AUSTRALIAN BANKERS' ASSOCIATION INC.

Submission

ABA response to the Inquiry into Home Ownership

June 2015

Australian Bankers' Association Inc. ARBN 117 262 978
(Incorporated in New South Wales). Liability of members is limited.

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Contents

1. Preamble

The Australian Bankers' Association (**ABA**) welcomes the opportunity to provide a submission into the House of Representatives Economics Committee Inquiry into Home Ownership (**Inquiry**).

With the active participation of 24 member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

2. Introduction

This submission addresses the key issues for the Inquiry, including the current rates of home ownership, demand and supply drivers in the housing market, the incidence of investment housing relative to owner-occupied housing, and current tax policy.

The ABA is an active participant in discussions on housing. Two recent papers produced by the ABA are attached to this submission and should be read as integral to it. Appendix 2 is the ABA submission to the Senate Economics References Committee Inquiry into Affordable Housing. Appendix 3 is an ABA economic report, *Key truths on housing in Australia*, which provides perspective on recent trends in the Australian housing market.

This submission does not reproduce the material in these attachments where it remains current but does update information where more recent statistics are available.

Taken as a body of work as a whole, the key findings are:

- Around two thirds of households own or are purchasing their home and about one third are renting. Australia's home ownership rate is around the middle of many of its peers in the Organisation for Economic Co-operation and Development (**OECD**).
- More recent data on housing finance commitments suggests that investors are increasing their share of the housing stock. This is not a uniform trend across Australia but is particularly marked in Sydney and to a lesser extent in Melbourne.
- First home buyers are still able to access the housing market but the rate of finance commitments for first home buyers since 2011 has been below the average of the previous two decades which may indicate there is unmet demand from this segment of the market.
- Banks are the predominant suppliers of finance for housing in Australia and housing loans comprise the major part of most bank's assets.
- Interest rates on home loans are at generational lows with the average advertised standard variable mortgage rate at 5.45 per cent in May 2015, the lowest since 1968[1]. These low rates are mostly a product of the globally low interest rate environment.
- There is no evidence of a credit boom. Bank lending for housing is accelerating but the rate of growth remains muted relative to the pre global financial crisis (**GFC**) rate of activity.
- Banks are maintaining high lending standards. The proportion of high loan-to-valuation ratio (**LVR**) loans and low doc loans continues to fall as does the ratio of non-performing housing loans.
- Household finances are in good shape. The value of housing assets continues to exceed the value of housing loans by a factor of 3 to 1. Interest payment-to-income ratios are declining in response to generational low interest rates. The household savings ratio remains elevated. Households are more than two years ahead in repaying their home loans.

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[1] Reserve Bank of Australia

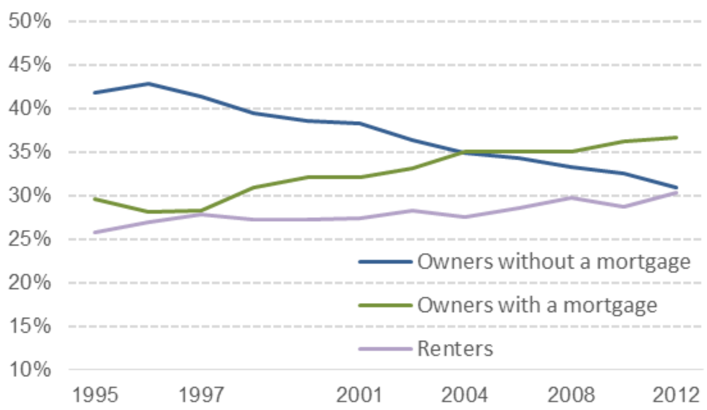
- Issues of rising house prices and housing (un)affordability are symptoms of excess demand relative to supply. Policies which seek to increase home buyers' purchasing power in an environment of insufficient supply will serve only to drive up prices and reduce housing affordability. While such policies to increase *demand* have some political appeal, in reality they are counterproductive. Such issues can only be resolved through policies which increase *supply*.
- In this context, policies which influence the demand for housing including policies which impact on immigration and the decision to have children are primarily the preserve of the Federal Government. In contrast, the policies which primarily determine supply, such as availability of land, are primarily the preserve of the state and local governments. This dichotomy in responsibility for the demand and supply policy decisions is a key factor in the imbalances and housing affordability issues in some cities, particularly Sydney and Melbourne. Better coordination between the three levels of government provides a major opportunity for reform.
- The supply side of the housing market is now lifting, although this is mainly a cyclic response to the progressive reductions in interest rates since late 2011. In terms of longer term structural impediments to increased supply, an international survey suggests that Australia ranks poorly on land availability for new dwelling construction. Addressing this issue is a further significant opportunity for reform.
- Taxation of the housing sector in Australia is complex with many different taxes, rates and carve outs and relies heavily on inefficient taxes, particularly stamp duties. A change in the mix of property taxes away from stamp duty, and with greater emphasis on land tax would likely improve turnover in the housing market, improving the efficiency of the use of the existing stock of housing. There would need to be consideration of transitional arrangements. These are matters for state and local governments. The current transitional arrangements in the ACT provide a guide.

3. Current rates of home ownership

3.1. Owners and renters

The latest data from the Australian Bureau of Statistics (**ABS**) published for the period 2011-12 shows that at that time around two thirds of households owned or were purchasing their home and about one third were renting.

Figure 1: Housing tenure in Australia

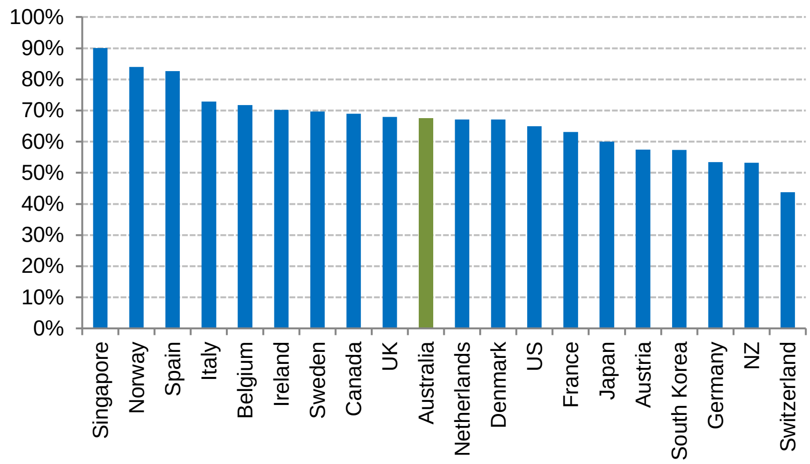


Source: ABS

It also shows that housing tenure was changing. The proportion of households owning their house outright (that is, without a mortgage) had fallen from around 43 per cent in the mid-1990s to 31 per cent in 2012. This fall had in part been offset by an increase in purchasers (that is, with a loan), rising from 28 per cent in the mid-1990s to 37 per cent in 2012. Combining home owners and home purchasers provides an overall measure of home ownership. This had declined, from 71.4 per cent in the mid-1990s to 67.5 per cent in 2012. The proportion of households renting had increased from 26 per cent to 32 per cent.[2]

At that time Australia's home ownership rate was around the middle of many of its peers in the OECD.

Figure 2: Home ownership rates (selected countries)



Sources: Eurostat, US Census Bureau, Turkish Statistical Institute, Statistics Canada, Singapore Department of Statistics, Australian Bureau of Statistics, Statistics New Zealand, Ha'aretz, Housing Finance Information Network, Journal of Housing and the Built Environment

Indirect evidence on more recent trends in ownership can be gleaned from information on borrowers. Household borrowings for housing stood at $1.46 trillion in April 2015. Of this, $953 billion was for owner-occupied housing and $503 billion for investor housing. So about two thirds of houses on which there are borrowings are being purchased by owners and about one third by investors.

This ratio is changing. Borrowings by both owner-occupiers and investors are rising, but borrowing by investors is rising much more quickly. Figure 3 shows that since mid-2013 investors have been driving a significant part of the increase in total home loan outstandings.

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[2] ABS 4130.0 Housing Costs and Occupancy

Figure 3: Investor contribution to increase in housing loan outstandings

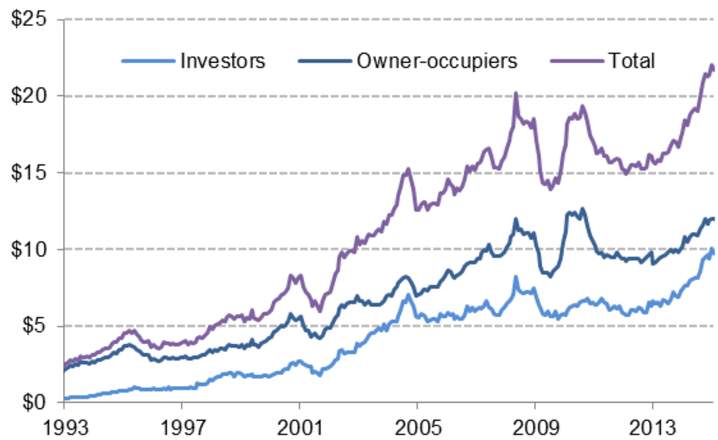
Sources: ABA/RBA

Further perspective on the owner/investor mix is provided by new finance commitments.

The monthly flow of new commitments for housing has accelerated since 2011. New commitments for owner-occupiers have historically exceeded that for investors, although the gap between the two has now narrowed.

The reason for this is that the recent lift in housing commitments has been much stronger for investors. Over the year to April 2015 commitments for investors increased by 24 per cent whereas commitments for owner-occupiers increased by only 6 per cent.

Figure 4: Housing loan commitments ($bn, monthly)

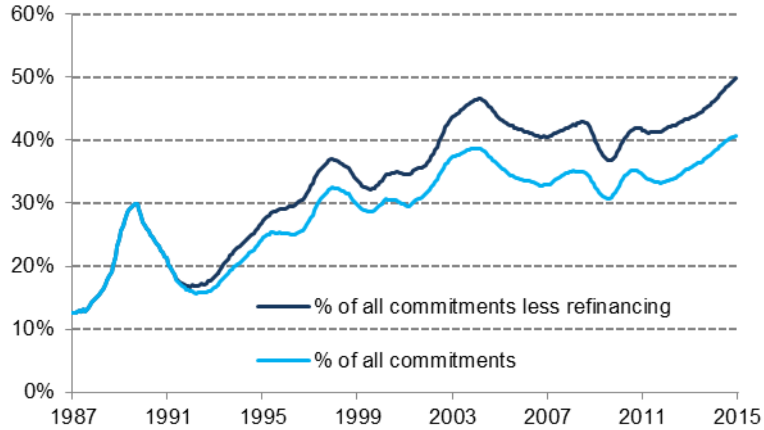


Sources: ABS, RBA

As a result the share of investors in total housing finance commitments has increased over the past 6 years from 30 per cent to 41 per cent.

This recent more rapid growth in investor borrowings does not seem particularly unusual as it is in line with previous cyclic upswings, although underlying the cyclic swings there has been a trend increase in the activity of investors relative to owner occupiers.

