Trends in home ownership: causes, consequences and solutions

Submission to the Standing Committee on Economics Inquiry into Home Ownership

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Overview:

This submission documents current rates of, and widespread declines in, home ownership by age and by household income. It explains the long-term decline in home ownership amongst younger households in terms of underlying structural trends in the Australian economy, arising from arise from social and demographic factors and from economic and institutional factors. In relation to the latter, it highlights the impact of demand from established households both as owner-occupiers and as investors in light of growing income inequality.

It points, in particular, to the role of

- the system of housing finance that makes it relatively easier for better-off households to accumulate housing assets through debt finance;
- the income taxation system that provides them with an incentive to treat property as a means of accumulating wealth ahead of its more essential role as providing shelter; and
- the system of property rights in Australia that ensures that those who do own land are able to act as rent-seekers by expropriate for their own the increase in land values not of their own making.

It suggests that increasing land values in urban locations are an inevitable outcome of the combined impact of

- the pressure of income and population growth;
- structural change which results in increasing urbanization and concentration of (knowledge-based) employment in its central locations
- a failure to invest in a rapid-transit transport infrastructure that facilitates cost-effective access to employment and essential services.

It concludes that that attention needs to be paid to the underlying structural factors that have contributed to declining home ownership if trends over the past 50 years or so are to be reversed. Land-release and urban planning policies might ameliorate supply shortages when pressures on dwelling prices arise from increasing demand driven by population (or, more specifically, household) growth. They are less likely to be effective when pressures on dwelling prices arise from increasing demand for bigger and better located dwellings driven by economic growth and/or increasing inequality. In this instance, policies are needed to reduce demand from existing households.

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1. Introduction

Although Australia's home ownership rate has remained relatively stable at around 70 per cent for half a century, much of this stability has arisen because of demographic change with an increase in the proportion of older households with a high incidence of home ownership offsetting a decline in the incidence of home ownership among households who have a reference person less than 45 years old. That this decline was already being observed in the late 1980s and has continued at a relatively steady rate since then suggests structural rather than cyclical drivers are critical.[2] This submission focuses on these trends and on the factors that explain declining rates amongst younger households.

Section 2 provides an overview home ownership trends over the past fifty years and shows these reflect a changed to structural rather than cyclical changes in Australia. Section 3 examines the housing market drivers that have contributed to them, focusing primarily on the impact of socio-demographic and economic drivers on an inherently constrained urban land supply. Section 4 provides an overview of the key arguments and suggests that band-aid solutions will not address fundamental problems. Section 5 provides a range of opportunities for structural reform.

2. Trends in home ownership

Home ownership in Australia expanded rapidly in the 1950s from a post-war level of 47 per cent to reach its current level of around 70 per cent by 1961, with much of its post war growth to economic and demographic drivers of the time.[3] Home ownership was promoted as a means of solving housing shortages and substandard rental accommodation prior to the Second World War and has been underpinned by both explicit and implicit government policies in the post war period. These have included direct subsidies (such as grants to first time home purchasers and subsidized mortgage interest rates) and indirect subsidies (such as exemptions from federal income taxes and state land taxes and concessions on stamp duties). A long standing ideological commitment to home ownership added to these drivers.[4]

Aggregate home ownership in Australia has been relatively stable for the past 50 years since reaching its current level of around 70 per cent in the 1960s. See Table 1. However, since the mid-1970s, the same observation cannot be made for home ownership rates for younger households (below 45 years).

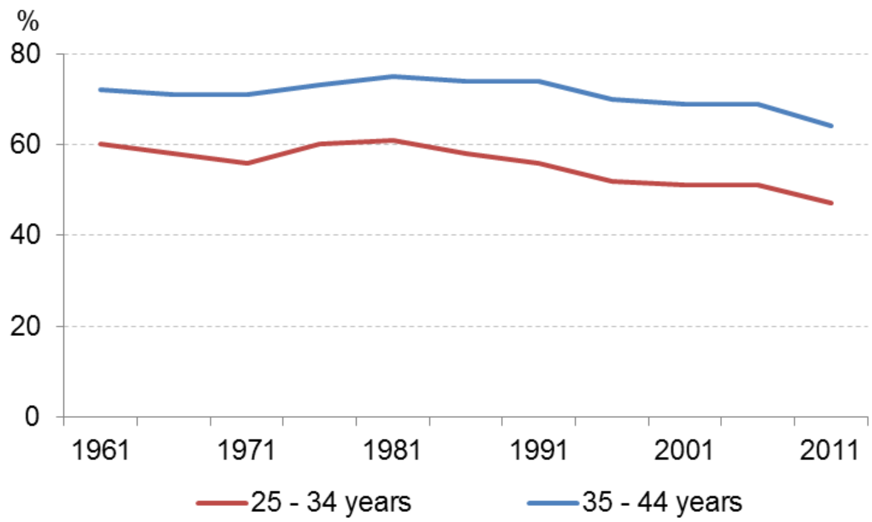
Table 1: Home ownership rates by age of household reference person, Australia 1961-2011

Age	1961	1966	1971	1976	1981	1986	1991	1996	2001	2006	2011
15-24 years	34	30	26	25	25	26	24	22	24	24	25
25-34 years	60	58	56	60	61	58	56	52	51	51	47
35-44 years	72	71	71	73	75	74	74	70	69	69	64
45-54 years	75	76	76	76	79	79	81	79	78	78	73
55-64 years	78	78	79	78	81	82	84	83	82	82	79
65+ years	81	80	80	75	78	80	84	82	82	82	79
All households	72	70	69	68	70	70	72	69	70	70	67

Source: special request tabulations from Census data; data for 1966 interpolated

Home ownership rates for those in the 25-34 year old group peaked in the mid-1970s and have declined more or less steadily since then, falling by 9 percentage points from 60 per cent to 51 per cent between 1976 and 2001 and by a further 4 percentage points to 47 per cent to 2011 – in other words, by 13 percentage points in 35 years.[5] The decline for those in the 35-44 year old group followed in the mid-1980s as the earlier cohort aged, falling from 74 per cent in 1986 to 64 per cent in 2011.

