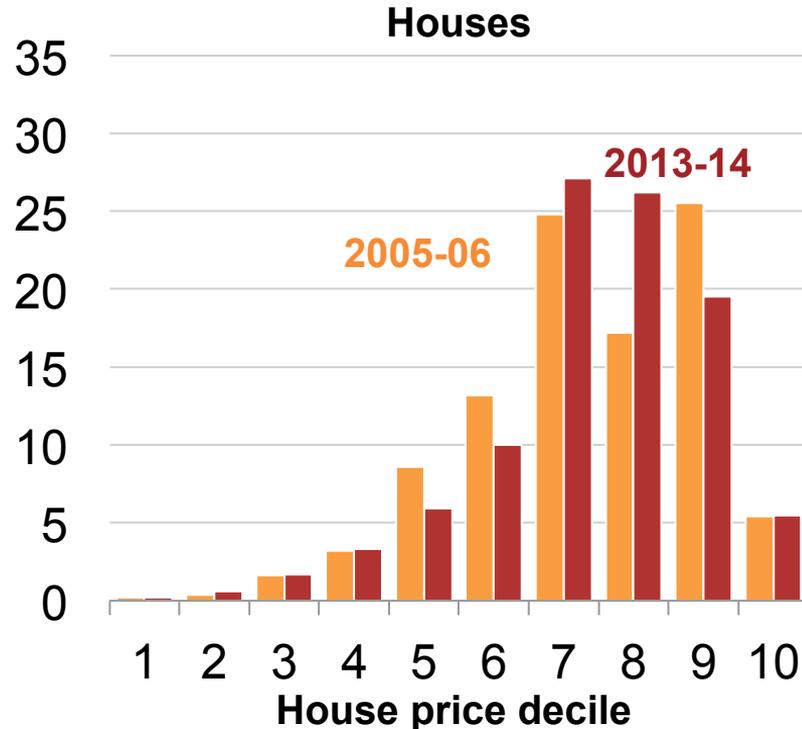


Notes: Towards Our Greater Sydney 2056: 725,000 additional dwellings over 2016-2036 (excludes the Central Coast). Plan Melbourne 2017: 1,550,000 additional dwellings over 2015-2051 (based on Victoria in Future projections). For 2006 to 2016 data, growth in dwelling stock is calculated using 2016 Greater Capital City Statistical regions.

Source: Greater Sydney Commission (2016); Victorian Government (2017); NSW Department of Planning and Environment

AHURI research claims most new homes are targeted at the top end of the market

Share of new housing and unit approvals (per cent) in 2005-06 and 2013-14 in each LGA, ranked by their median house and unit price deciles

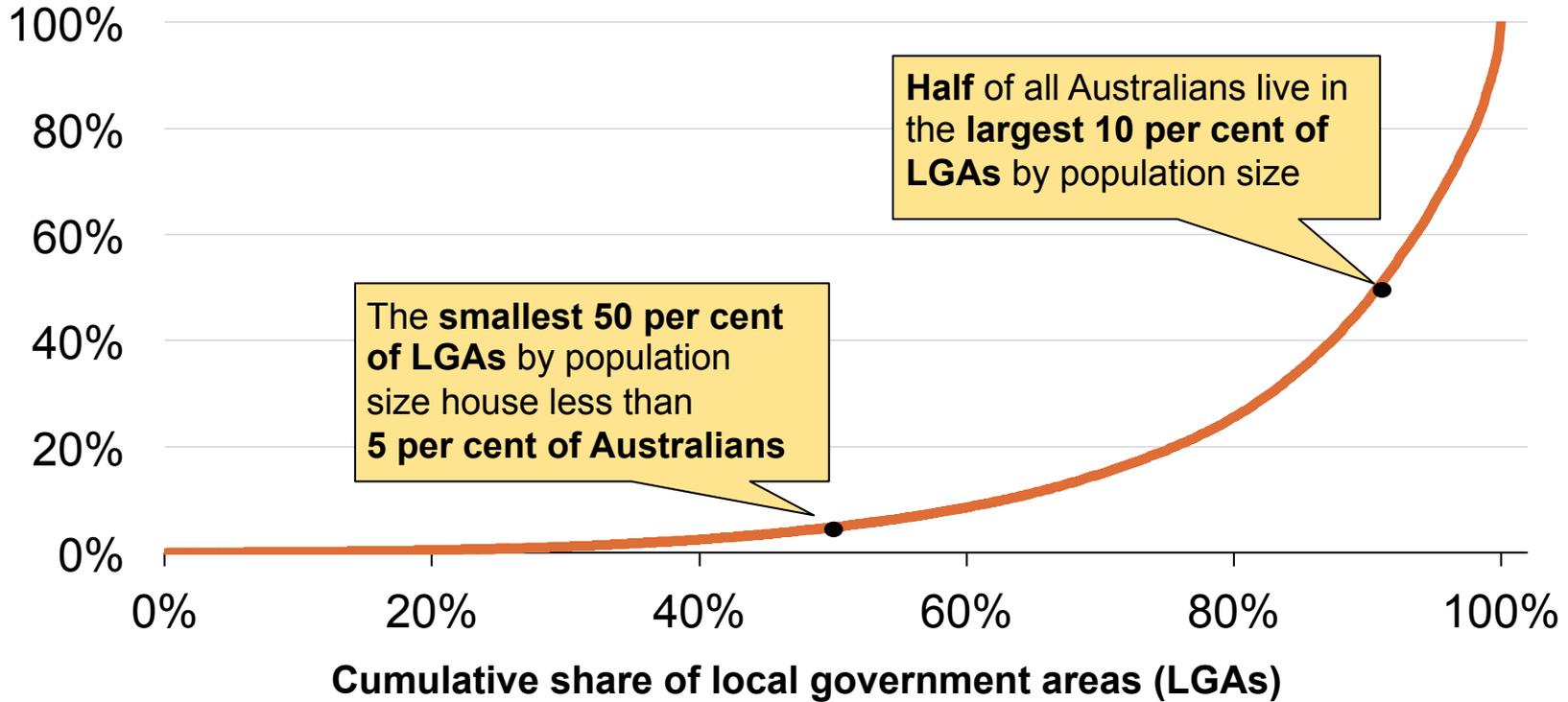


Notes: Price deciles are calculated on median house and unit prices in each LGA across Australia, unweighted for population size of LGAs. 'Units, apartment, townhouses' includes approvals for units, apartments, flats, semi-detached, row or terrace houses or townhouses.

Source: Ong et al (2017), Housing supply responsiveness in Australia: distribution, drivers and institutional settings.