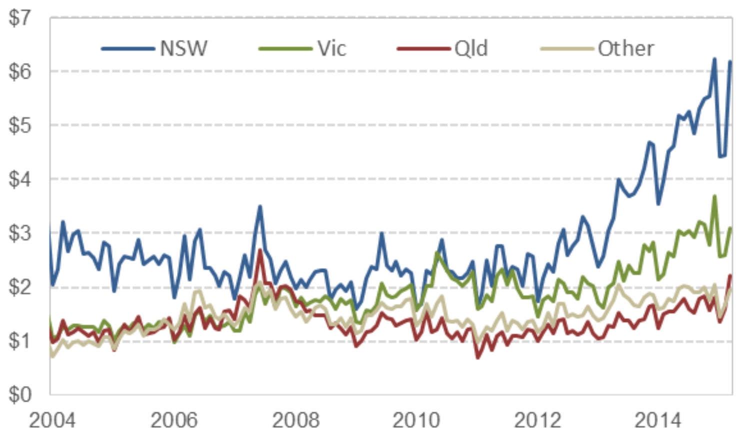
Figure 5: Investor share of housing loan commitments



Source: ABS

An increasing proportion of this investor interest is focused in NSW, where investor housing loan approvals have increased by 31 per cent over the year ending March 2015 and by 87 per cent over the past two years (Figure 6).

Figure 6: Investor housing loan commitments ($bn, monthly)



Source: ABS

The data on finance flows for investors capture investors who borrow from domestic financial institutions – who are likely to be mainly *resident* investors - but would not include *foreign* investors who access funds from offshore.

The information on foreign investment in residential real estate is dated. The latest data from the Foreign Investment Review Board is for the year ending June 2014[3]. It shows a doubling of foreign investment in that year to $34.7 billion. The bulk of the approvals – around 80 per cent – were in NSW and Victoria.

This data, together with recent revelations that some foreign investors have purchased existing dwellings without notification to or the permission of the Foreign Investment Review Board suggests there may be an underestimation of the extent of foreign investor activity in the Australian housing market. While the impact of foreign investment on the housing market is not clear, it is likely that it is having a notable effect on demand in some cities.

[3] Foreign Investment Review Board, *Annual Report 13/14*

Overall the recent data suggests that investors are slowly increasing their share of the housing stock relative to households purchasing their own home. This is not a uniform trend across Australia, but is particularly marked in Sydney and to a lesser extent in Melbourne.

There is considerable public debate about the impact of investors on house prices, affordability, and construction activity. There is insufficient empirical evidence to draw unambiguous conclusions. The Reserve Bank of Australia (**RBA**) has recently provided some views on this, noting[4]:

> *"…the strong growth of investor housing loans has driven the growth in household debt (as a share of disposable income) over recent years and contributed to a rise in both housing prices and dwelling construction…….this….will support overall economic activity nonetheless."*

3.2. First home buyers

The issue of housing affordability is most often raised in the context of first home buyers.

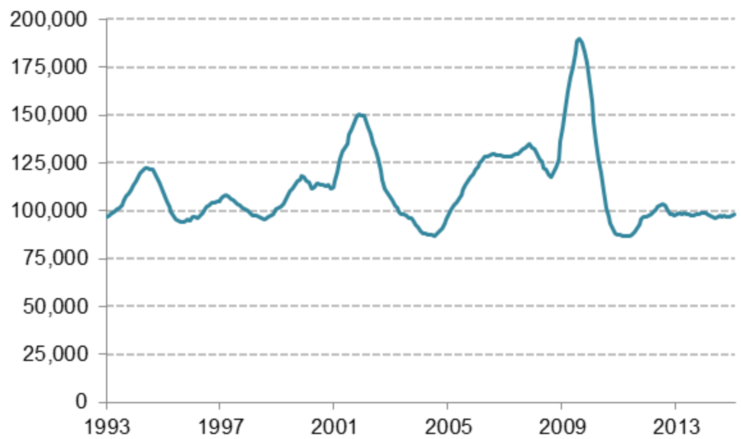
The ABA addressed the issue of housing affordability at length in the paper annotated as Appendix 3. Without covering this ground again, the perception of affordability depends in part on which yardstick is used. Measures which look at household income relative to prices suggest that over the longer term house prices in Australia have become more expensive relative to the purchasing capacity of both individuals and households. However, measures which incorporate the interest servicing burden suggest that affordability has improved in recent years as interest rates have declined.

Whichever conclusion is drawn, a number of commentators have suggested first home buyers are being priced out of the market as investors bid more aggressively for the existing housing stock.

While there is no doubt the competition for houses is fierce in some cities the empirical evidence suggests first home buyers are still active. Housing loan commitments to first home buyers have remained relatively stable since 2011. In addition, the volume of first home owner grants for new dwellings has increased over the past four years (Figure 7). This data shows that significant numbers of first home buyers are still able to access the housing market.

Nevertheless, the proportion of commitments for first home buyers since 2011 has been below the average of the previous two decades or so, which may indicate there is unmet demand from this segment of the market.

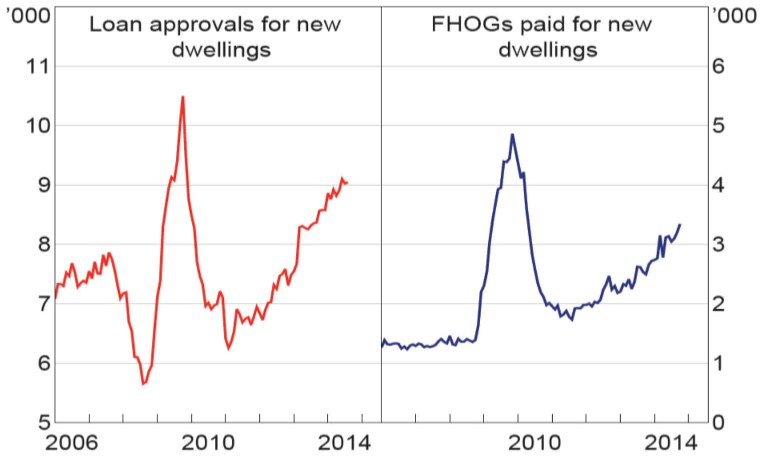
Figure 7: First home buyers – number of commitments (annual)



Source: ABS

[4] Reserve Bank of Australia, *Monetary Policy Transmission – What's Known and What's Changed*, Christopher Kent, 15 June 2015

Figure 8: Owner-occupiers selected indicators (monthly)



* Includes both new construction and newly erected dwellings

Source: RBA (2014) *Statement of Monetary Policy*, November, using data from: ABS, NSW Office of State Revenue and RBA

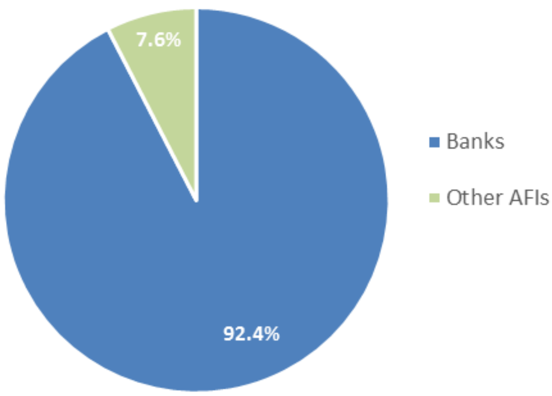
4. Lending for housing

4.1. Loans outstanding

Banks are the predominant suppliers of finance for housing in Australia and housing loans comprise the major part of most banks' assets.

Loans outstanding for the purchase and construction of houses total $1.46 trillion. Of this, $1.35 trillion is lent by banks, with the remainder spread among building societies, credit unions and finance companies.

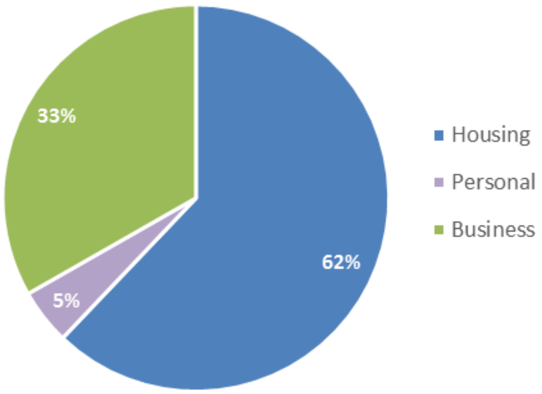
Figure 9: Housing loan outstandings of AFIs (April 2015)



Source: RBA

Housing loans comprise 62 per cent of the total lending assets of banks and, as we have seen, about two-thirds are loans to owner-occupiers and the remaining third to investors.

Figure 10: Banks' lending assets (%distribution, April 2015)



Source: RBA

Since the GFC, the rate of growth of borrowing for housing has been much slower (Figure 11). The low point was over the first quarter of 2013 where the annual growth rate was 4.4 per cent.

Over the past two years or so the growth rate has gradually accelerated and has now reached 7.2 per cent over the year ending April 2015. The growth rate over recent months has been the highest since late 2010, but it is well below the average rate of growth in the pre GFC era. The last historical high point was in March 2004 at almost 22 per cent.

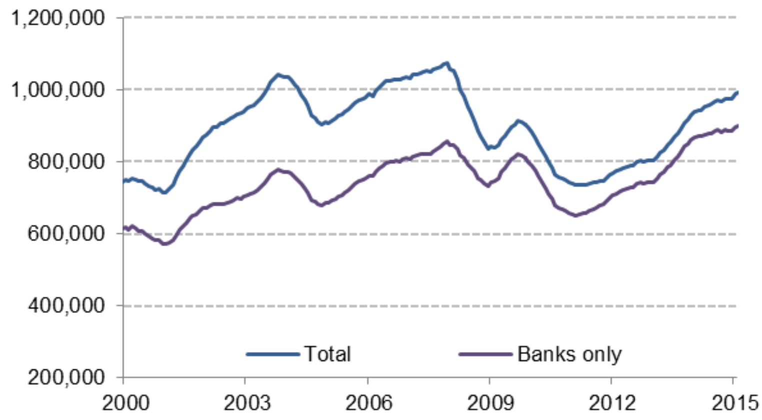
Figure 11: Housing loan outstandings (annual growth)

Source: RBA

Another perspective on recent developments in borrowing is shown by new finance commitments.

Over the year ending April 2015, there were an estimated 1 million housing loan commitments of which about 900,000 or 91 per cent were made by banks. The pace of commitments has picked up since 2011. Commitments by all lenders in total are still below the peaks of the last decade, although commitments by banks have reached new highs.