Figure 1: Home ownership rates for selected age groups, Australia, 1961-2011

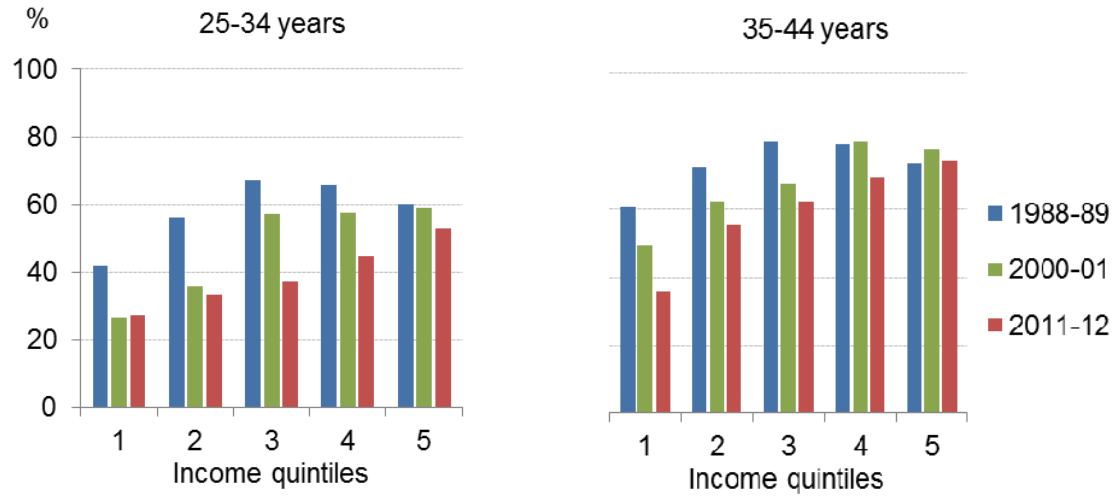


Source: as for Table 1

Many studies have shown that age, marital status and family composition are key demographic determinants of home ownership.[6] They also have shown that home ownership is significantly constrained by economic factors, such as household income (both current and permanent) and wealth and affected by economic factors (such as housing subsidies and taxation) that affect the relative cost of owning vis a vis renting.[7]

In broad terms, these tenure choice studies show that, for the past 50 years or so, home ownership rates in Australia have been higher for older than for younger households, higher for couples than for single person households and, for each of these household types in each age group, higher for households with children than without children. On an age specific basis, home ownership rates are higher for higher income and higher wealth households. At least since the 1990s, the declines in home ownership rates for younger households have been greatest for lower income households. See Figure 2.[8]

Figure 2: Home ownership rates for younger households by income quintiles, Australia



Source: ABS Surveys of Income and Housing, derived from basic confidentialised unit record files. Income quintiles are based on equivalised disposable household income.

Changes in these socio-demographic and economic drivers over time explain the relative stability of the aggregate home ownership rate in light of declining rates for younger households. In other words, it is the ageing of the population that has been the dominant factor that has kept Australia's aggregate home ownership rate stable at around 70 per cent.[9] More complex explanations are required to explain the declining rates for younger households.

3. Explaining the decline in home ownership rates amongst younger households in Australia

These explanations can be broadly categorised into demand factors driven by social and demographic or institutional and economic factors and supply factors that affect the structure of Australia's urban housing markets.[10] Socio-demographic factors appear to be the primary drivers of decline from the mid-1970s through to the 1980s with economic and market structure factors and being the primary reasons for this decline being sustained through the 1990s and 2000s.

3.1 Social and demographic factors

Key socio-economic drivers that affected the home ownership rates of younger households from the 1970s arise through changes in household composition of these households and to a growth in single person and single parent households.[11] These include:

- An increase in the proportion of two income households
- A decline in marriage rates and an increase in divorce and separation
- A decline in fertility rates
- An increasing share of migrants in population growth.

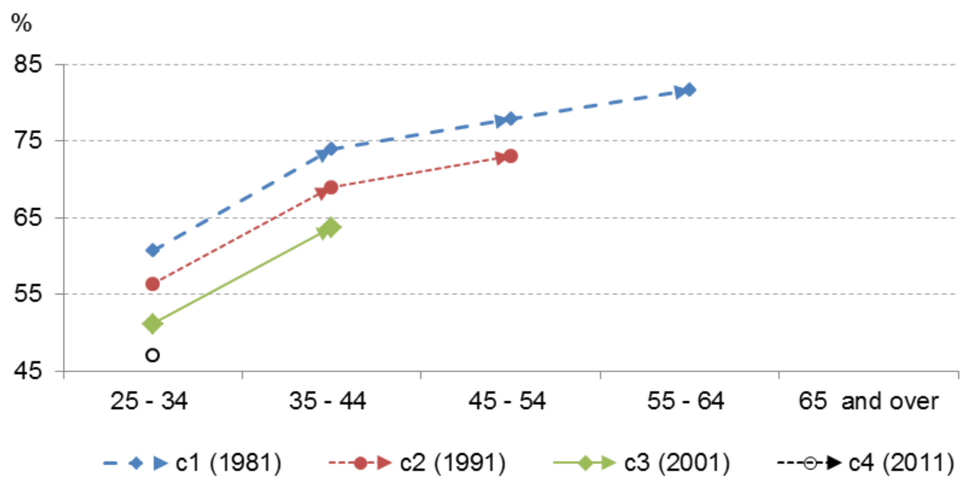
The combined effect of these changes contributed to a relative increase in the proportion of single person and childless couple households amongst those in the 25-44 year age group with lower home ownership propensities than other household types.

These social changes had two significant but offsetting economic impacts. An increase in the number of two earner households resulted in a move away from the traditional model of a single (male) breadwinner family household and increased the number of potential first home buyers who were higher income households. Changes in social attitudes, however, also meant many younger people deferred partnering, and many who had been partnered, divorced or separated which increased the number of single adult households, many of whom had relatively low incomes. The combined effect of these changes contributed to changes in income distribution and to market pressures that impeded access for lower income households (covered further below).