Most Australians live in only a few LGAs, concentrated in our largest cities

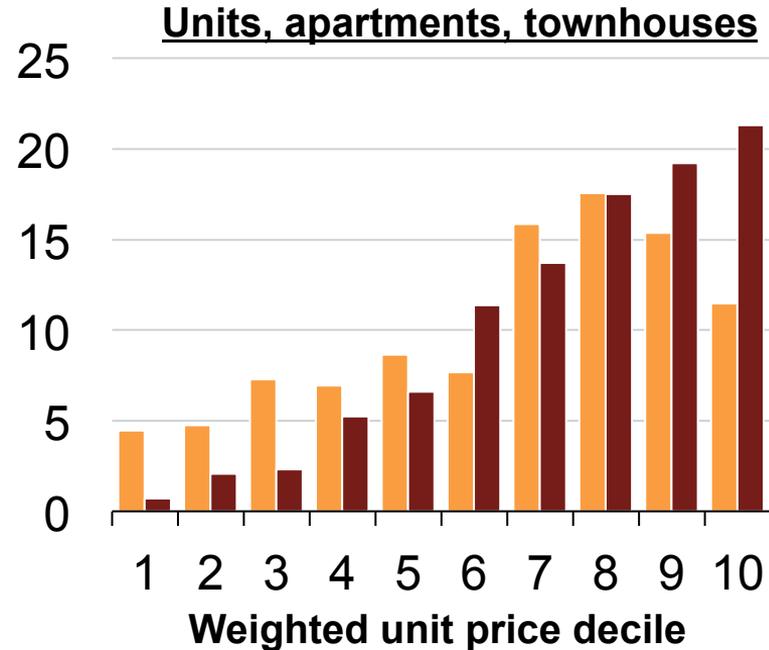
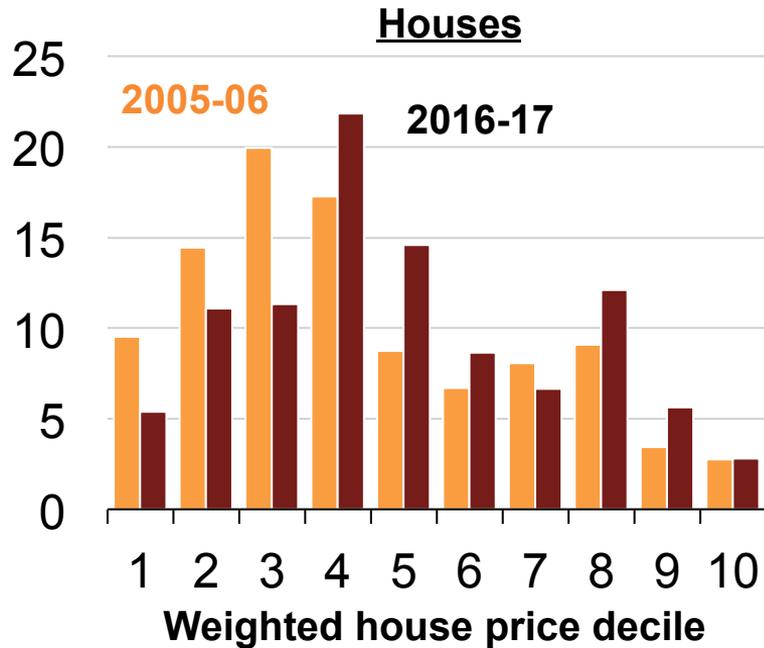
Cumulative share of Australian population by LGAs, 2016



Note: LGAs are ranked by population size from smallest to largest.
Sources: ABS 3218.0 Regional Population Growth, Australia, 2015-16; Grattan analysis.

Most new houses are in median-priced LGAs; new units are in higher price brackets

Share of new housing and unit approvals (per cent) in 2005-06 and 2016-17 in each LGA, ranked by weighted median house and unit price deciles

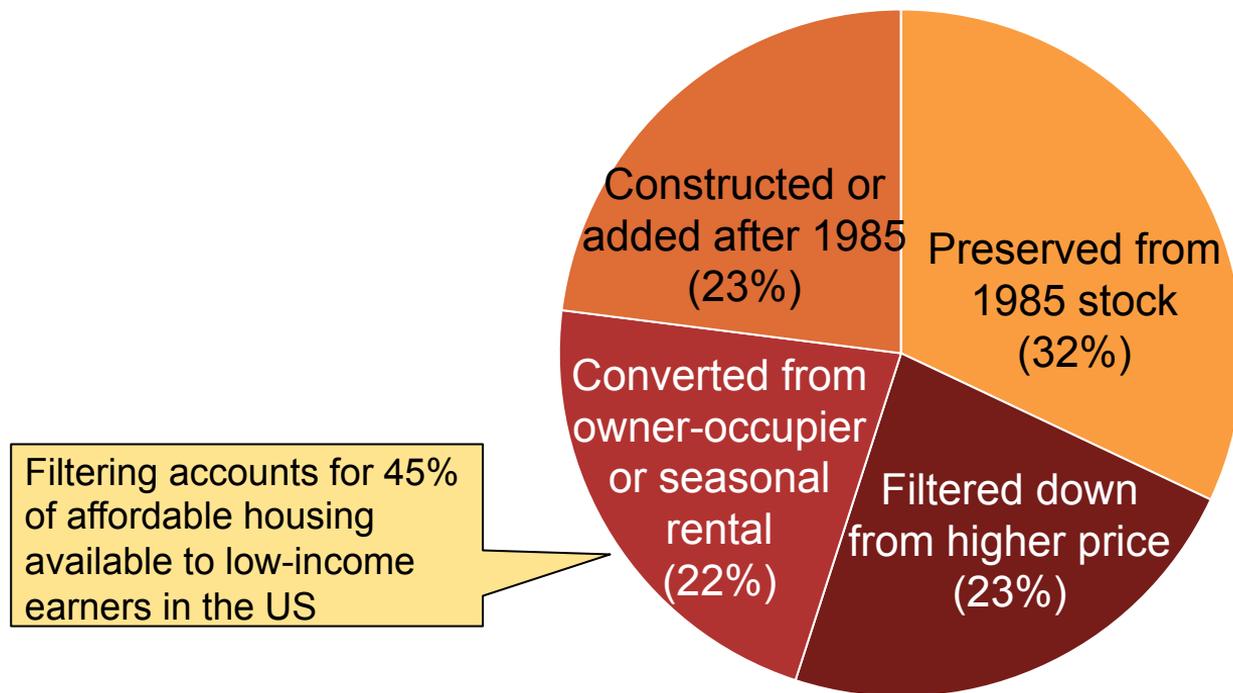


Notes: Weighted price deciles are calculated by ranking LGAs from lowest to highest according to their median price values, and dividing into deciles weighted by the total dwelling stock in each LGA so that each decile has a similar number of dwellings. For example, in 2016-17, each decile has a dwelling stock of approximately 987,000 for houses and 947,000 dwellings for units, apartments (LGAs without price data were excluded). All building approvals for an LGA are assigned to the decile that it sits in. An LGA may not be in the same decile in both 2005-06 and 2016-17. LGAs are as they were in 2006 (for 2005-06) and 2016 (for 2016-17), with best available price data assigned to that LGA, some small LGAs excluded. Units, apartments and townhouses includes approvals for units, apartments, flats, semi-detached, row or terrace houses or townhouses.

Source: Grattan analysis based on CoreLogic data; ABS Census; ABS 8731.0 Building Approvals.