Figure 12: Number of housing finance commitments



Sources: ABS/ABA

4.2. Interest rates

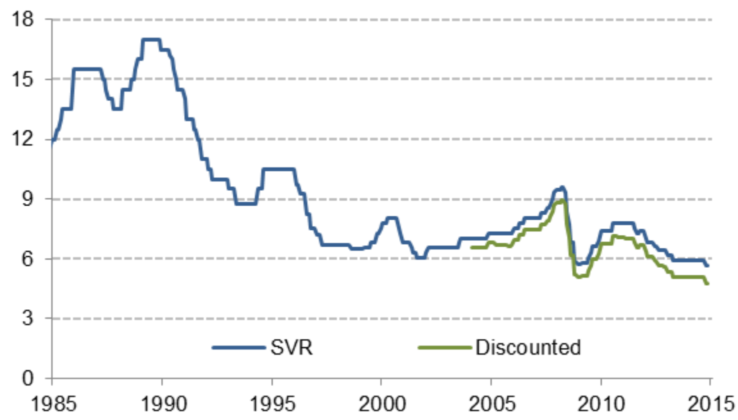
Interest rates on home loans are at multi-generational lows.

The average advertised standard variable mortgage rate was 5.45 per cent in May 2015, the lowest since 1968[5]. Today's discounted rate is even lower at less than 5 per cent.

These low rates compare to the 17 per cent peak recorded between June 1989 and March 1990.

These low rates charged to home borrowers are in part a reflection of the intense competitive environment faced by bank and non-bank lenders. Mostly however, they are a product of the globally low interest rate environment. The RBA's cash rate was reduced to 2.00 per cent in May 2015 - the lowest in a generation.

Figure 13: Selected housing loan interest rates



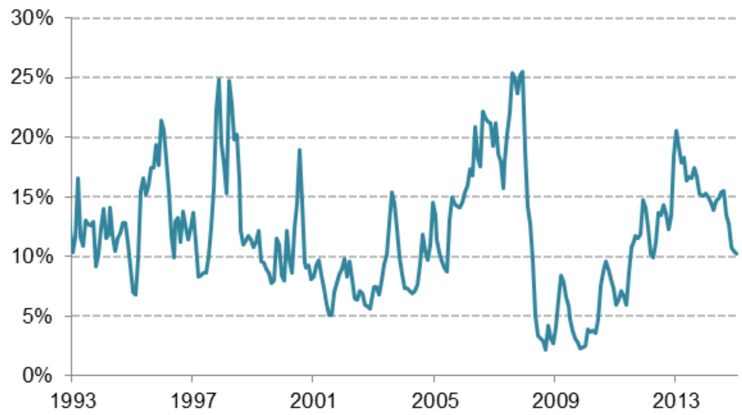
Source: RBA

Interest rates on fixed rate loans are also very low at below 5 per cent.

[5] Reserve Bank of Australia

The proportion of loans which are fixed rate is now falling. Around 10 per cent of new loans are fixed rate, which is about half the proportion in 2013.

Figure 14: Proportion of new housing commitments which are fixed rate loans



Source: ABS

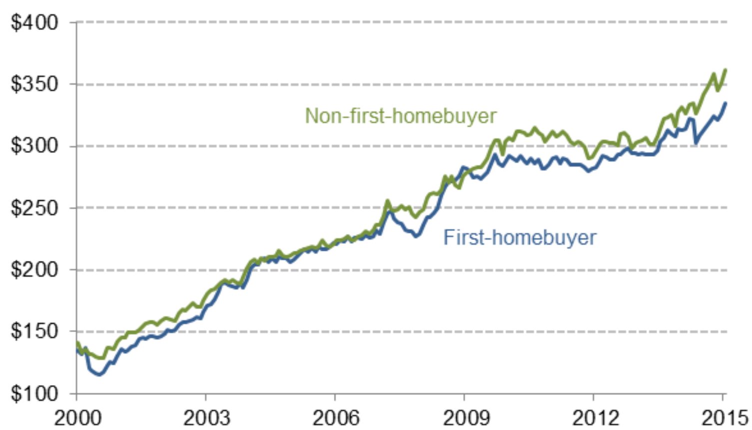
4.3. Size of home loan

The buying power of most home purchasers is determined ultimately by the amount of money they can borrow.

The average loan size is now $357,500 or 8.7 per cent higher over the past year, and not surprisingly the highest on record. What might be unexpected is that the loan size does not always rise. From the end of 2010 to early 2012 the loan size declined slightly. This was associated with higher interest rates which would have reduced the size of loan which could be serviced, and also some softening in house prices. The upward trend then resumed as interest rates were reduced to generational lows.

There is a difference between the size of loans taken out by first home buyers to that of other purchasers, although the difference is not particularly large. The average loan size for a first homebuyer is $334,800, $26,800 less than for other home borrowers at $361,600.

Figure 15: Size of home loan



Source: ABS

4.4. Lending standards

Finance providers are maintaining high lending standards.

The proportion of new loan approvals to high LVR borrowers, i.e. LVRs more than 90 per cent, has fallen since 2009 for all borrowers (Figure 16) and remains below 10 per cent for investor loans (Figures 17 and 18).

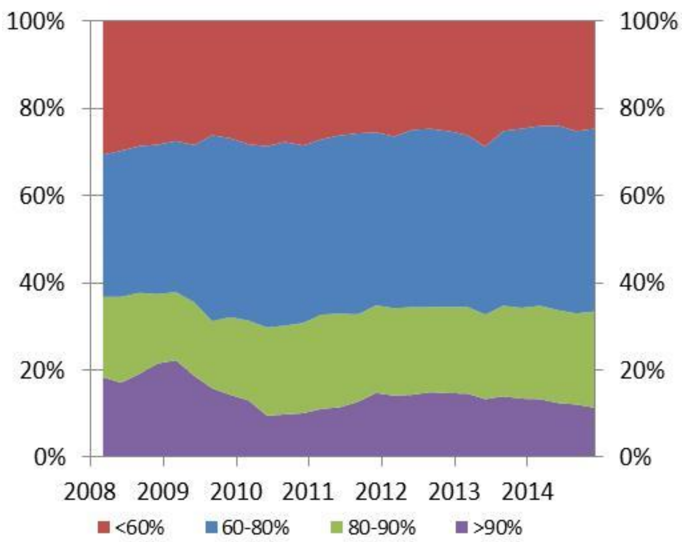
Low doc loans have fallen to very low levels for both owner-occupiers and investors.

The proportion of interest only loans has been gradually rising since 2009, with investors showing a greater propensity to use this form of financing compared with owner-occupiers.

The share of housing loans which are impaired has been falling since 2011.

Figure 16: LVR of home loan commitments

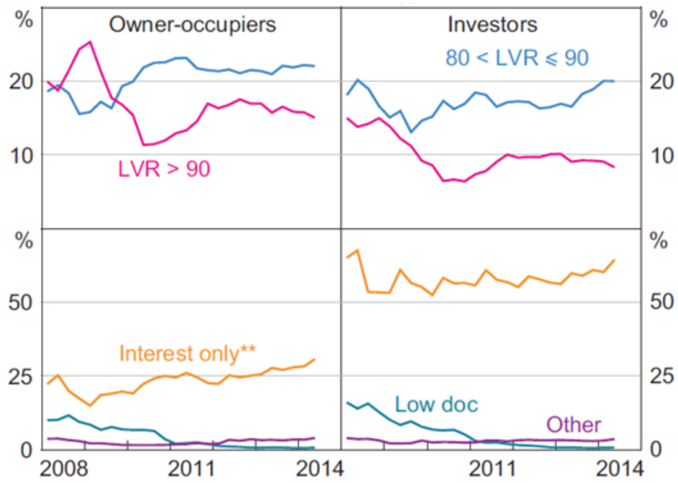
per cent of total



Source: APRA

Figure 17: Banks' housing loan characteristics*

share of new loan approvals

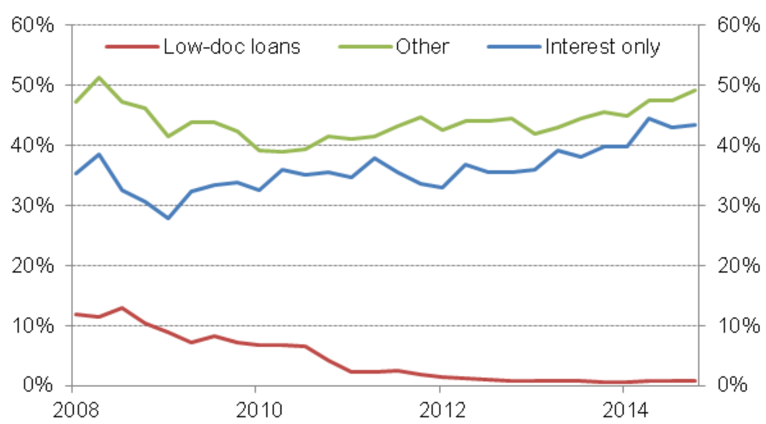


* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal debt-serviceability policies, and other non-standard loans
** Series is backcast before December 2010 to adjust for a reporting change by one bank

Source: RBA (2014) Financial Stability Review, September, using data from APRA and RBA

Figure 18: Banks' distribution of housing loans by type

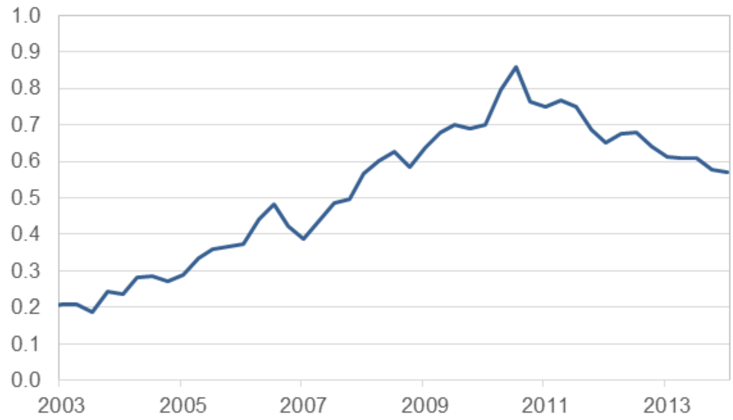
per cent of total number of loans



Source: APRA

Over the past three and a half years, there has been a downward trend in non-performing housing loans which are now at 0.57 per cent of housing loan outstandings of banks, the lowest in six years.

Figure 19: Non-performing housing loans 90+ days (%)



Source: RBA

The Australian Prudential Regulation Authority (**APRA**) has announced a heightened focus on mortgage lending standards[6], with particular attention to be paid to: higher risk mortgage lending including high loan-to-value ratio loans and high loan-to-income ratio loans; investor lending where portfolio growth is materially above 10 per cent per annum; and loan serviceability tests for new borrowers with a suggestion that banks should lend with a minimum interest rate in the serviceability calculation of 7 per cent, with a buffer of 200 points.

The APRA Chairman has observed that APRA is not targeting house price levels and is not asking banks – as at March 2015 - to materially reduce their lending. The focus is to contemplate potential actions with respect to *emerging* risks and to *maintain* sound lending standards. He has noted that the macroprudential tool most likely to be deployed by APRA would be a targeted increase in capital for particular banks whose growth in lending to property investors continued to exceed 10 per cent, although that figure of 10 per cent is a benchmark rather than a cap. He has also noted that APRA would not disclose if such intervention has taken place.

5. Household finances

Household finances are in good shape.