Because of the social changes that were occurring, there was some disagreement over whether the decline in home ownership observed from the mid-1970s until the 1990s was simply a temporary deferral or whether it was a result of economic changes that increasingly constrained access so that the decline would more likely be permanent.[12]

A cohort analysis based on tracking households in different age groups over time suggests there has been little 'catch up' in the past 30 years. See Figure 3 (and the data in Table 1).[13] Cohorts are defined on the basis of the year in which households were in the 25-34 year age group.

Figure 3: Cohort analysis of home ownership rates by year in which household was 25-34



Source: as for Table 1

Home ownership rates of those in cohort 1, who were 25-34 in 1981, increased from 61 per cent to 78 per cent by 2001, 20 years later when they were 45-54. Home ownership rates of those in cohort 2, who were 25-34 in 1991, increased from 56 per cent (5 percentage points lower than cohort 1 at the same age) to 73 per cent by 2011 (still 5 percentage points lower than cohort 1 at the same age). Whether or not younger households in any of these cohorts can catch up to the home ownership rates currently experienced by older age groups will depend on the economic (and institutional) environment over the next 30 years.

3.2 Economic and institutional factors

The decline in home ownership rates not explained by social and demographic change can be explained by changes in the underlying economic and institutional arrangements that have contributed to declining affordability over the period. These include:

- Changes in the distribution of income;
- Changes in inflation, interest rates and house prices;
- Changes relative access and user costs of renting vis a vis owning; and
- Institutional changes in lending practices

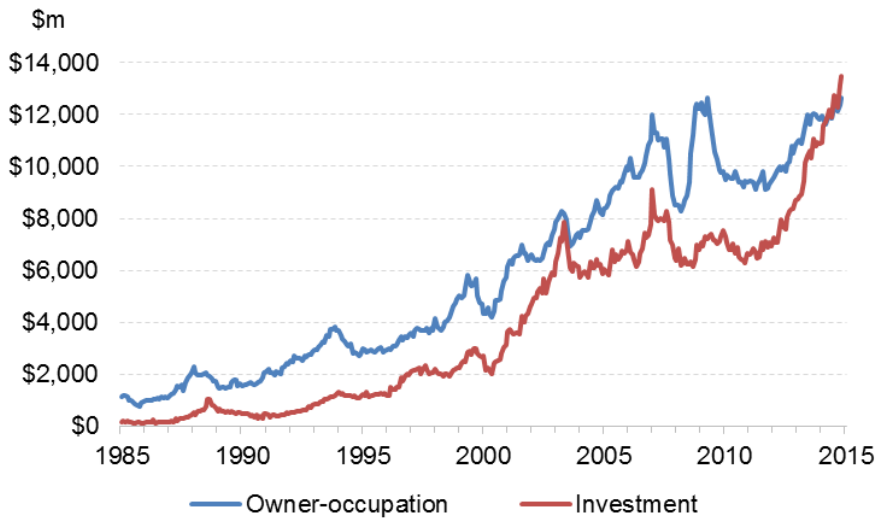
Growing earnings inequality from the 1970s to the 1990s in response to structural changes that were occurring in the economy at the time led to the phenomenon of 'the disappearing middle'. At a household level, this increase in income inequality was reinforced by the changes in household structure that had begun to emerge in the 1970s and was only partly offset by changes in the tax transfer system. Increasing inequality continued through from the mid-1990s until the late 2000s, having accelerated between 2003-04 and 2009-10 as a result of its uneven economic growth generating disproportionate benefits for those in the top half of the income distribution.[14]

Disproportionate growth in incomes at the top end of the income distribution meant increased borrowing capacities for households with high home ownership propensities. The institutional environment in which mortgage finance is provided has always provided larger loans for higher income households simply because of their higher incomes. Increased borrowing capacity for higher income households was enhanced by liberalization of lending practices in the 1990s that gave greater recognition to the income of a second earner in the household. Financial innovations in the 1990s and 2000s added to these biases by a greater relaxation of restrictions on borrowing for higher income households than for lower income households.[15]

Encouraged by persistent and high capital gains from the mid-1990s generated by population and real income growth and underpinned by housing supply shortages, established households, the primary beneficiaries of increasing income and wealth inequalities, increased their demand both for owner-occupied housing and, increasingly, for investment housing. Increased demand for owner-occupied housing is reflected in a demand for bigger, higher quality and better located dwellings. Increased demand for investment housing is reflected in a demand to own more dwellings. Increased demand for owner-occupied housing from existing owners is fostered by tax concessions (primarily associated with the 1985 exemption of income from housing from the income tax base) that are biased towards high income households with considerable equity in housing. Increased demand for investment housing is fostered by both the 1985 and 1999 tax concessions to investors in housing (primarily associated with the asymmetric tax treatment of income and costs) that are biased towards high income investors who debt finance their acquisitions.[16]

This increased demand from established owners is reflected in housing finance commitments, as illustrated in Figure 4. In the early 2000s the high growth in new lending commitments to repeat buyers and to investors in private rental property promoted concerns that this reflected a speculative response to housing market conditions. Similar concerns are being expressed in the current boom.[17] However, these concerns are tempered by the fact that most of the associated mortgage debt is held by high income, high wealth households. These are the households with an economic capacity to outbid many potential first home buyers and who benefit from tax privileges that provide them with an incentive to do so.