Filtering is an important source of affordable housing for low-income earners

Per cent of US affordable rental housing stock in 2013 by source



Notes: Affordable housing is defined as costing no more than 30 per cent of income for households with very low incomes (earning less than 50 per cent of area median). Units added include rentals that were temporarily out of the stock in that year.

Source: Weicher, Eggers, Moumen (2016), The Long-Term Dynamics of Affordable Rental Housing.

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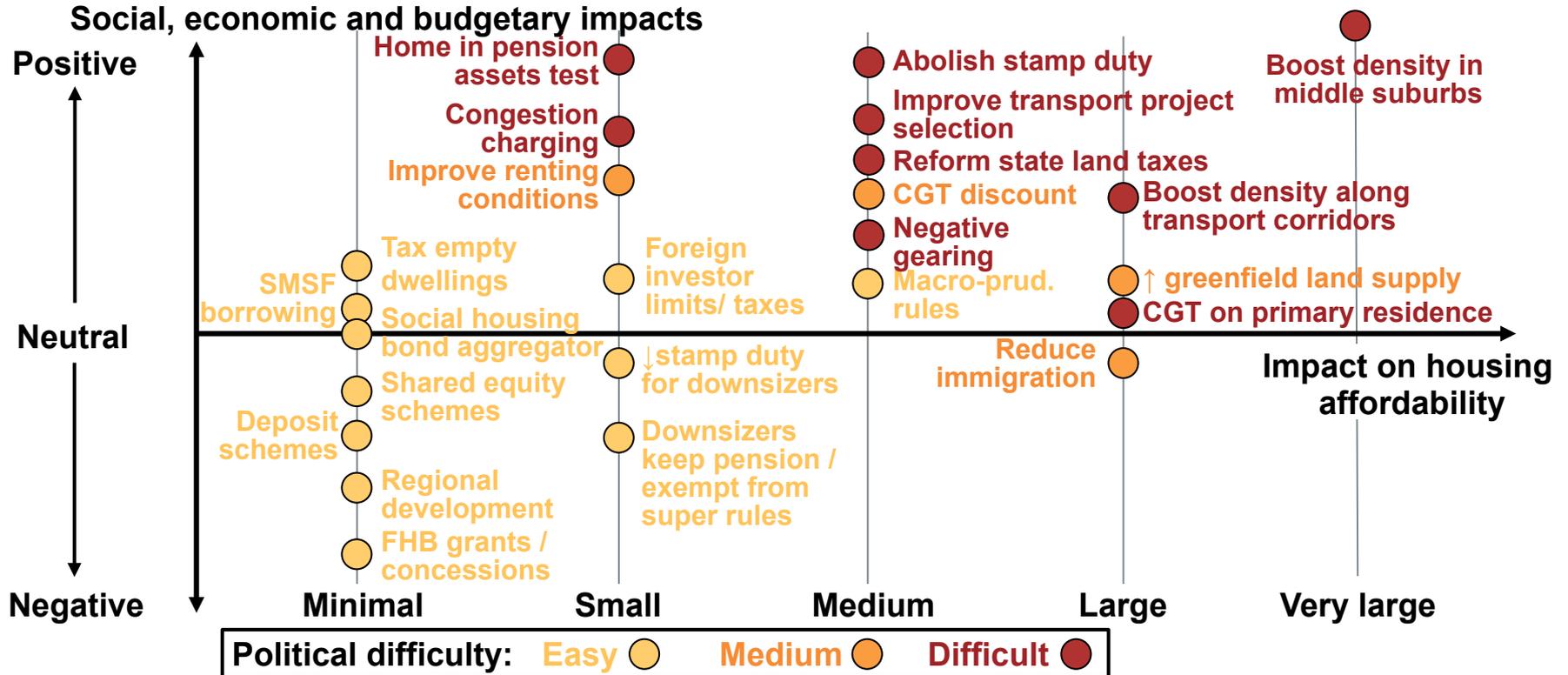
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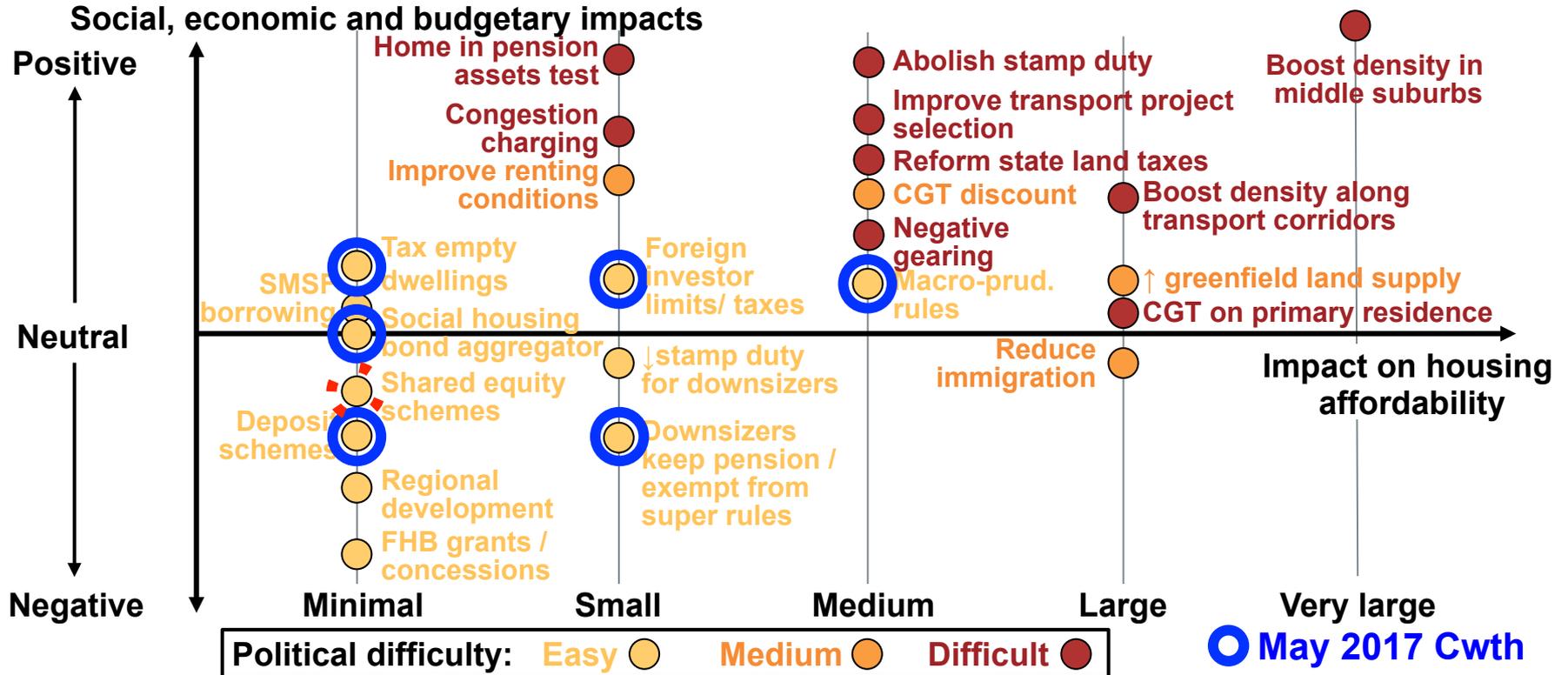
All the important reforms are difficult; all the easy reforms are cosmetic



Source: Grattan analysis.