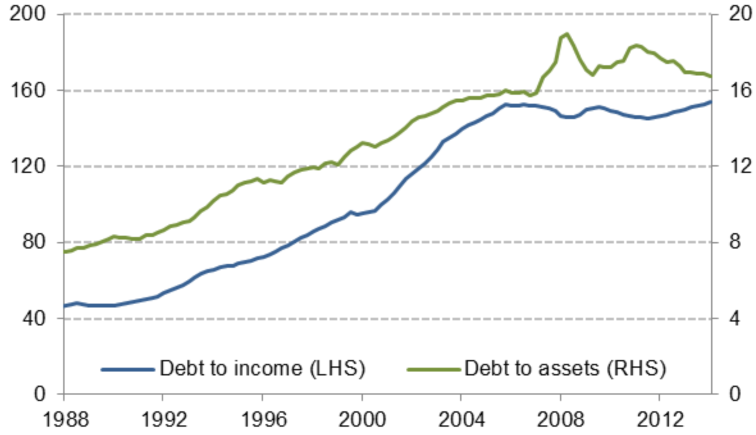
Households continue to borrow, but they also continue to invest and to save. The value of household assets is much greater than the value of household debt, so on average households have a positive net worth (Figure 20). At the end of 2014, every $1 of household debt was matched by almost $6 of assets.

Dwellings are the single largest component of household wealth at $5.1 trillion, with superannuation at $1.9 trillion. The ratio of housing debt-to-housing assets is around 28 per cent, with every $1 of debt being matched by over $3 in house value.[7]

[6] Hansard, House of Representatives Standing Committee on Economics, *Australian Prudential Regulation Authority annual report 2014*, 20 March 2015.

[7] Reserve Bank of Australia, Table E2 Household Finances, http://www.rba.gov.au/statistics/tables/

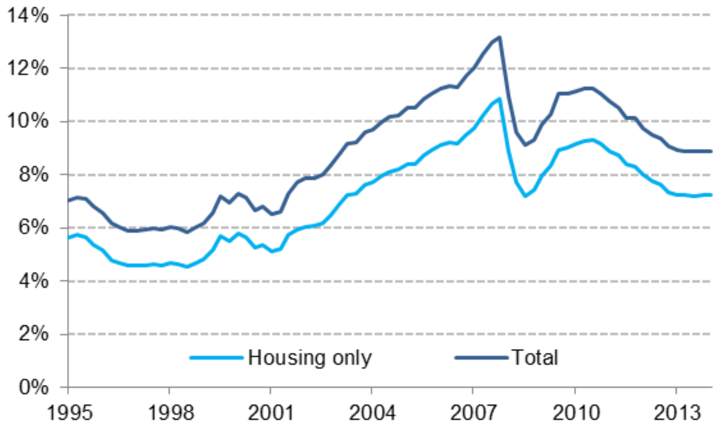
Figure 20: Household finances (%)



Source: RBA

Looking at the interest servicing burden also suggests households are in control of their finances. Over 2014, households paid $68 billion[8] in interest on housing and other consumer debt – a fall of $15 billion compared with three years ago. That is a large number in dollar terms, but the proportion of household disposable income consumed in interest payments is not high in an historical context, with both the ratio of *total* interest payments to income and *housing* interest payments to income at the equal lowest levels since the early 2000s (Figure 21).

Figure 21: Interest payments-to-income

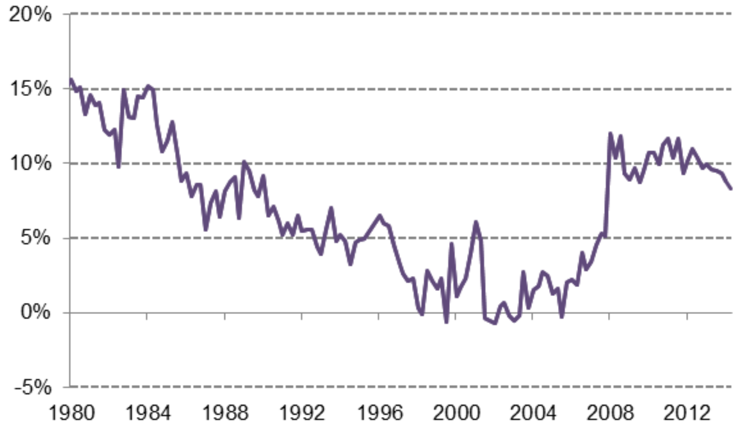


Source: RBA

Further evidence of prudent financial management is that households continue to show considerable capacity to save money, with the household savings ratio still high at 8.3 per cent (Figure 22). This continues the marked step up in the savings rate following the GFC.

[8] ABS 5206.0 Australian National Accounts

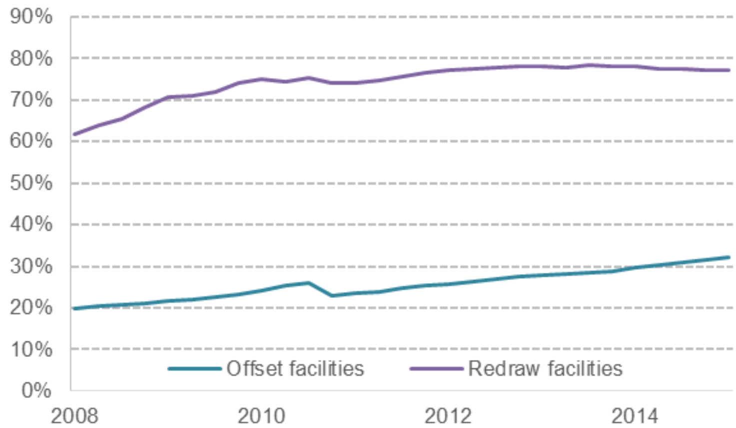
Figure 22: Household savings ratio



Source: ABS

Although households are increasing their borrowings for housing, they are also prepaying their loans to a greater degree. This repayment of the principal faster than required by the minimum payment is being achieved by putting extra money into mortgage offset or redraw accounts, or by paying down the loan directly. The proportion of housing loans with a redraft and/or offset facility has increased steadily in recent years (Figure 23). The increase has been marked. For example, the rise in the proportion of housing loans with offset facilities from 20 per cent in 2008 to over 30 per cent in 2015, means there has been in excess of a 50 per cent increase in the proportion of housing loans with this facility over those seven years.

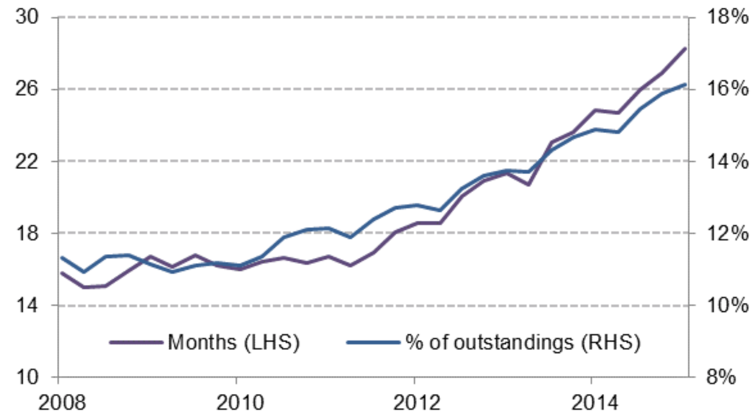
Figure 23: Proportion of bank housing loans with offset and redraw facilities



Source: APRA

As a result of this increased rate of prepayment, households are now on average the equivalent of 28 months, or more than two years, ahead on their mortgage repayments (Figure 24). This gives households greater resilience in managing their finances, as the prepayment buffer can be drawn upon in times of stress, such as unexpected expenses or changes in employment. It also means households are well placed to accommodate an increase in interest rates when the RBA eventually commences a new policy tightening cycle.

Figure 24: Mortgage pre-payment buffers



Sources: APRA and RBA

6. Demand and Supply

Issues of rising house prices and housing (un)affordability are symptoms of excess demand relative to supply. These issues cannot be resolved through policies which increase *demand*, for example, government subsidies to first home buyers or policies which allow home buyers to utilise their superannuation, to name just two. Such issues can only be resolved through policies which increase *supply*.

To elaborate on this point, policies which seek to increase home buyers' purchasing power in an environment of insufficient supply will serve only to drive up prices and reduce housing affordability. While such policies to increase demand have some political appeal, in reality they are counterproductive.

Australia needs to progressively increase its housing stock to shelter its growing population. Australia's population increase is determined by natural increase – births less deaths – and net overseas migration.

Over the year ending September 2014 Australia's population is estimated to have increased by 354,600.[9] Of this, 150,700 was natural increase and 203,900 was net overseas migration. So natural increase and net overseas migration contributed 43 per cent and 57 per cent respectively to total population growth (Figure 25).

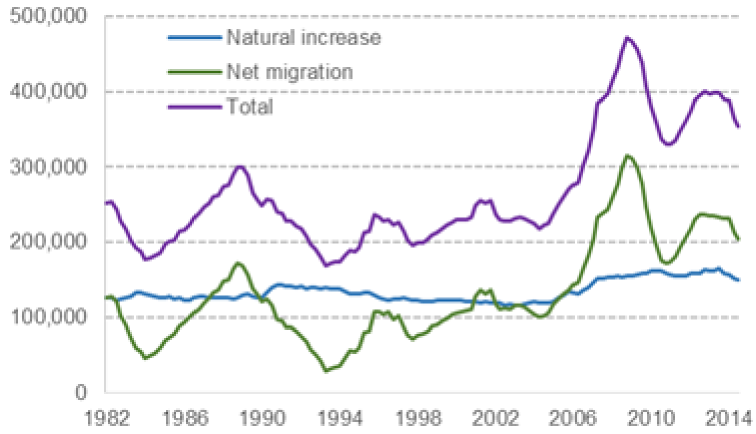
Population growth in the individual states and territories is also influenced by net interstate migration – that is, people moving between states and territories.

The three factors together lead to wide differences in population growth across Australia. Over the year to September 2014 the fastest population growth was in Western Australia at 2.1 per cent, followed by Victoria at 1.8 per cent. The slowest population growth was in Tasmania at 0.3 per cent. These differences can lead to large variations in the demand/supply dynamics and in price movements and housing affordability.

There is a danger that policy prescriptions that seek to address issues in particular markets – such as excess demand in Sydney and Melbourne – but which are applied across the nation may have unintended consequences in other areas of Australia where such issues are less pressing or absent.

9 ABS, *Australian Demographic Statistics*, Catalogue Number 3101.0, March 2015.

Figure 25: Australia's population change



Source: ABS

Governments can influence the rate of population growth through policies which impact on immigration and to a lesser extent through policies which may influence the decision to have children such as payments to families, or parental leave and childcare schemes. These policy decisions are primarily the preserve of the Federal Government.

In the past a number of reports have suggested that the supply of housing has not been able to keep up with the growing demand[10], and it is widely held that in certain cities and regions of Australia there is a shortage of housing.