Figure 4: Housing finance commitments, 1985-2015



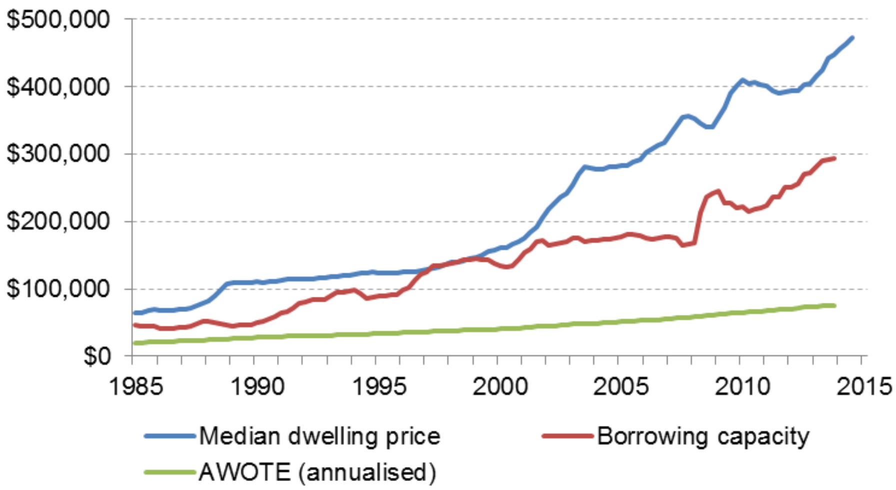
Source: ABS

Increased willingness to borrow and increased borrowing capacity for established households has put upward pressures on house prices and has added to access constraints for lower income would be first home buyer households. In the mid-1970s to mid-1980s borrowing capacity was already significantly constrained by the front loading problem created by interaction of high nominal interest rates and high inflation with standard mortgage instruments. Prior to the 1970s, a household on average weekly earnings had a borrowing capacity that was more than adequate to fund purchase of a median price dwelling. By the mid-1980s, however, when average house prices began to diverge from average incomes, a significant deposit gap had emerged between what a household on average weekly earnings could afford to borrow and median house prices. The early 1990s brought a temporary respite to this growing wealth constraint as a result of declining nominal interest rates associated with declining inflation. It re-emerged in the early 2000s as a result of the credit-fueled house price boom.

Figure 5 shows the rapid growth in house prices during this period and the steadily emerging gap between house prices and average weekly earnings (which roughly equate to median household incomes in Australia) in the fifty years from the 1960s. It illustrates median house prices, average weekly earnings and borrowing capacity. The gap between house prices and borrowing capacity yields a wealth (deposit) constraint that became increasingly severe in the early to mid-2000s.[18] In the last few years, households on the equivalent of average weekly earnings have needed to save two to three times their annual income to meet the gap between the loan they might be able to afford and the Australia wide median house price. Their parents had to save just one third of this amount. Their grandparents didn't even need to take out as big a loan as they would have been able to afford.

This deposit gap has been marginally reduced with recent reductions in interest rates. However, the uncertainty created by the impact of post 2007 credit and debt crises on housing, finance and labour markets raises significant questions as to whether or not moderate income households would be prepared to commit to such an outlay in the current economic environment even if they were able to do so.

Figure 5: Dwelling prices, moderate incomes and borrowing capacity: 1985-2015



Source: ABS, RBA

3.3 Housing markets

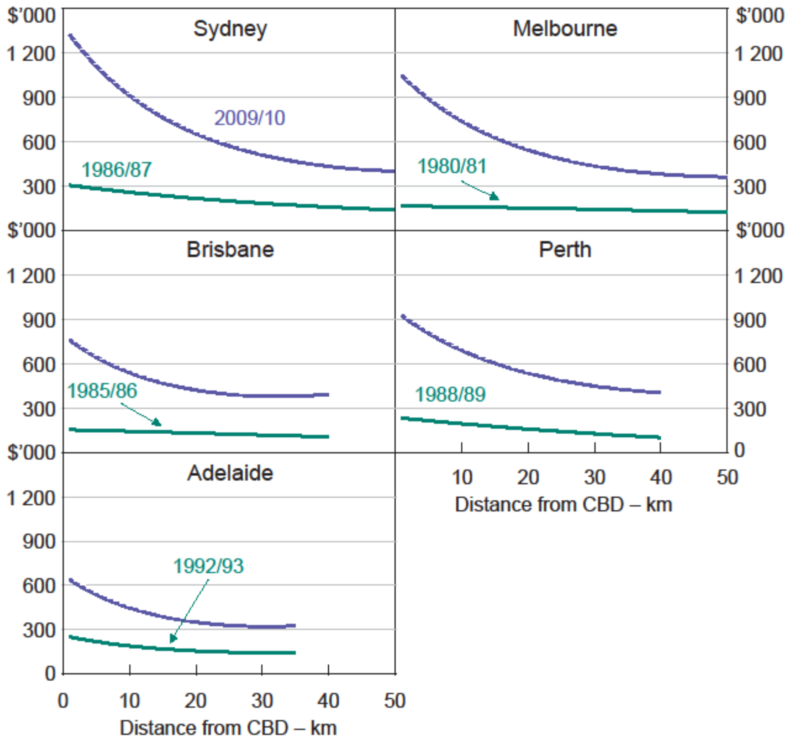
The constraints on access for new households created by the impact of demographic and economic changes on Australia's housing markets have been reinforced by the structure of these markets and, in particular, by the pressures created by:

- Increasing urbanisation; and
- General housing shortages.

In the past 40 years, population in Australia has grown at an average rate of 1.4 per cent per year. Declining household size has meant that household growth has been higher (at around 2.2 per cent per year). A disproportionate share of population has been in Australia's urban areas. The share of Australia's population in major cities increased from 54 per cent in the immediate post war period to 70 per cent by 1971. Currently 67 per cent of the population lives in one of Australia's 6 state capitals and 40 per cent live in either Sydney or Melbourne.[19] Increasing urbanisation contributed both to an increase in, and a steepening of, house price gradients in the major capital cities in the two decades to the late 2000s. This is partly a result of the innate shortage of centrally located land in areas where job concentration is greatest[20], partly in response to state government strategic policies encouraging infill development,[21] and partly in response to the inadequate investment in, and cost of, transport infrastructure.[22] It has contributed to a trend towards higher density living and to changing preferences for smaller dwellings in more central locations.[23]

These trends have contributed to increases in centrally located land and have resulted in higher and steeper dwelling price gradients in Australia's major capital cities, as can be seen in Figure 6. These increases, particularly for Sydney, Melbourne and Brisbane, have continued through to the present time.[24] As a result of the current property right system in Australia,[25] these increases in land (and dwelling) prices have generated increases in unearned wealth for those fortunate enough to own this land. These unearned increases can be seen as a transfer from prospective buyers to prospective sellers rather than as a nationwide increase in wealth. The wealth of cities is not necessarily the same as the wealth of the nation.