Notes: Prospective policies are evaluated on whether they would improve access to more affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Estimates of the economic, budgetary or social impacts should not be treated with spurious precision.

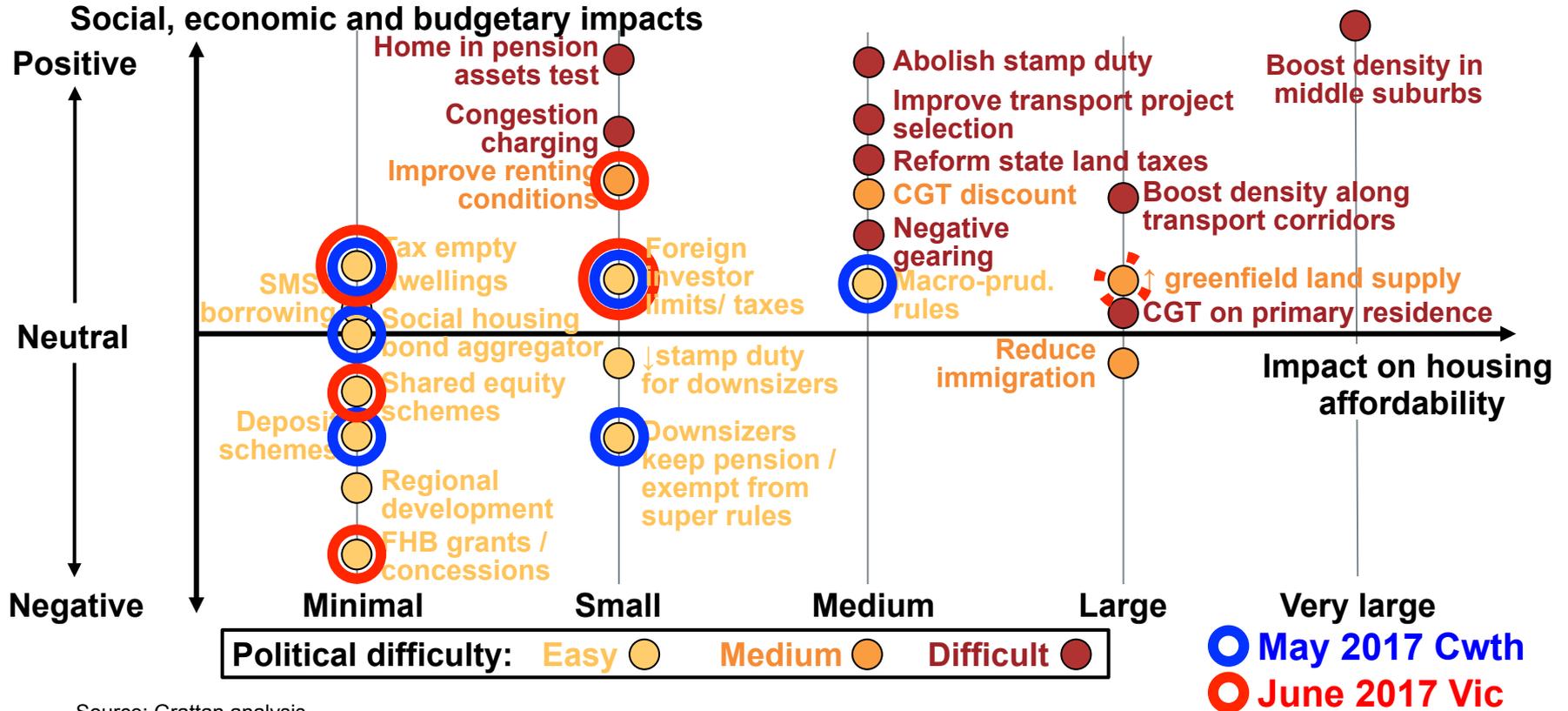
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All the important reforms are difficult; all the easy reforms are cosmetic



Source: Grattan analysis.

Notes: Prospective policies are evaluated on whether they would improve access to more affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Estimates of the economic, budgetary or social impacts should not be treated with spurious precision.

Most housing tax reforms do more for the budget or economy than for affordability

	Economy	Budget	Inequality	Housing	Consensus
Stamp duty – property tax swap	Big economic benefits (~\$17b / yr)	Budget neutral swap	Small windfall gains & losses	Better use of housing stock	Near unanimous, but transition the issue
Flatten progressive land taxes	Increase incentives to scale	Budget neutral swap	Windfall gains for commercial landowners	More secure tenure for renters	Why not on agenda?
Negative gearing / CGT reform	Reduces over-investment in housing	+\$2b to \$6b	Hits wealthier Australians	Prices ↓ ~2% overall Rents won't rise	Rent impact?
Home in pension means test		+\$1b to \$7b	Hits wealthy seniors; helps inter-gen equity	Modest increase in downsizers, but not main constraint	Only unity ticket among think tanks

Other housing tax reforms will be less effective

	Economy	Budget	Inequality	Housing	Consensus
CGT for owner occupiers (and taxing imputed rents?)	Reduce over-investment in housing Exacerbates “lock-in”	Up to \$18b But could be negative if mortgage tax deductible	Hits wealthy and middle Australia	House prices ↓ 5-10%, much less (or not a all) if mortgages tax deductible	Strong support among academics Politically “difficult”
Vacant property taxes		Unlikely to collect much revenue	Hits wealthier Australians	Won’t help much: easy to avoid	Unresolved admin issues But nothing to lose
Tax foreign investors more		Raising ~\$1b nationwide		Won’t help much	Impact on supply?

For more ...