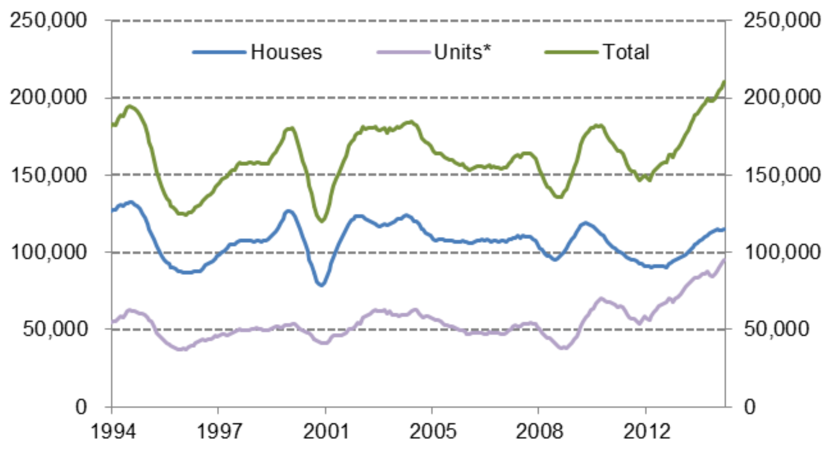
Looking forward, it is estimated that Australia may need to construct up to 250,000 homes per year to meet future needs, a figure which does not take into account the claimed backlog in the shortage of housing.[11]

Having said that, the supply side of the housing industry is now beginning to lift. Approvals to build new dwellings have been trending up since mid-2012 and over the year to April 2015, 214,000 approvals were issued for the construction of dwellings (Figure 26).

[10] For example the HIA's 2010 report *Housing to 2020: The state of Australian housing to the year 2020.*

[11] HIA (October 2014) *Housing Australia's Future: Demographic Analysis of Australia's Housing Requirements*

Figure 26: Building approvals



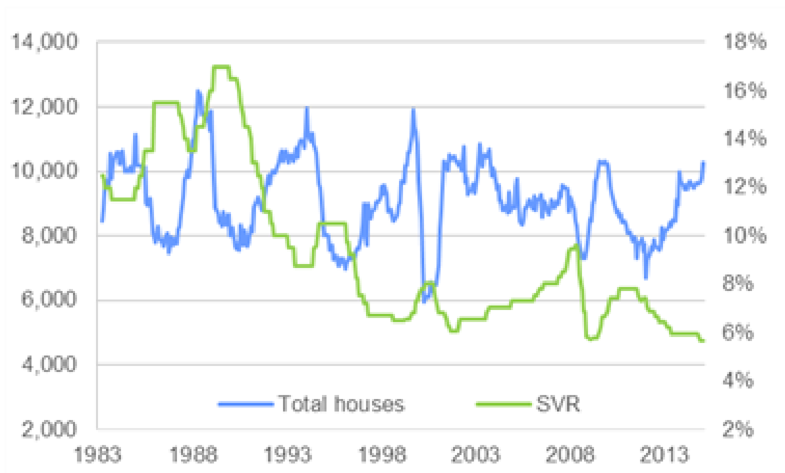
* Units include all non-house approvals

Source: ABS

6.1. The impact of interest rates

A key influence on housing construction approvals is interest rates. The supply side of the housing industry is very cyclical. Construction approvals rise when interest rates are falling and go into reverse when interest rates rise. The recovery in construction approvals in recent years has been closely linked to the progressive reduction in interest rates since late 2011. This suggests that availability of finance is not a constraint on housing supply in the current environment.

Figure 27: House construction approvals and interest rates



Sources: ABS & RBA

The close relationship between interest rates and housing construction approvals does not mean that interest rates can be used as a policy tool to address issues of housing shortages. Interest rates influence the short term cycles in construction, but do nothing to address the longer term structural imbalance between demand and supply.

6.2. A structural issue - availability of land

In terms of structural issues a persistent complaint is that development is hindered by a shortage of green field sites, reflecting insufficient land release by state governments, and by excessively restrictive council regulations and developer levies. International surveys confirm that Australia ranks poorly on land availability for new dwelling construction.

Demographia supports the assertion that higher land prices are a major factor and that a key reason for expensive land is inadequate release of new land for development. The 11th Annual Survey[12] notes that:

> *"housing has become severely unaffordable in many of the markets covered….., most notably in Australia, New Zealand, the United Kingdom and some markets in Canada and the United States."*

It goes on to observe that:

> "*In every case where severe housing affordability has been identified…….there are significant land supply restrictions that have led to an excess in the housing demand relative to the supply of land for building houses*."

Further, the specific comments in relation to Australia were:

> *"For the 11th year in a row…..all of Australia's five major metropolitan areas were severely unaffordable. This is in significant contrast to broad housing affordability that existed before implementation of urban containment policies. Before urban containment was adopted, each of Australia's major markets had housing that was affordable."*

The RBA has recently commented on land availability, noting that[13]:

> *"There is evidence of some tightening in supply in pockets of the country. In some cities, stocks of unsold lots suitable for development appear to be unusually low. Shortages are most evident in Sydney, where green field land releases have not kept pace with recent strong demand. Also, some of the bank's liaison contacts are concerned that the stock of suitable sites for apartment developments in Sydney has been depleted in the past few years."*

Policies to increase land release for housing construction are primarily the preserve of state governments. There is significant opportunity for reform.

7. Tax policy

Taxation of the housing sector in Australia is complex with many different taxes, rates and carve outs. This section addresses four taxes that have substantial effects on housing investment: negative gearing; the Capital Gains Tax (**CGT**) discount; stamp duties and land tax. These issues were discussed in the ABA's response to the Government's Tax discussion paper[14] and those comments are reproduced in this submission for ease of reference.

7.1. Negative gearing

Negative gearing allows individuals who incur a net loss from their investment to deduct the loss (adjusted by the investor's marginal tax rate) from their total personal income tax liability so that losses from an investment can be offset against other income. A taxpayer is able to claim a deduction for expenses incurred from borrowing money that is used for the purpose of producing assessable income. This provides an effective tax reduction for negatively geared assets.

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[12] Demographia, *11th Annual Demographia International Housing Affordability Survey: 2015*

[13] Reserve Bank of Australia, *Monetary Policy Transmission – What's Known and What's Changed*, Christopher Kent, 15 June 2015

[14] Australian Bankers' Association, *ABA's response to the Tax discussion paper*, 1 June 2015

Negative gearing can lead to investors facing different effective tax rates depending upon whether they finance the asset through debt or equity. This creates an incentive to finance investments using debt, since loans larger than otherwise can be serviced. This may induce higher levels of investment than may have been the case.

Around 5 per cent of investor lending relates to the construction of new dwellings, with the majority relating to established dwellings.[15]

In 2012-13, over 1.2 million Australians owned a negatively geared property,[16] with deductable losses of more than $12 billion. The distribution of debt is highly skewed towards high income investors. While nearly 800,000 negative gearers had a gross income of less than $80,000, households with incomes in the top 20 per cent of the income distribution owe most of investor housing debt (around 60 per cent).[17]

The effect of current negative gearing arrangements on housing prices, supply and rental affordability is uncertain. The ABA refers the Committee to the commentary in the recent Senate Economics References Committee report into housing affordability[18], that Treasury is unable to quantify these effects. It supports the recommendation of the Committee (recommendation 9.70) that Treasury should prepare and publish a study on the influence of negative gearing on the housing market. Public policy-making would be assisted by greater transparency and certainty on these issues.

7.2. Capital gains tax discount

The CGT discount allows a resident individual or trusts to pay tax on only 50 per cent of any nominal capital gain that is realised when an investment that is sold has been owned for at least 12 months. This gain is taxed at the individual's marginal tax rate. Domestic superannuation funds only pay tax on two-thirds of nominal capital gain in the accumulation phase.

Some commentators argue that current CGT arrangements combined with negative gearing encourage speculative investment as deductions are made at the taxpayers' marginal tax rate, but gains are taxed at half of that rate. There is little evidentiary support for this view.

7.3. State government stamp duties

State and territory governments levy stamp duties on the purchaser of land or buildings. The duty is based on the reported sale price and is charged at a progressive rate. The states and territories charge different rates of stamp duty and apply different thresholds and exemptions.

In 2012-13, stamp duties contributed $12.8 billion to aggregate state and territory revenues and were the second largest source of revenues that states and territories generated themselves.

Stamp duty is a highly inefficient tax. A recent Treasury analysis found that stamp duty had the highest excess burden of any of the taxes analysed, with a burden of 72 cents in the dollar for every dollar of revenue raised.[19]

Stamp duty reduces turnover in the stock of housing. Stamp duties put "sand in the gears" of trading activity, so that sales and purchases that would otherwise be beneficial to both parties are lower than they would otherwise be. In terms of the sensitivity of turnover to taxes, one study estimated that an increase in stamp duties of 10 per cent would lower property transaction volumes by up to 6 per cent in the long term.[20]

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15 ABS, (2013), Lending Finance (cat. no. 5671.0), February 2015
16 Australian Taxation statistics 2012-13, Table 9, Individual selected items by taxable incomes and total incomes
17 Reserve Bank of Australia, (2014), Financial Stability Review: Box C, September 2014
18 The Senate Economics References Committee, (May 2015), *Out of reach? The Australian housing affordability challenge*
19 Treasury, Cao L, Hosking A, Kouparitsas M, Mullaly, D, Rimmer X, Shi Q, Stark W, Wende S, (2015) *Understanding the Economy-Wide Efficiency and Incidence of Major Australian Taxes*, Working Paper 2015-01
20 Davidoff, I and Leigh, A, (2013), *How Do Stamp Duties Affect the Housing Market*? IZA Discussion Paper No. 7463.

Stamp duty on housing transactions acts as a barrier to labour force mobility, with stamp duty acting as a tax on moving in response to changing employment opportunities.

The reduced turnover of the housing stock resulting from stamp duty is reflected in poor allocation of housing stock. Older homeowners who no longer need a large home are discouraged from downsizing. This in turn makes it harder for people to find housing that meets their needs and creates incentives to renovate and add to existing housing.

Stamp duty also presents equity issues as it places a larger tax burden on those who move. Those who do not move are not subject to the tax.

Finally, stamp duty acts as a barrier to entry for new homeowners, with the stamp duty requirement reducing the size of the available deposit.

From the perspective of the states and territories, stamp duty is a highly variable revenue stream that shifts with transaction volume and property prices, leading to large fluctuations in income.

The economic costs of stamp duties can be reduced or removed through a reduction in the rate of duty or its complete abolition.

Removal of stamp duty on housing transactions would simplify taxation arrangements. It would improve efficiency by increasing the level of beneficial transactions and by improving the allocation of resources. It would also result in a substantial decrease in the excess burden of taxation, given that stamp duty is one of the least efficient forms of taxation.

Abolishing stamp duty would result in a more efficient allocation of housing, as it would no longer act as a barrier to downsizing or moving to a more suitable property. It would also cease to act as a barrier to workers seeking to move for better employment opportunities.

An abolition of stamp duty would be expected to result in an increase in property values, particularly in an environment of constrained supply.

For banks this would improve (reduce) the LVRs of existing borrowers, with a concomitant reduction in the riskiness of the existing housing book. It would lift the effective available deposits for new borrowers although the effect of this on improved housing affordability may be offset by higher purchase prices.