Figure 6: Changing dwelling price gradients in Australia's capital cities



Source: Yates (2011b), using charts prepared by Anthony Richards

The existence of clearly defined property rights is supposed to create incentives to use resources efficiently. However, the fragmentation of land ownership within our major metropolitan regions can mean that the pursuit of individual self-interest has the effect of limiting the extent to which more efficient use can be made of land that has increased in value. Constraints on more efficient land use arise from a combination of difficulty of aggregating land to a scale suitable for higher density development, and from delays in obtaining planning permission once land has been consolidated.

The pressures on urban land markets due to economic restructuring, income growth and increasing inequality have been made worse by the failure of the supply of housing to keep pace with the growth in the number of households in Australia for much of the 2000s. By the end of the 2000s, the National Housing Supply Council estimated this shortage to be around 180,000 dwellings. Factors that have contributed to supply shortages include: barriers to adding to housing supply through infill development as a result of higher construction costs for medium- and high-density dwellings than for detached dwellings; difficulties in aggregating and preparing land for construction; problems in securing development finance; lengthy and sometimes uncertain planning and development assessment processes; delays in securing legal title for flats, units or apartments; and community opposition to infill and to medium- to high-density dwellings.[26] The increased rate of dwelling completions in the past few years has assisted in reducing demographically driven demand pressures but is unlikely to have been sufficient and broad-based enough to have eliminated all latent demand.

The combined effect of increasing urbanisation and housing supply shortages has added to the constraints faced by lower income potential first home buyers. By the end of the 2000s, only 27.5 per cent of dwellings were affordable for households at the 60 percentile of the income distribution (which puts them above the average weekly income benchmark used in Figure 5.[27] These estimates are likely to overestimate the size of the stock affordable for lower income households as they ignore the possibility that the limited stock of affordable dwellings could be purchased by households with greater repayment capacities (such as higher income owners or investors). They also ignore its location.

Recent research shows the retreat of affordable housing to the metropolitan periphery where employment opportunities are relatively weak, and access to public transport and other key urban services relatively poor.[28] These constraints are often used to explain why many younger households are "choosing" to rent in more desirable locations than those in which they can afford to buy.[29] Because gross rental yields have been systematically lower than nominal mortgage rates in the past 50 years or so (in part because of tax breaks in investment housing and in part because of expectations of significant real capital gains on such investment), rented housing requires considerably lower outlays for younger households who need to borrow at high loan to valuation ratios in the short run are lower than does access to owner-occupied housing. This adds to short-term incentives to rent rather than own for households with little accumulated wealth, and to long-term incentives for those with little prospect of accumulating discretionary wealth. These incentives are enhanced when gross rental yields are lower on high valued properties than low.[30]

3.4 Housing and other policies

The final factor that contributes to the explanations of declines in access to home ownership for younger households are government policies, including both those intended to improve access and those intended for entirely different purposes. These can be categorized broadly as:

- Housing assistance for first home buyers; and
- Education and superannuation policies.

From the mid-1960s, the Australian government has implemented a range of direct subsidies, primarily in the form of deposit assistance, that were intended to facilitate access to housing finance for first home buyers.[31] Critics of both past and current schemes have suggested that the main effect of this form of assistance has been to bring forward home purchase for those who would ultimately have entered home ownership without any form of direct subsidy. [32] To some extent, their value has been offset by state based transactions taxes (in the form of stamp duties) that have added to up-front cash requirements and reinforced the impact of wealth constraints on would-be first home buyers. A further critique of Australia's system of direct subsidies (which have been provided without any targeting to all first home buyers regardless of need and, until the 2008 initiative, were equally available for purchase of new or established dwellings) is that, like the indirect subsidies provided to all home owners through tax concessions, they have simply added to housing demand and to pressures on housing prices. As such, they have had perverse effects in terms of providing access to home ownership for younger households.

A number of non housing specific policies introduced from the 1980s also have had perverse effects on access to home ownership for younger households through the significant impact they have had in reducing capacity to save for a deposit. One of these was the introduction of the Higher Education Contribution Scheme (HECS) in 1989 which morphed into the Higher Education Loan Program (HELP) in 2005. Under this scheme, tertiary students are required to pay a contribution towards their higher education. No interest is charged on outstanding debt, but the debt is indexed to inflation and loan repayments are compulsory once income exceeds a (relatively low) threshold. Currently accumulated debt can range from about $15,000 to $50,000 and is to be repaid as a part of the tax system at a tax rate of 4 per cent once income reaches about 75 per cent of average earnings to 8 per cent when income is about 140 per cent of average earnings (which are currently around $60,000 per year).[33]

The introduction of the Superannuation Guarantee Scheme in 1992 also is likely to have had an indirect impact on home ownership rates for younger households. Saving through this compulsory superannuation scheme receives significant tax concessions and presents households with a vehicle for long term savings that is almost as beneficial as saving through home ownership. As such, it reduces the incentive to invest in home ownership. To the extent that employer contributions have been at the cost of wage increases (as was explicit in its 1985 precursor), it also has reduced take home income and reduced the ability to save.

4. Conclusions

This overview of some of the factors that have contributed to the observed decline in home ownership rates among younger households in Australia has highlighted their origins in social, demographic and economic change that dates back at least to the 1970s. It has highlighted the possibility that social change can bring with it unintended consequences in terms of housing market outcomes both as a result of the change itself and as a result of the impact that such change can have on housing markets. These unintended changes can be magnified by the economic environment and both related and unrelated policy responses that follow.

The social change of the 1970s that resulted in an increase in the number of single adult households and, simultaneously, an increase in the number of dual income households in the critical households formation age group contributed to a process by which the housing demand from higher income households has put pressures on housing markets to squeeze out lower income households. During the 1980s, this process was exacerbated by the high inflation and high nominal interest rates that prevailed at the time and added a wealth constraint on access to housing for households already facing an income constraint. Younger households were additionally constrained by the burden of education debt and deterred by the implementation of compulsory superannuation which provided a replacement long-term savings scheme. During the 1990s, inflation and nominal interest rates fell and financial deregulation and liberalisation contributed to an increase in the availability and reduction in the cost of housing finance. Growing income inequality and relaxation of lending restrictions on dual income households significantly increased the borrowing capacity of higher income households, many of whom were already home-owners. The willingness to invest in both owner-occupied housing and investor housing by well-off established households was encouraged by tax induced incentives.