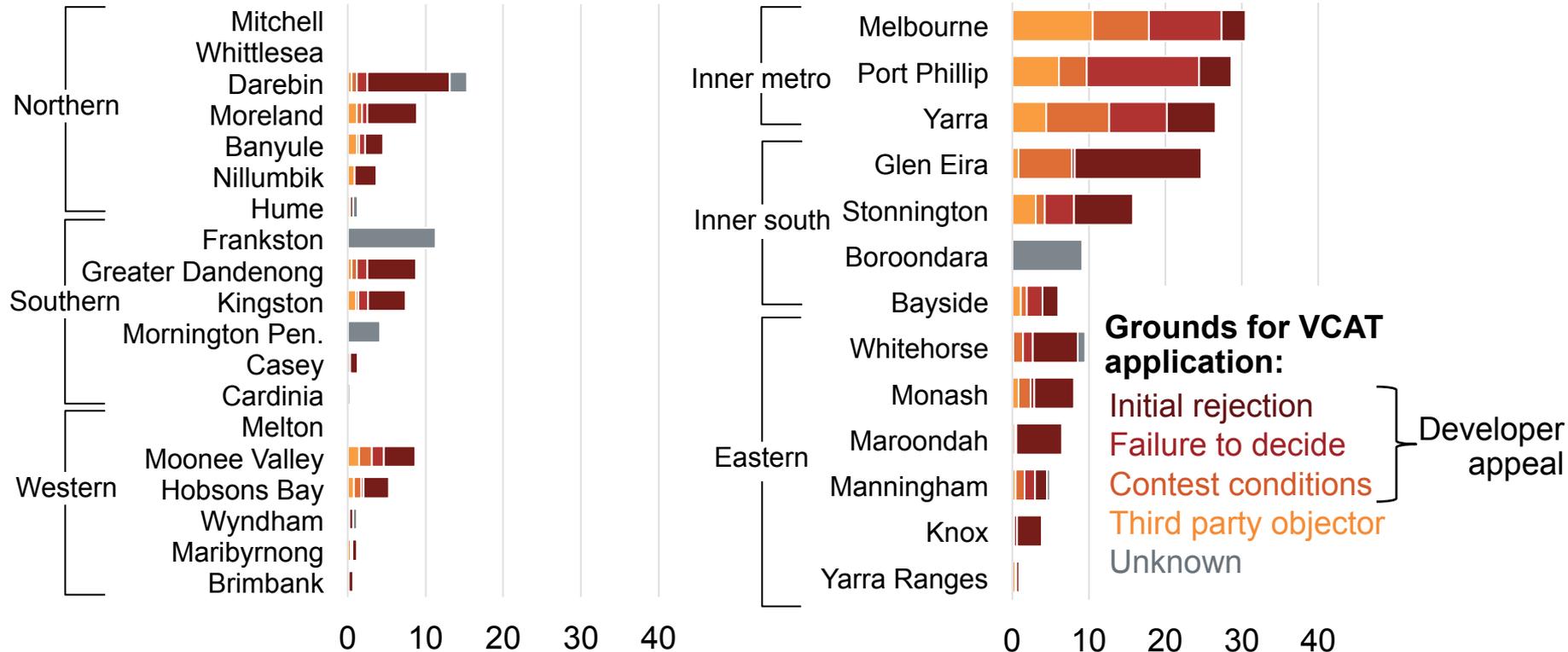
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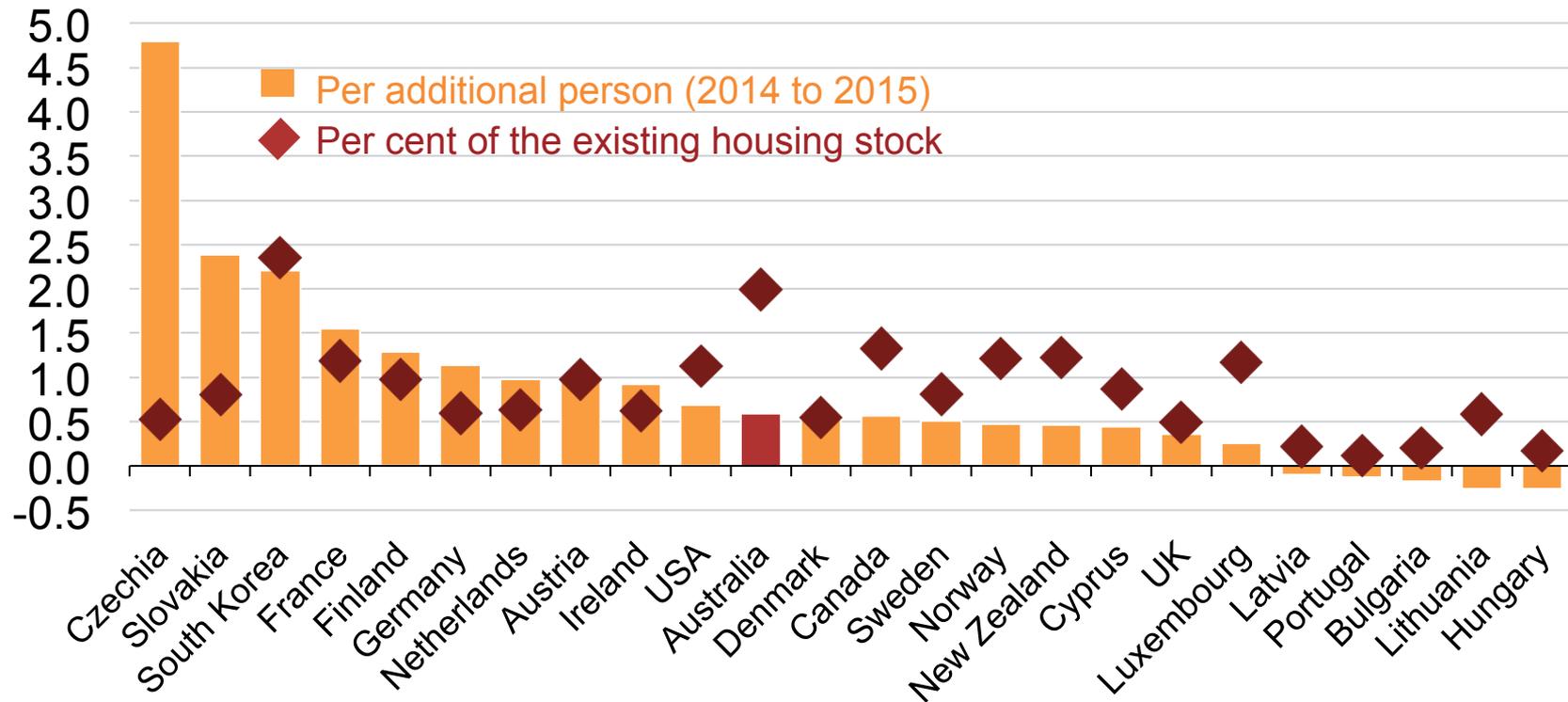
More applications go to VCAT in the inner and middle ring suburbs of Melbourne