7.4. Land tax

Land taxes are levied by state and territory governments on the unimproved value of land. It is applied through a progressive scale based on an entity's total land holdings (except the ACT, where it is based on value per property). The Northern Territory does not levy land taxes.

Land taxes are narrowly applied. They are levied on commercial land and investor-owned residential land but with exemptions. While exemptions vary by jurisdiction, they tend to include owner-occupied residential land, primary production land, land for child care and aged-care facilities, land owned by not-for-profit and charitable organisations, leasehold land and state, territory and Commonwealth owned land.

Land tax is a more efficient form of property tax than stamp duties, particularly when it is broad-based. However, the current arrangements effectively exclude around 70 per cent of land through owner-occupier and primary production exemptions. Land can shift in and out of the tax base as ownership changes, which is itself a source of complexity and can distort economic decisions.

To illustrate the problems, rental property owners need to recoup land tax through higher rents, so renters bear the burden, whereas owner-occupiers do not "pay" a land tax in the imputed housing services they receive from ownership. This has implications for equity.

Further, housing investment will tend to be directed toward properties where land is a low proportion of total value, such as apartments.

Also, with land tax levied on a progressive scale, it distorts investor behaviour, discouraging large-scale investments. This may lead to a fragmentation of the housing investment market and lead to its dominance by small-scale investors.

Taken together, the current arrangements are complex and produce less efficient and equitable outcomes than would otherwise be delivered.

Options to change land tax arrangements include broadening the land tax base by reducing the large number of exemptions, which would include extending land tax to owner-occupied housing, and adjusting land tax rates.

A broad-based land tax is an efficient tax. A recent Treasury working paper estimated the excess burden of a broad-based land tax to be minus 10 cents in the dollar (it is negative due to foreign ownership of land and hence some incidence of the tax falls offshore).[21]

The effect of broadening land tax, however, is to impose a new tax burden on many landowners.

Extending land tax to existing home owners would hurt their cash flow and may impact on the financial viability of recent borrowers. It would also likely reduce home prices, increasing loan to valuation ratios, which again could be an issue for recent borrowers. Any tax changes which increased the financial vulnerability of borrowers would be of concern to banks.

There would need to be consideration of transitional arrangements, particularly if land tax is broadened in combination with stamp duty reductions. A change in arrangements over a short timeframe will result in those who recently paid stamp duty being hit with another tax obligation.

Extending land tax to the place of primary residence may also affect asset-rich but income-poor landowners, such as retirees. Arrangements such as enabling the capitalisation of land tax obligations against the sale of the property may be required.

Broadening the scope of land taxes provides an opportunity to lower the rate of tax.

The revenue implications of changing the rate of land tax vary markedly depending on its scope. The only argument in favour of higher rates of land tax is to increase government revenue. Due to the low excess burden of land tax, changing the rate of land tax to increase government revenue would be one of the least distortionary methods to boost receipts.

However, a change in rate by itself does not address the issues of complexity or fairness.

[21] Treasury, Cao L, Hosking A, Kouparitsas M, Mullaly, D, Rimmer X, Shi Q, Stark W, Wende S, (2015) *Understanding the Economy-Wide Efficiency and Incidence of Major Australian Taxes*, Working Paper 2015-01

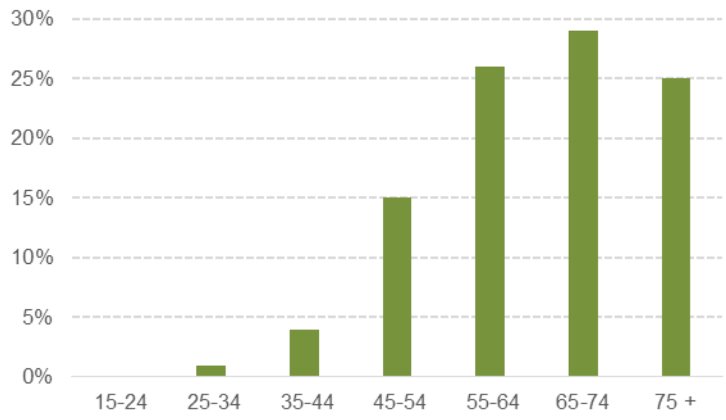
Appendix 1 – Profile of home owners and purchasers

Profile of home owners

Data on the age and income distribution of home owners and home purchasers is quite dated. As noted earlier, the 2011-12 Household Income and Income Distribution Survey conducted by ABS shows that 31 per cent of Australian households own their home outright.

Households with a reference person aged 55 and over account for 80 per cent of all homes owned outright in Australia.

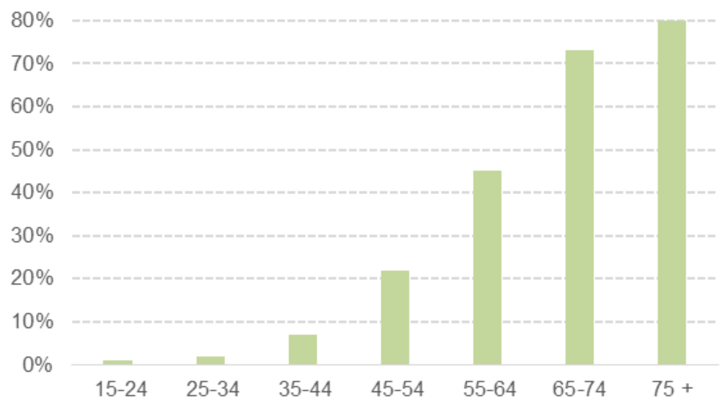
Figure 1: Age profile of home owners without a mortgage



Source: ABS

The proportion of home owners who own their home outright within each age group rises steeply as age increases.

Figure 2: Proportion of home owners without a mortgage by age



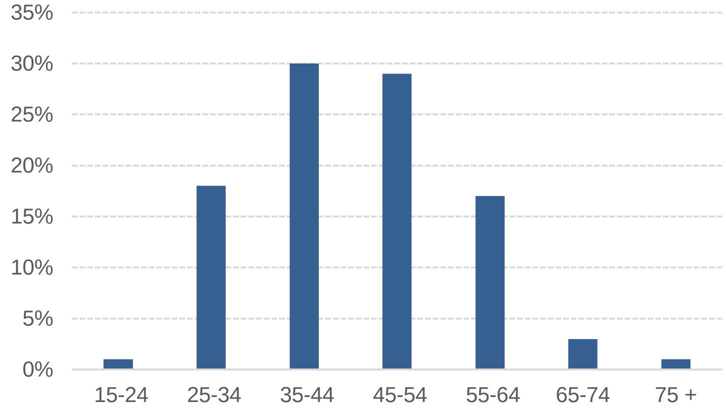
Source: ABS

Profile of home purchasers

The 2011-12 Household Income and Income Distribution Survey conducted by ABS shows that 36.6 per cent of Australian households are purchasing their home.

Households with a reference person aged 35-44 make up 30 per cent of households purchasing their homes. This rises to 59 per cent if households with a reference person aged 45-54 are included.

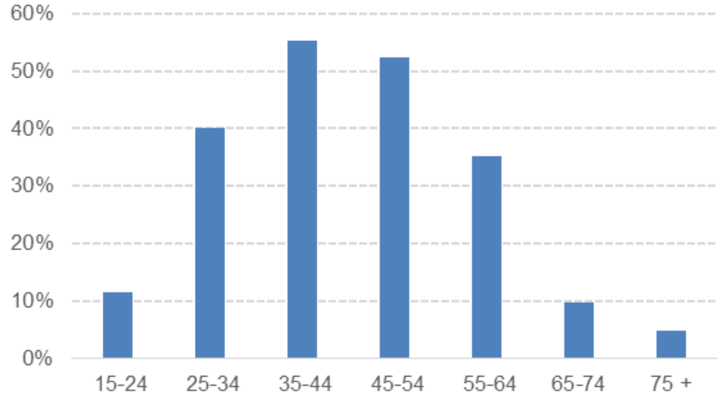
Figure 3: Age profile of owners with a mortgage



Source: ABS

Fifty-four per cent of households with a reference person aged 35-54 are purchasing a home.

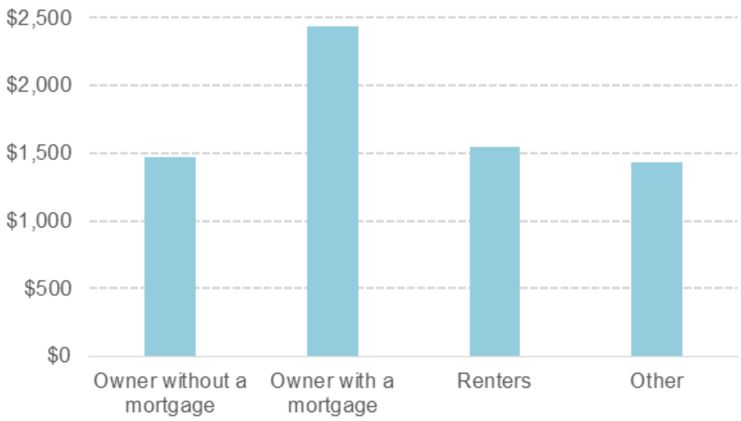
Figure 4: Proportion of owners with a mortgage by age



Source: ABS

At $2,437 per week, the gross weekly income of households with a mortgage is 65 per cent higher than that for owners and 58 per cent higher than renters.

Figure 5: Gross weekly household income by tenure type



Source: ABS

There is a very high proportion of households (63 per cent) with a mortgage which have two or more persons which are employed.

Figure 6: Proportion of households with two or more employed by tenure type

Source: ABS

Appendix 2

Submission to Senate Economics References Committee on Affordable Housing

AUSTRALIAN BANKERS' ASSOCIATION INC.

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3 April 2014

Dr Kathleen Dermody
Secretariat
Senate Economics References Committee
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Parliament House
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Dear Dr Dermody,

Affordable housing

The Australian Bankers' Association (ABA) appreciates the opportunity to provide comments to the inquiry into affordable housing.

Opening remarks

The ABA and our member banks have been involved in various consultations and discussions about housing affordability over the past years. Unfortunately, progress has not been substantially achieved to promote home ownership and other housing options broadly across our community and within parts of our community. We consider promoting home ownership, increasing housing supply and improving housing affordability in Australia will take a national plan to address the various supply and demand factors.

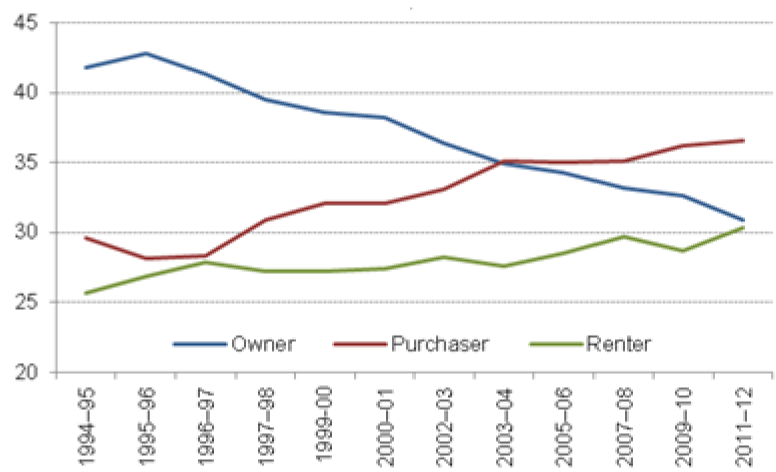
A national plan should contain a holistic approach based on a better understanding of the motivations for home ownership by individuals, families and communities, the incentives and disincentives for home ownership during changing market and economic conditions, the barriers to home ownership across different cohorts and geographical areas, the lessons learned from policies, interventions and assistance programs designed to encourage home ownership, and the potential responses which could better integrate public and private sector initiatives, and in partnership.