The rapid growth in house prices during the 2000s that arose from increased borrowing by established households added further constraints on access to home ownership by lower income households – including many new, younger households but also older households excluded from home ownership by preference or choice at an earlier life-stage. One factor that may add to these constraints beyond 2010 is the impact of uncertainty about incomes and housing markets brought about by post 2007 events.[34]

Over the 50 years or so covered by this overview, Australia's urban settlement pattern, with its increasing concentration of population in a small number of capital cities has added to spatial differentiation of housing prices within these cities and created further incentives for an increasing number of single person and dual income households to make 'life-style' choices that favoured higher cost locations providing flexibility in relation to employment opportunities. For lower income households with limited wealth, the lower up-front costs associated with rental over owner-occupied housing expand their choices (both in relation to household structure and to housing location) and encourage a move towards renting. Therefore, whether a decline in home ownership rates amongst younger households reflects choice or constraint may be regarded as ambiguous. Whether the declines currently observed represent decline or deferral, on the other hand, however, seems less ambiguous given the economic factors that currently constrain access for lower income households. Existing trends might be reversed if there is a reversal of the social trends of the 1970s (signs of which are already present in Australia with a decline in household formation as young adults who have the option to do so defer the move to independent living and remain for much longer in the family home).

They might be reversed if the economic pressures that have contributed to rising real housing prices and to rising inequality in household incomes and household wealth are reversed.

This submission has focused on underlying structural factors rather than short-term cyclical factors that can be used to explain declining rates of home ownership amongst younger households.

In particular, it has point to:

- the system of housing finance that makes it relatively easier for better-off households to accumulate housing assets through debt finance;
- to the income taxation system that provides them with an incentive to treat property as a means of accumulating wealth ahead of its more essential role as providing shelter; and
- to the system of property rights in Australia that ensures that those who do own land are able to act as rent-seekers by expropriate for their own the increase in land values not of their own making.

These institutional arrangements reinforce existing housing and wealth inequalities. Our financial system facilitates investment by the economically advantaged by making it relatively easier for them to obtain finance. Our tax system encourages high income and high wealth individuals to invest in property (or more specifically land) that is likely to generate unearned capital gain. Our treatment of property rights allows unearned increases in the value of land that do not arise from individual effort, to be captured by owners for their own private purpose.

It suggests that increasing land values in urban locations are an inevitable outcome of the combined impact of

- the pressure of income and population growth;
- structural change which results in increasing urbanization and concentration of (knowledge-based) employment in its central locations
- a failure to invest in a rapid-transit transport infrastructure that facilitates cost-effective access to employment and essential services.

Land-release and urban planning policies might ameliorate supply shortages when pressures on dwelling prices arise from increasing demand driven by population (or, more specifically, household) growth. They are less likely to be effective when pressures on dwelling prices arise from increasing demand for bigger and better located dwellings driven by economic growth and/or increasing inequality.

In an environment of population growth, income growth and increasing inequality, policies are needed both to expand supply for new households and reduce demand from existing households.

If the decline in home ownership among younger households is not reversed, then, ultimately, Australia's aggregate home ownership rate will fall. Whether this matters is an entirely different question. However, it does suggest that policies that support property ownership might need to be considered (and reconsidered) in light of which households benefit from them.

5. Opportunities for reform

This focus on structural or institutional drivers suggests that a key focus needs to be how our institutions might be changed in order to reduce inequalities in housing. They lead to a focus on what has been called pre-distribution and to a focus on the way in which the market distributes its rewards in the first place, rather than attempting to redistribute these rewards after the event. Pre-distribution is consistent with the notion that redistribution, while it protects the most disadvantaged, often does little to change the *causes* of their disadvantage. Redistribution attempts to change outcomes. Pre-distribution attempts to change the institutions that give rise to these outcomes.

Suggestions below are limited to the three institutional constraints outlined above.

5.1 Property rights

The first relates to our system of property rights over land. Enforceable property rights over private possession and over the use of land are seen as essential to ensure that land markets operate effectively. Use rights, however, do not *have* to mean that private owners should be allowed to appropriate any socially created wealth that is independent of the productive or other use they make of their land.

Ownership of land does not have to include a right to the development value that results from urban growth, or from the provision of infrastructure. One suggestion, therefore, is to unbundle our current system of property rights and to remove the right to derive unearned income from land from the right to use and exchange land. A more extreme solution is to extend existing compulsory acquisition laws. Currently these apply when land is needed for the public interest, as would be the case if a new road or railway line was to be constructed. They could be applied to any land which has increased in value is currently not being used most effectively, as might be the case if fragmented land holdings are limiting redevelopment opportunities.

A different approach to property rights that could help reduce the perpetuation of housing and wealth inequalities can be found in the Community Land Trust model. This model, which retains many of the benefits of home ownership such as security, freedom and responsibility, is already a well-established way of ensuring affordable housing in perpetuity in a number of countries. The extent of wealth accumulation that is possible, however, is constrained by the rights as defined in the Community Land Trust lease. Public housing, shared equity models being developed by State Housing Authorities, and social rental models being developed community housing providers all have the capacity to achieve similar outcomes. The extent to which socially generated wealth is retained in the community, however, is limited to the ownership share retained by the State or community provider.

The broad principle behind these solutions is that land is owned by the community rather than by the individual and leased out for individual or community use.

5.2 Taxation

A more direct approach, based on retaining private ownership of land, is to work through the tax system and, in particular, through changes to the way in which we tax land and wealth.