Proportion of finalised dwelling applications taken to VCAT 2015-2017



Housing construction in Australia has been strong, but so has population growth

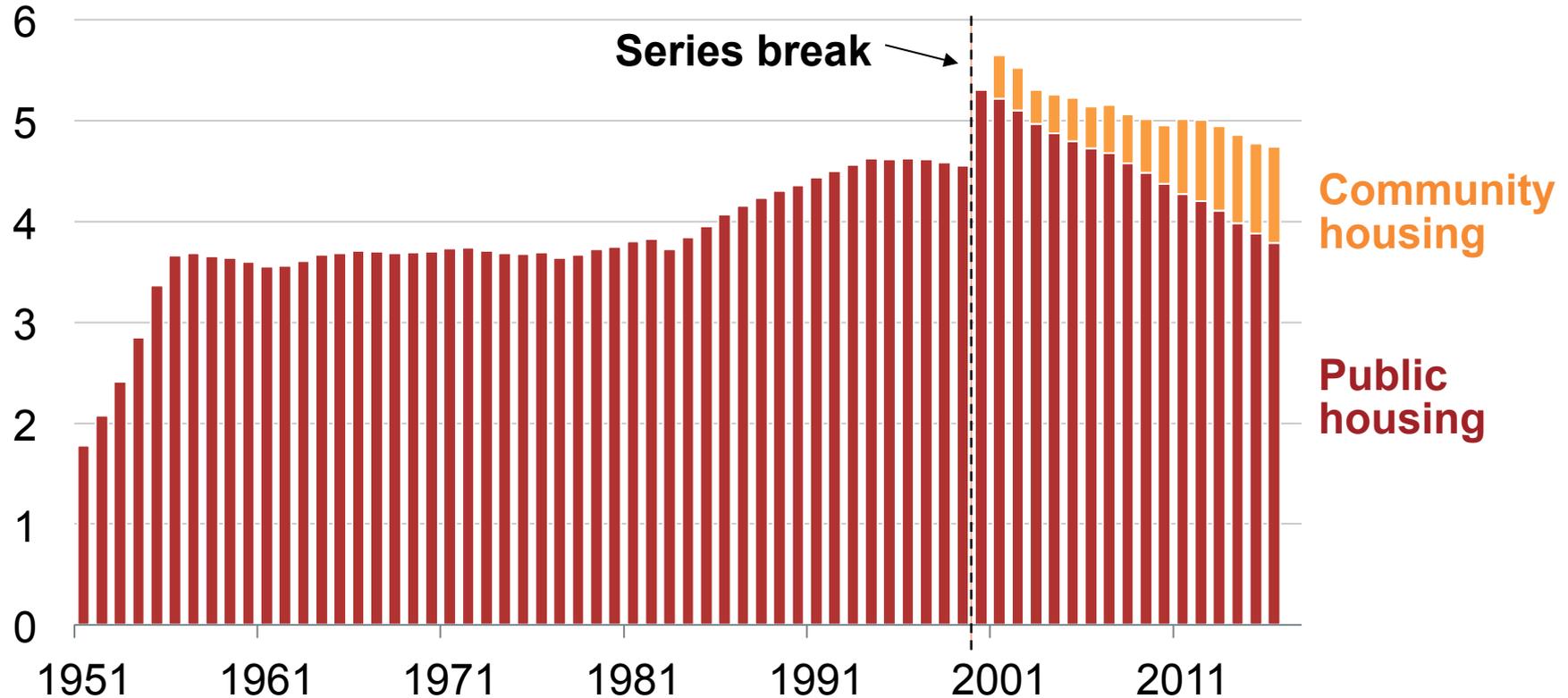
Dwelling completions in 2015



Notes: Estonia, Japan and Poland not shown due to large negative numbers. Dwelling construction data for 2015 or closest year.
Source: OECD Affordable Housing Database; United Nations population database

Social housing is can't be the (primary) solution

Social housing as a proportion of all housing, per cent

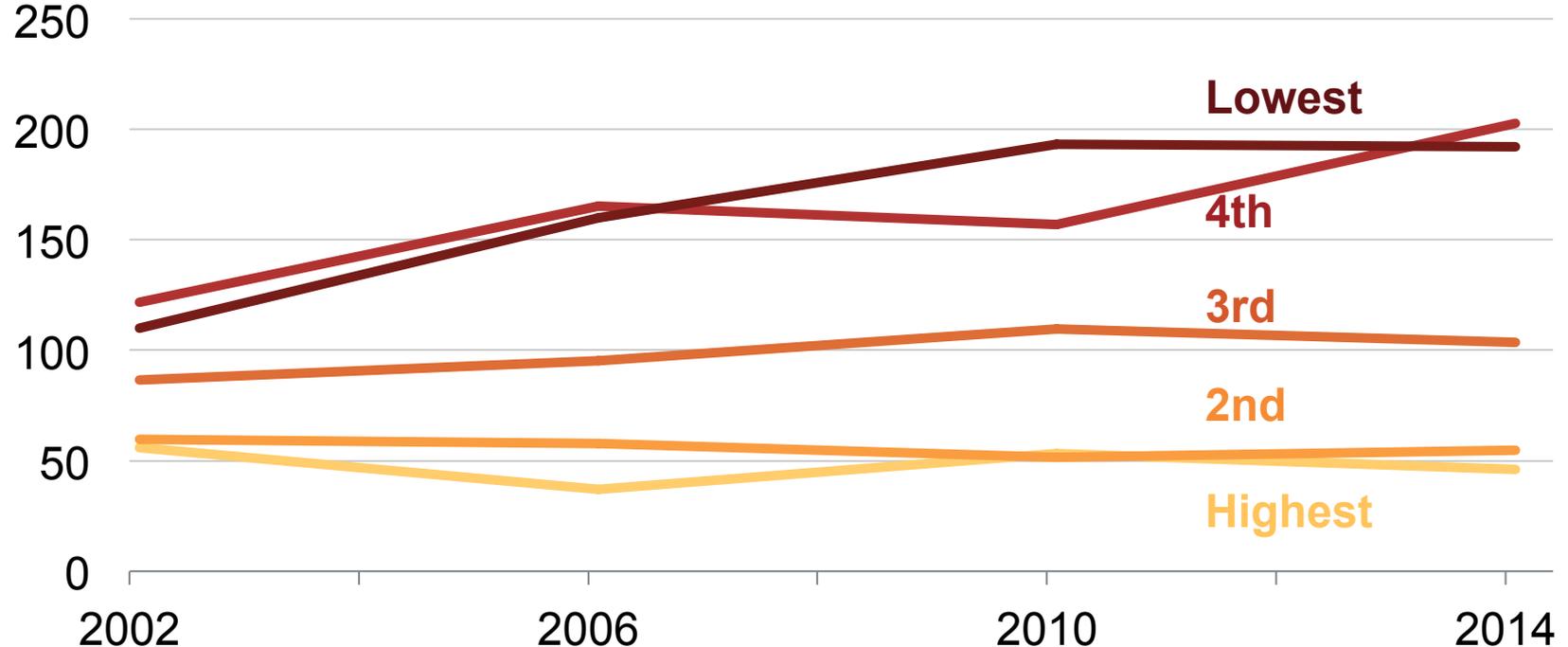


Notes: Series break after 1999.