Home ownership

The ABA believes that home ownership is an important part of achieving financial and social wellbeing and economic and social participation. Home ownership is an important financial goal and lifestyle aspiration for many Australians and an important mechanism for wealth accumulation. The following provides a snapshot of housing and home ownership in Australia.

The 2011-12 ABS Income and Housing Survey shows that the distribution of housing tenure has changed since the mid-1990s in Australia. All three major categories of housing tenure have changed with the proportion of households owning their house outright (i.e. without a mortgage) falling from around 43% in the mid-1990s to 31% in 2012. Purchasers have largely offset this fall, rising from 28% in the mid-1990s to 37% in 2012. Renters as a proportion of households have seen a small increase since the mid-1990s, from 26% to just over 30% in 2012. Around 4% of households are renting from a State/Territory housing authority with the remainder renting from a private landlord.

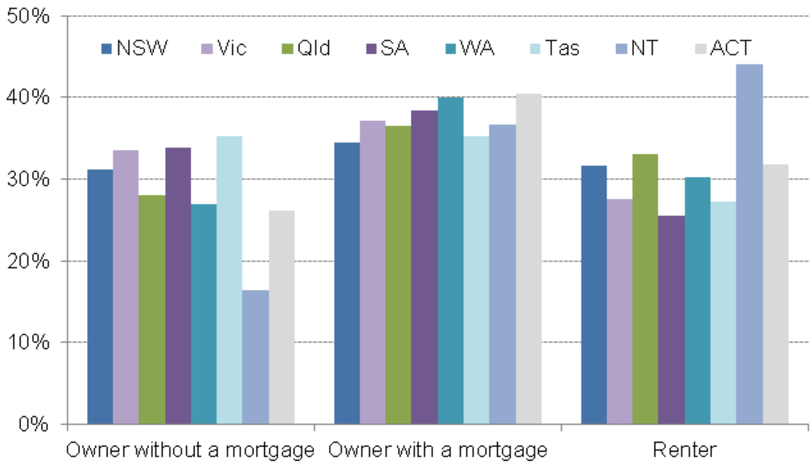
Chart 1: Housing tenure - %distribution



Source: ABS

As a simple measure, the fact there are now more home purchasers than home owners, a trend which has been increasing over the past two decades, could suggest a decline in housing affordability. However, the decline in the proportion of home owners may reflect a number of other influencing factors, including increased flexible low-cost financing options that allow households to extend their existing home mortgages for purposes other than the original home purchase.

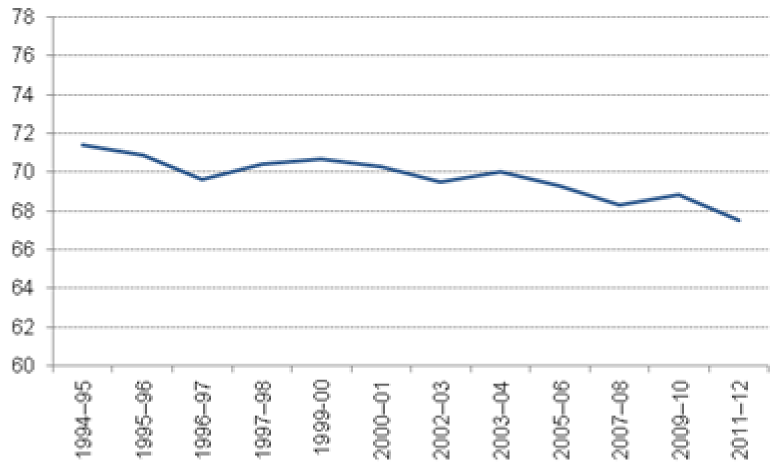
Chart 2: Housing tenure by State/Territory (2012)



Source: ABS

Combining home owners and home purchasers provides a generally accepted measure of *home ownership*, which has seen a fall from 71.4% to 67.5% from the mid-1990s to 2012.

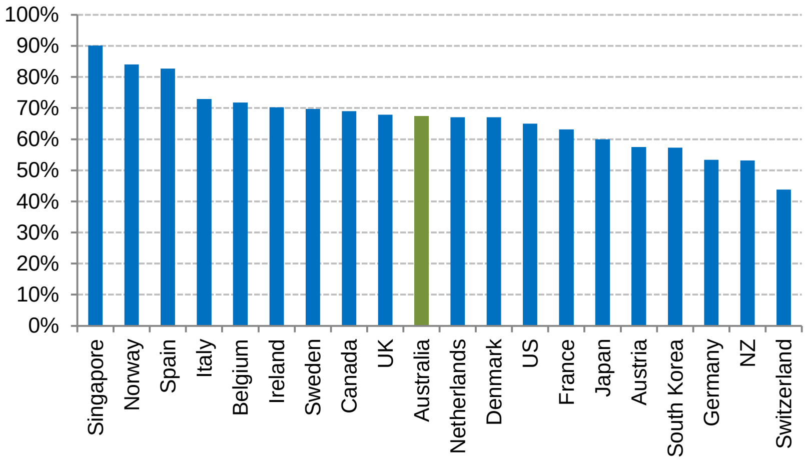
Chart 3: Home ownership (%) (Australia)



Source: ABS

Home ownership in Australia is among the highest in the world, but is only slightly above the OECD average.

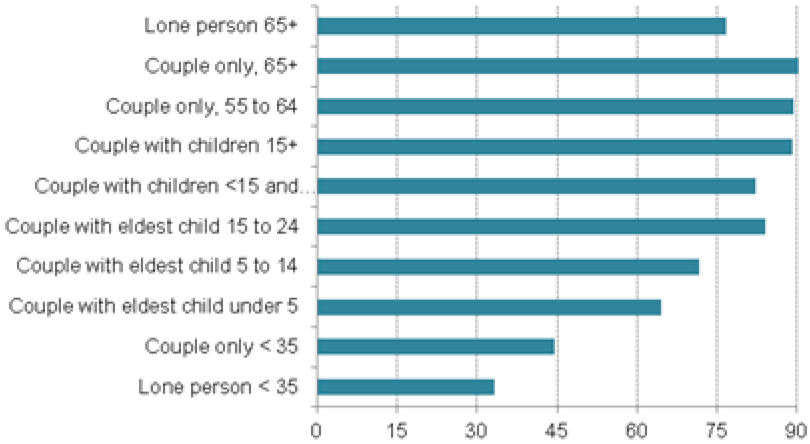
Chart 4: Home ownership (selected countries)



Sources: Eurostat, US Census Bureau, Turkish Statistical Institute, Statistics Canada, Singapore Department of Statistics, Australian Bureau of Statistics, Statistics New Zealand, Ha'aretz, Housing Finance Information Network, Journal of Housing and the Built Environment

There are two life stage groups that have a low proportion of home ownership, being lone person households where the reference person is aged 35 or younger – only 33% of these households have home ownership (comparing to 77% for lone person households where the reference person is aged 65 and over). The other category where housing ownership is low is for couple only households where the reference person is aged 35 years or younger – only 45% of these households have home ownership (comparing to 90% for couples only households where the reference person is aged 65 and over). Households comprising couples with children have a high proportion of home ownership.

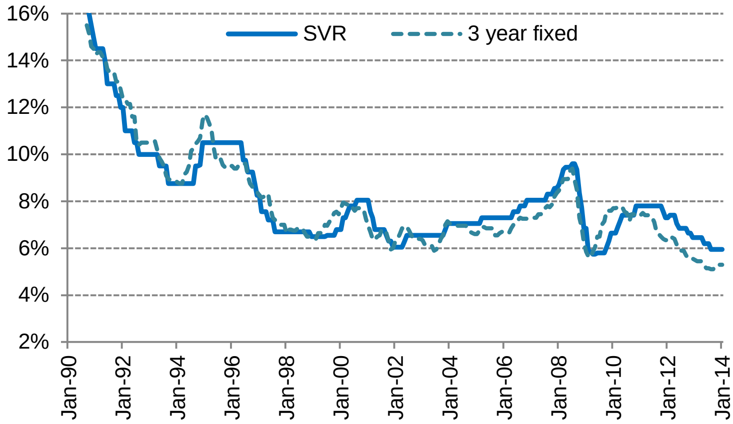
Chart 5: Housing tenure by life stage group (2012)



Source: ABS

Average housing loan interest rates are published on a monthly basis by the Reserve Bank of Australia (RBA). Both the standard variable rate home loan and the 3-year fixed rate home loan are now at a historically low level (around the lowest levels in two decades for which data is available). It should be noted that the interest rates published by RBA are 'advertised' rates and do not reflect any discounting, which is regularly offered by banks.

Chart 6: Standard variable and fixed home loan interest rates

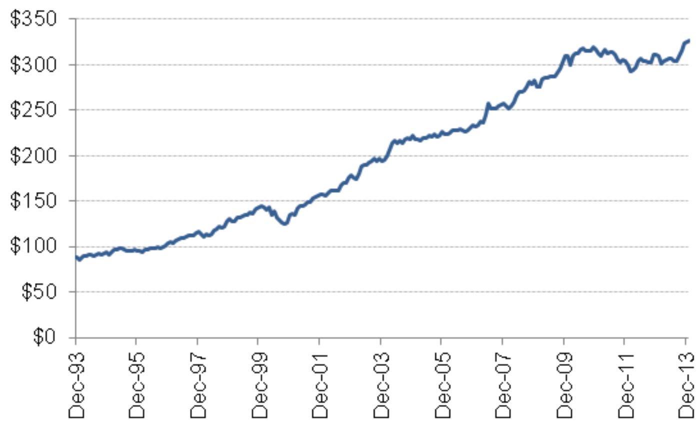


Source: RBA

For the past three years there has been little change to the average home loan made by banks to owner-occupiers.

At the end of 2013, the average loan size was $324,700. It reached $310,000 in December 2009, and then dropped slightly over the following several years.