The most extreme solution to limiting intergenerational transmission of inequalities in wealth is through the use of gift and inheritance taxes.[35] Gift and inheritance taxes involve a fundamental shift from taxing income to taxing wealth. The Henry Review recognised that an inheritance tax of one sort or another does exist in most OECD countries and concluded that such a tax would be an economically efficient way of raising revenue in Australia. It was ruled out, however, on the basis of its controversial history.[36]

Within the income tax system options that would limit the extent to which individuals benefit from unearned increases in land values also exist. The most obvious is to eliminate the exemption of owner-occupied property from the capital gains tax and remove the bias that encourages negative gearing by investors. The fact that both of these proposals were ruled out of consideration when the Henry Review was undertaken reflects the political realities of mass home ownership and Mum and Dad investment in rental property. It is a testament to the concerns that wealth inequalities generate political power for some that, in turn, limit equality of opportunity for all.

We do, however, already have in place taxes designed to capture at least some of the increased value of land associated with zoning changes. These are the planning gain supplements, impact fees or infrastructure charges introduced as a means of funding infrastructure. However, in the main, these apply to newly released land at the urban fringe and, as a result, do not address the central issue about how to treat externally generated increases the value of *all* urban land, not just land at the urban periphery.

We do have a means of capturing these increases in the value of all urban land. One option, which was *not* excluded from the Henry Review's terms of reference, is to remove the exemption of owner-occupied property from State land taxes. A land tax could be regarded as a resource rent tax - a tax imposed on the super-profits derived from the ownership of land. Like the resource rent tax it, too, is likely to be resisted by the wealthy who benefit from the exploitation of a non-renewable resource. In this case, however, the wealthy are not the extremely wealthy mining magnates, but are the 20 per cent or so of the general population who are owners of the well-located land that has increased so much in value.

5.3 Finance

The final set of institutional constraints are those arising from the finance system. At an individual level, there are few obvious antidotes to current biases in favour of higher income and older, established owners with significant wealth. One variation of macro-prudential regulations that have been proposed to limit speculative investment could be a return to past requirements that lenders restrict the size of loans available. For younger households entering the housing market for the first time, greater use might be made of repayment schedules that respond to an increasing capacity to repay over time. Because this is likely to add to the risk associated with mortgage finance, consideration could be given to the introduction of compulsory mortgage protection insurance that protects the borrower, to supplement the existing forms of mortgage insurance that protect the lender.

Any first home owner grants might be restructured to reduce the value of the subsidy they provide. This might be achieved, for example, by requiring that any assistance provided is eventually repaid, for example, from the capital gains made once the property is sold. A similar solution might be provided by enabling HECS debt to be replaced by a government equity share in the first property bought by new entrants to the housing market, to be repaid when the dwelling was sold. Such changes could begin to change attitudes amongst home-buyers about their inalienable right to the unearned gains that come from rising dwelling prices and would provide a risk sharing solution for any losses when prices fell.

In addition to changing the way in which the family home is treated by the pension assets test, One institutional change that might discourage older established households from using debt to increase their investment in owner-occupied or investment housing, or from assisting their offspring into home ownership, could be to require superannuation payouts to be taken as an annuity rather than a lump sum. This could reduce the scope those close to retirement have for double-dipping on government retirement income support.

Perhaps the biggest changes that need to be made to the financial system, however, are those that deal with financing of alternatives to home ownership for households who are currently excluded from it. This might be achieved by the setting up of a Housing Finance Corporation, underpinned by government guarantees or some other form of credit enhancement, to ensure community housing providers or community land trusts could obtain access to cost-effective finance. It might be done by requiring mainstream lenders or institutional investors (such as superannuation funds) to commit a specified part of their portfolio to what many would regard as socially desirable investment. It could be done by a return to direct government funding of affordable rental housing.

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Endnotes

[1] This paper is based on, and updates, Yates, J. (2011a) and Yates (2012). Home ownership is taken to include owners with and without a mortgage.

[2] See Yates (2000) for an early analysis of declining home ownership rates amongst younger households and Yates (2011c) for a more recent analysis of structural drivers of this decline.

[3] Bourassa et al (1995) provide an excellent account of the early history of home ownership in Australia.

[4] See, for example, Yates (2003) for an overview of past policies and Badcock and Beer (2000) for a discussion of the ideological commitment to home ownership.

[5] These data reflect household home ownership rates. Data based on person in home ownership show even greater declines because they reflect, in addition, the increasing tendency for younger persons to stay longer in the family home. Data for the youngest age group in Table 1 are not commented upon because of their relatively small share (less than 4 per cent) of all households. The data in Figure 1 suggest that the low home ownership rate for 25-34 year old households recorded in the 1971 census might have been something of an anomaly, possibly associated with the form and number of new questions about housing introduced that year.

[6] See, for example, McDonald and Baxter (2005) for an analysis of the role of these drivers in Australia in the 1980s and 1990s and Beer and Faulkner (2011) for an update.

[7] See, for example, Bourassa et al (1994) for the impact of these factors in the 1980s and 1990s and Hendershott et al (2009) for a more recent analysis.

[8] The data on home ownership rates in this submission are based on owner-occupied housing; they ignore the (relatively small) proportion of renter households who are home-owners as investors. In 2011-12, about 8 per cent of renter households aged less than 45 years owned rental property as investors. Virtually all of these had household incomes in the top 2 quintiles of the equivalised disposable income distribution.

[9] See Yates (2002) and Flood and Baker (2010)

[10] This categorisation ignores the interdependence between the categories (such as household formation being affected by economic factors).

[11] Much of these followed legislative changes affecting the role of women in Australian society such as: equal pay for work of equal value" in 1969; anti-discrimination legislation from 1975; affirmative action legislation from the mid-1980s, work and family policies in the early 1990s; and managing diversity from the late 1990s (Strachan, Burgess and Henderson, 2007: 2). The introduction of 'no fault' approach to divorce in the 1975 Family Law Act contributed to the rise in sole parent households.

[12] McDonald and Baxter (2005) provide an example of the first view, Yates (2002) of the second.

[13] This shows the cumulative home ownership rate for households in 25-34 year old cohorts from 1981. Cohort 1 represents households in the 25-34 year age group in 1981 (and who were, therefore, in the 35-44 year age group in 1991 and so on). Cohort 4 represents the most recent (2011) cohort of households in the 25-34 year old age group. Note that these are household based data. Person weighted survey data shows even greater declines for young people because of the declining rate of household formation for those aged between 25 and 44.