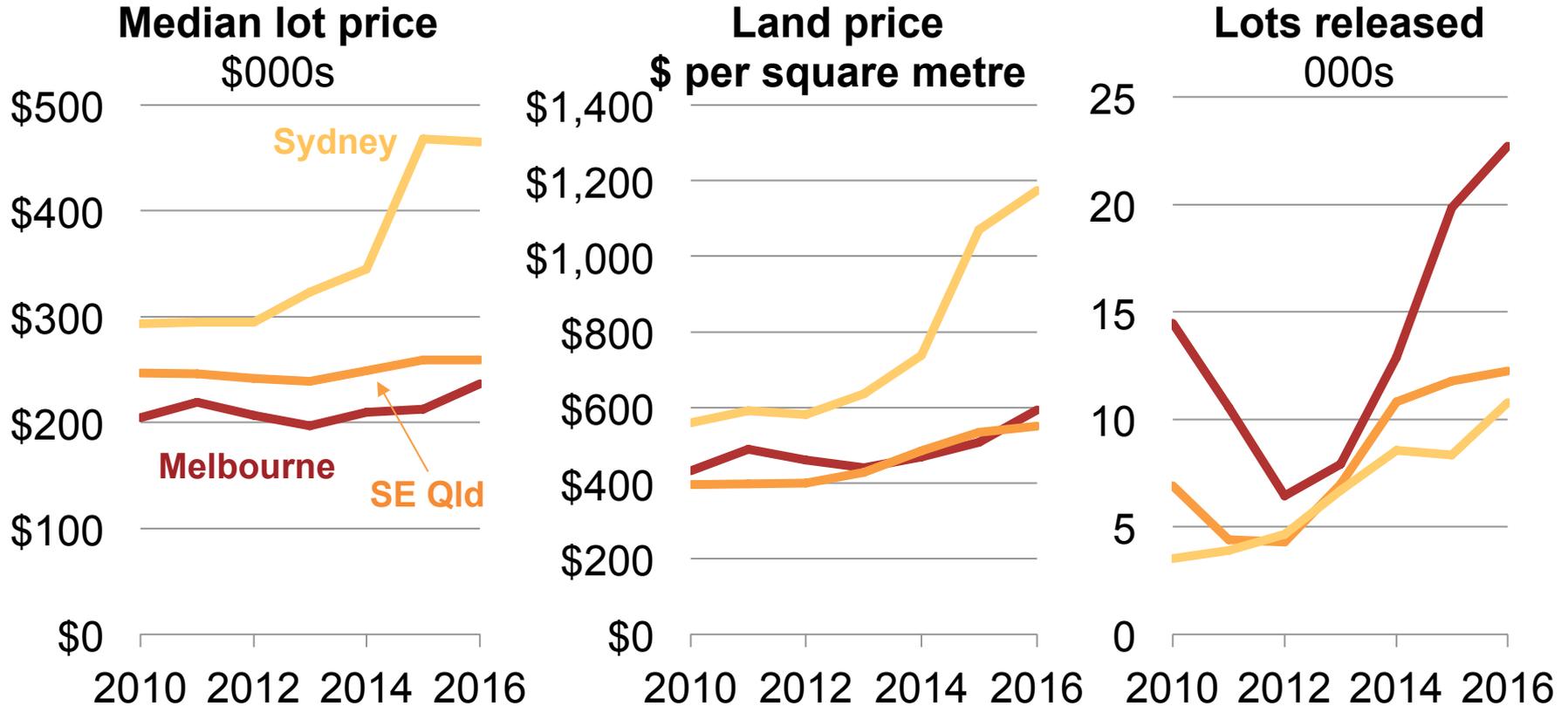
Sources: Eslake 2015; Productivity Commission 2015

But debt has increased the most among high-income households

Household debt to income ratio (for households with debt), by income quintile (median), per cent



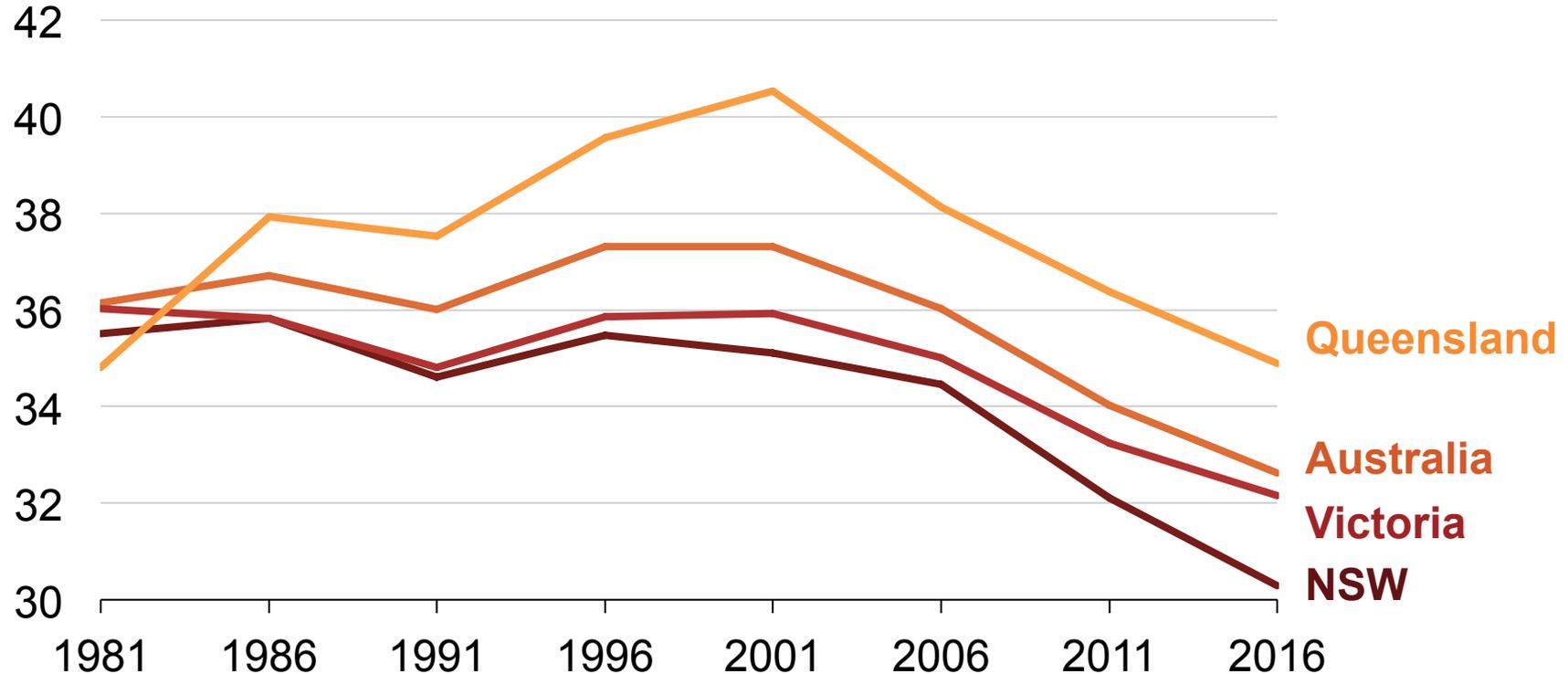
Greenfield land is most expensive and land release slowest in Sydney



Notes: Nominal dollars
Source: UDIA 2017 State of Land Report; Charter Keck Kramer