[14] Gregory (1993), Harding (1997) and Johnson et al (1995) described trends in income inequality through to the 1990s, Greenville et al (2013) update this for the 2000s.

[15] An example of a financial innovation that contributed to increased availability of finance for some households was the shift away from a simple 'rule of thumb' 30 per cent ratio measure to use of a residual income measure effectively based on a net income surplus measure (which allows for costs of children and other dependents in assessing repayment capacity). For a given level of income, this results in households with no children being assessed with a greater repayment capacity than those with children. It also results in higher income households with a given household structure being assessed as having disproportionately greater repayment capacity than lower income households with the same household structure. In 2007, just prior to the global financial crisis, higher income earners (on double average weekly earnings) and modest income households with no children were permitted repayment ratios of up to 40 or 50 per cent of gross household income. A 30 per cent ratio, however, remains for a single earner household with 2 children on the equivalent of average weekly earnings. Relaxation of loan to value ratios immediately following deregulation may have assisted those who were wealth, but not income, constrained but any subsequent tightening of these will have reversed this advantage.

[16] The treatment of the family home in the assets test for the age pension provides an additional incentive to that provided by the income tax system for older owner-occupiers to retain equity in their owner-occupied housing. For individual investors, the switch from the taxation of real capital gains from 1985 at the investor's marginal tax rate to taxation of nominal gains with a 50% discount in 1999 provided a more favourable tax environment to investors whenever house price inflation was more than twice general inflation.

[17] See, for example, Macfarlane (2003), Wilkins and Wooden (2009) and Bilston et al (2015). Official expressions of concern with the early 2000s boom can be found in Macfarlane (2003) and with the current boom in RBA (2014, 2015).

[18] The median house price used in these calculations was just less than $475,000 in June 2015; the annual equivalent of average ordinary time earnings was a little more than $75,000, borrowing capacity at 5.95 per cent rate of interest was set at $300,000. At a more conservative 'normal' rate of 7.5 per cent, this would be $50,000 lower. Borrowing capacity is the maximum amount that could be borrowed over a 25 year term by a household earning average weekly ordinary time earnings, assuming repayments were set at 30 per cent of total household income and that the current standard bank variable rate of interest applies. No account is taken of the practice of adjusting borrowing capacity to provide for an interest rate buffer when interest rates are well below their long-term norm.

[19] Population data from Infrastructure Australia (2010).

[20] Or in existing suburbs that provide reasonable access to employment opportunities. See Rawnsley and Spiller (2012) for evidence on concentration of employment opportunities.

[21] See NHSC (2010: 111) for discussion of state and local government policies,

[22] See, for example, Kelly and Donegan (2015)

[23] See Kelly (2011)

[24] See Kulish et al (2011) for an analysis of change through to the late 2000s and Ellis (2014: Graph 11) for an update since then.

[25] Property rights broadly can be expressed in terms of the right to use land, the right to exchange it and the right to derive income from it. In Australia, use rights generally are limited in some way; usually by planning and building regulations. Exchange rights are limited only to ensure the smooth functioning of transactions between consenting individuals. For most residential land owners, however, within the constraints imposed by use rights, the right to earn income from land is more or less unlimited. With only some partial exceptions relating to the tax system, individual owners are able to expropriate any increases in land value that arise from external pressures. Such pressures could arise from population or economic growth, from agglomeration benefits associated with increasing city size, or from zoning changes. None arise from individual land-owner effort.

[26] This estimate is based on comparison of 'latent' or 'underlying' demand with the total number of dwellings, where underlying demand is measured as that which would have taken place on the basis of past rates of household formation had there been no constraints on demand. See National Housing Supply Council (NHSC) (2010:71) for estimates of supply shortages and NHSC (2010: 110) for an overview of constraints on supply. Suggestions that the existence of a high proportion of vacant dwellings (or even of vacant bedrooms) provides evidence against arguments of under-supply ignores the reality that increased demand for housing in the form of larger dwellings and second dwellings comes from economic as well as demographic factors.

[27] As reported by the Council of Australian Governments (COAG) Reform Council (2010: 59). The Council also suggest that less than 5 per cent were accessible for households at the 30th percentile of the income distribution in 2007-08. Richards (2008) quotes a slightly greater figure of 30-35 per cent of transacted dwellings being affordable for the median household in the 25-39 year age group in four of the major capitals.

[28] See, for example, Phillips (2011: 17-20) and Wood et al (2008: 287-288) and mainstream media throughout 2015 (for example, Bleby and Tadros for the Australian Financial Review)

[29] See Hulse and Yates (2015)

[30] Gyourko et al (2006) identify this as a characteristic of 'superstar' cities. Wood (2001) identifies this as a general characteristic of rental property in Australia.

[31] Bourassa et al (1995) and Yates (2003) provide overviews of early schemes. The most generous of later schemes was implemented in 2008 as a short term response to the global financial crisis. When combined with generous State based supplements, this provided a grant of up to 10 per cent of the value of a modest price starter home. Along with stimulatory monetary policy, this fiscal response ensured that, in stark contrast with outcomes in a number of countries, first home buyer activity in Australia supported the housing and housing finance markets in the post 2007 period.

[32] See, for example, Wood, Watson and Flatau (2006) show the 'bring-forward' effect; Wood et al (2006) show that stamp duty exemption would result in the deposit gap being bridged for fewer than 10 per cent of potential first home buyers.

[33] Pearse (2003) has argued this has contributed to reduced access to home ownership for younger households.

[34] Berry and Dalton (2000) provide an excellent early insight into the implications of a 'risk society' categories by uncertainty, flexibility and change.

[35] This is not a new idea, even for an economist. In the 1960s, Nobel laureate James Meade proposed a scheme of inheritance and gift taxation to break up large inherited fortunes. Meade, and later Rawls, both argued in favour of a property owning democracy, with a wide and relatively equal distribution of assets. This was seen as more likely to provide equality of opportunity than current models of welfare state capitalism, where the focus is on redistribution rather than pre-distribution. A basis of their concern was that economic inequalities are the source of political power that prevent adoption of policies designed to spread wealth more equally. See Williamson (2009: 437-8)

[36] AFTS (2009, vol 1: 37)