Younger Australians are responding by starting new households much later in life

Headship ratio, 20-34 year olds

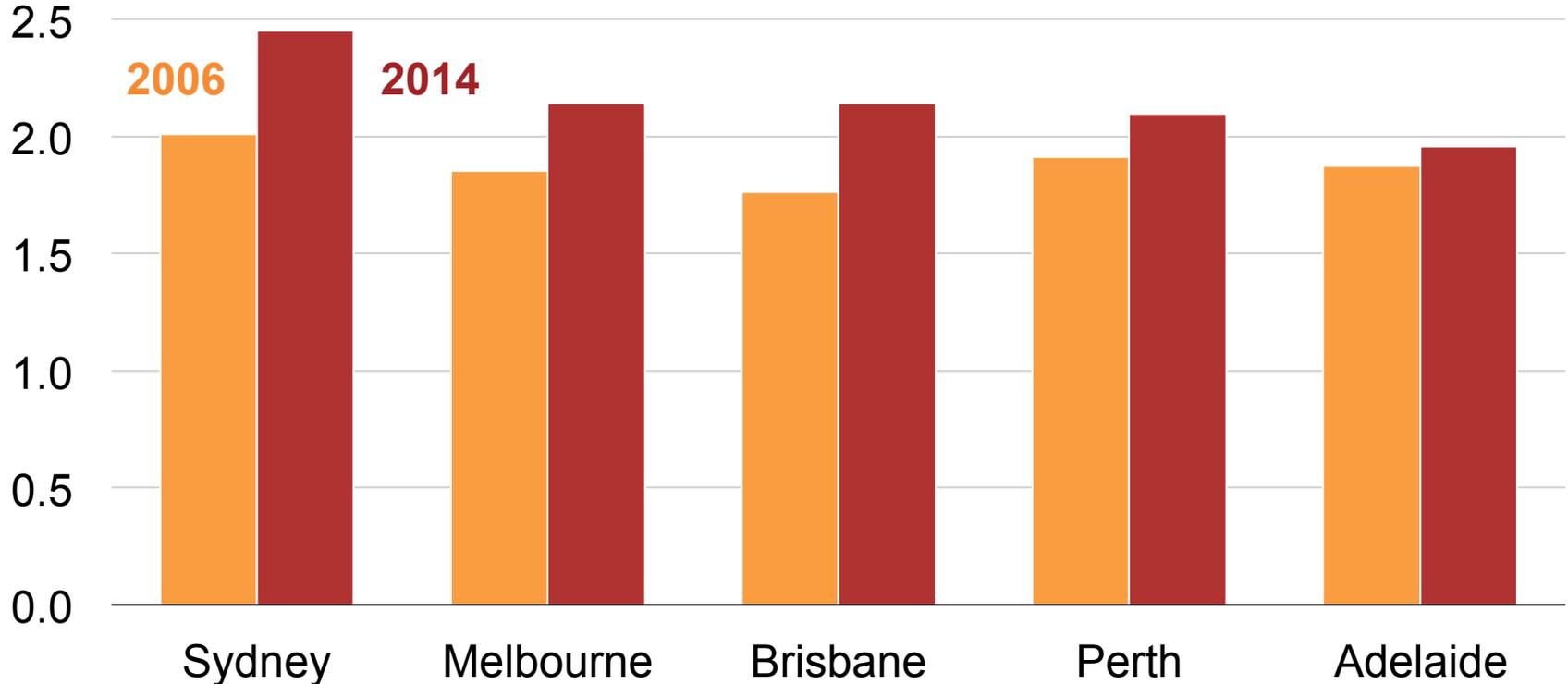


Notes: The headship ratio represents the share of the population that are the heads of households. For example, a headship ratio of 0.4, means that 40 per cent of the population are the head of their household.

Source: Gradwell (2017): Census

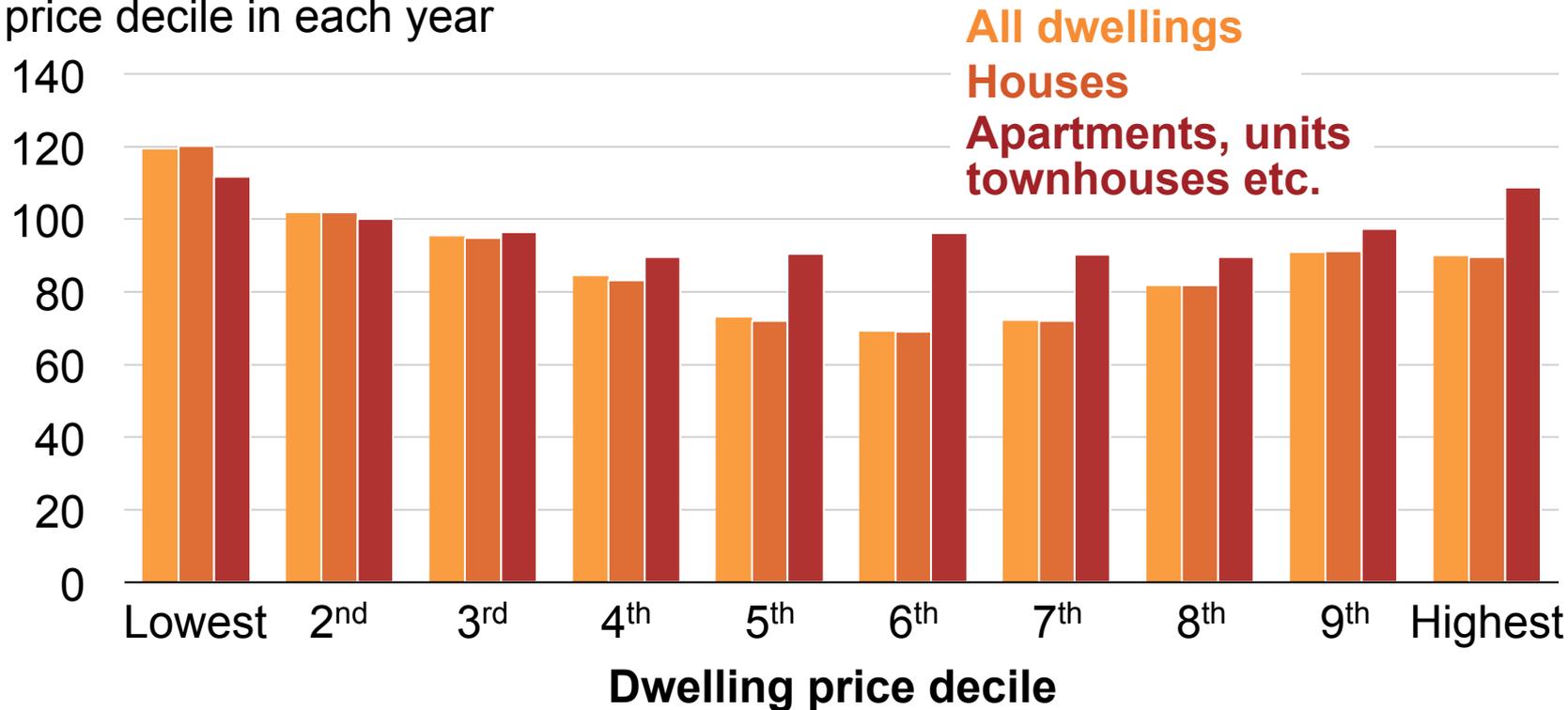
(Scarce) inner ring house prices grew faster than outer ring prices

Ratio of inner ring to outer ring median prices, detached houses only, four-quarter average



Cheaper dwellings have increased in price by more than expensive dwellings

Per cent change in dwelling prices between 2003-04 and 2015-16, by dwelling price decile in each year



Notes: average dwelling price in each decile. 'Apartment, units, townhouses etc.' includes semi-detached houses, row or terrace houses townhouses, flats, units and apartments.

Source: ABS Survey of Income and Housing