Chart 7: Banks – Average home loan size to owner-occupiers ('000)



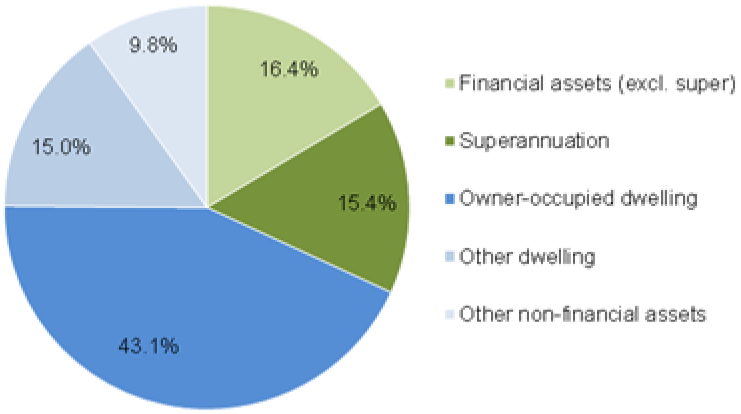
Source: ABS

The ABS measures of household wealth and distribution for 2011-12 show that two-thirds of household assets were non-financial assets and one-third were financial assets.

Direct ownership of dwellings makes up the majority of all household assets (58%). Of this, owner-occupier dwellings account for nearly three quarters (74%) of dwellings owned by households while the remainder is investment and other property (26%).

Financial assets owned by households are split almost equally between superannuation and other financial assets (such as, deposits and other accounts, shares, unit trusts, etc) (noting that superannuation is then invested into different asset classes, not an asset class in itself).

Chart 8: Household assets – distribution (2012)



Source: ABS

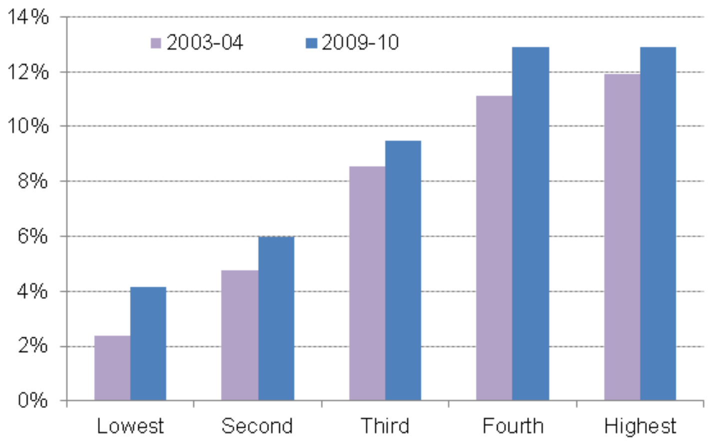
The ABS Household Expenditure Survey shows that average weekly household expenditure on a mortgage (both principal and interest components) rises with income. Conversely, as income rises, the proportion of weekly expenditure on rent falls. It should be noted that the unemployment rate has lifted over the last year, however, nationally remains at a historically low level (5.6%).

Table 1: Mortgage and rent payments as % of average weekly spend (by income quintile)

2009-10	**Lowest**	**Second**	**Third**	**Fourth**	**Highest**	**Total**
Mortgage (P&I)	4.1%	6.0%	9.5%	12.9%	12.9%	10.5%
Rent payments	9.8%	9.4%	8.1%	5.6%	3.8%	6.3%
2003-04						
Mortgage (P&I)	2.4%	4.7%	8.5%	11.1%	11.9%	9.2%
Rent payments	8.6%	7.3%	7.1%	4.1%	3.2%	5.2%

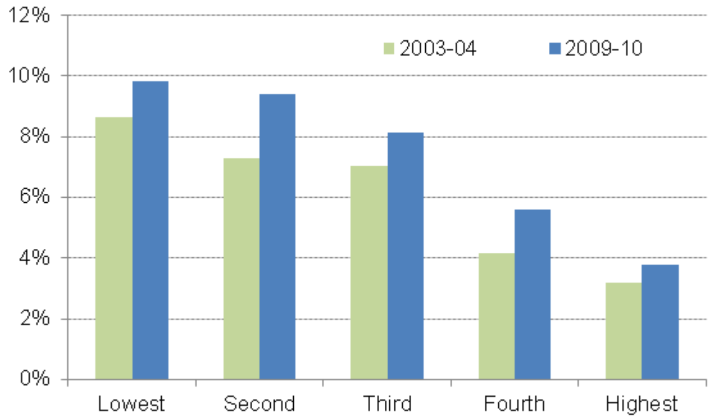
Source: ABS

Chart 9: Mortgage payments as % of average weekly spend (by income quintile)



Source: ABS

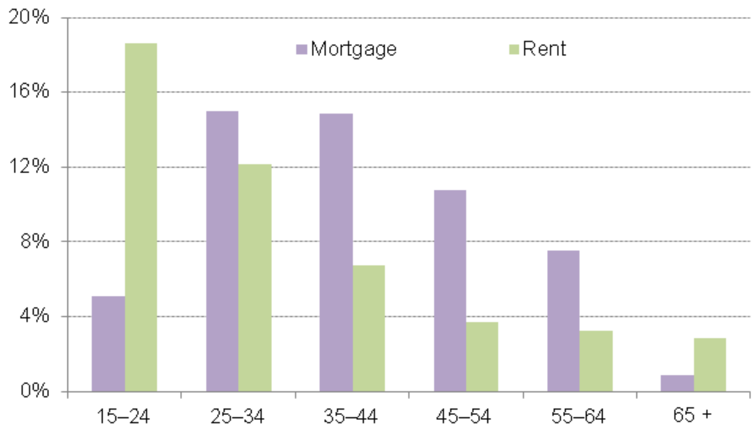
Chart 10: Rent payments as % of average weekly spend (by income quintile)



Source: ABS

Looking at the data by age group shows that households with reference persons aged 15-24 and who rent, pay 18.6% of their average weekly expenditure on rental payments. As a simple measure, the fact there has been an increase in younger people renting as well as an increase of spending on rent payments as a portion of income by younger people, this could suggest a decline in housing affordability. However, historically home ownership rises with age and is generally associated with increased income and capacity to service the loan and make repayments.

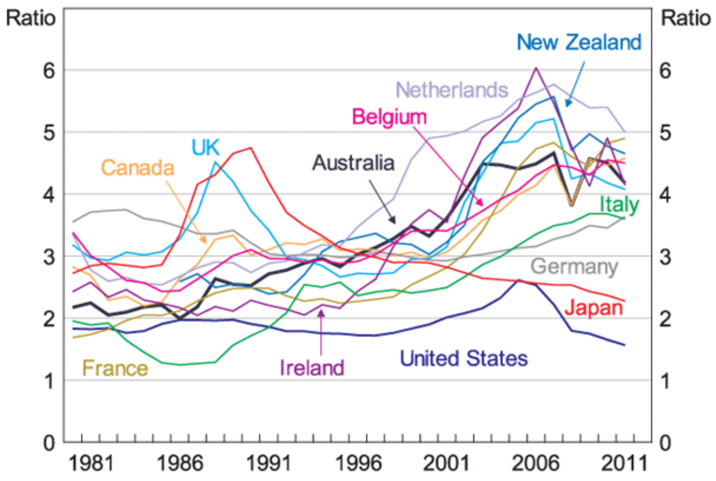
Chart 11: Housing payments as a percentage of spending (by age group) (2010)



Source: ABS

Looking at the data by dwelling price to income across Australia and compared with other countries, Australia is around the OECD average.

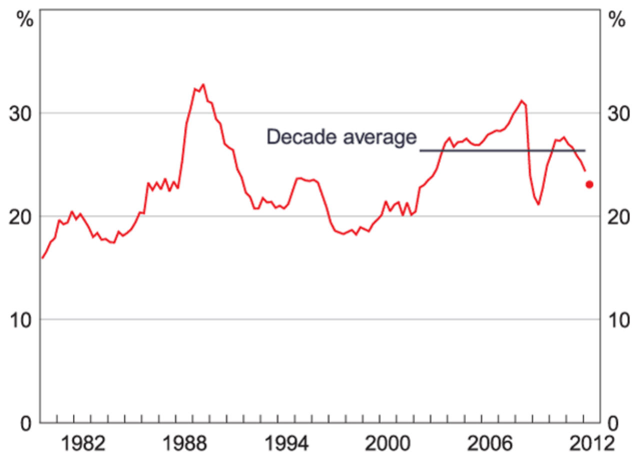
Chart 12: Dwelling price to income ratios



* Average dwelling prices to average household disposable income
Sources: BIS; Bloomberg; CREA; Halifax; Japan REI; OECD; Quotable Value; RP Data-Rismark; Thomson Reuters; UN; national sources (statistical agencies, central banks and government departments)

The percentage of income being allocated to housing loans has increased over the last decade, but more recently declined. Subdued housing prices and lower interest rates, coupled with income growth, means that the repayment on a new home loan based on a median-priced house as a percentage of average income is at its lowest for a decade (with the exception of the peak of the GFC in 2009 and record low interest rates). Arrears remain low and the percentage of households ahead on their mortgage repayments is also high. The median dwelling price to income ratio is now 3.9 the lowest (best) affordability rate in over a decade according to Rismark. Furthermore, the HIA-Commonwealth Bank Housing Affordability Index shows that housing affordability increased during the September 2013 quarter to 75.1 and is at its highest (best) level since June 2002. During the quarter, affordability increased by 3.2% compared with the previous quarter. Compared with a year earlier, affordability was 15% higher representing the most favourable result in over 11 years. Some commentators have observed that over the past several months the housing affordability index has slightly declined.

Chart 13: Repayments on new housing loans as percentage of disposable income



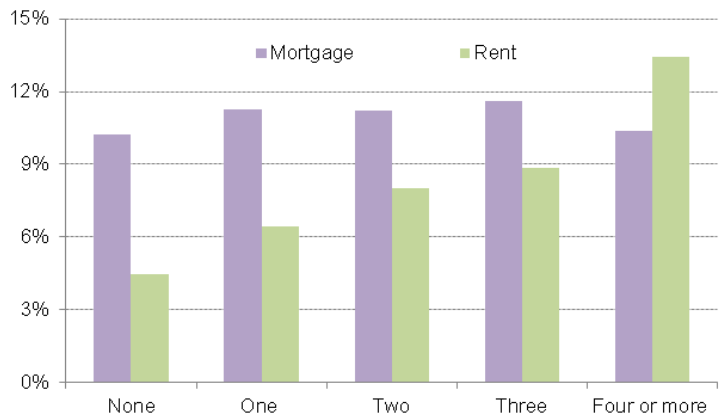
* Housing loan repayments calculated as the required repayment on a new 80 per cent LVR loan with full documentation for the nationwide median-price home; based on capital city house price data prior to 1990; household disposable income is before interest payments; RBA estimate for June quarter 2012
Sources: ABS; RBA; REIA; RP Data-Rismark

As the average weekly proportion of spending on housing costs increases, so does the number of financial stress indicators that a household faces (markedly with rental payments).

Table 2: Mortgage and rent payments as % of average weekly spend by financial stress indicators

2009-10	None	One	Two	Three	Four or more	Total
Mortgage (P&I)	10.2%	11.2%	11.2%	11.6%	10.4%	10.5%
Rent payments	4.5%	6.4%	8.0%	8.8%	13.4%	6.3%

Chart 14: Housing payments and number of financial stress indicators (2010)



Source: ABS

Of those households having four or more financial stress indicators, 54% of these households are renting. National rental vacancy rates are at 2.6% according to SQM Research. Low rental vacancy rates puts upward pressure on rental markets.

Table 3: Tenure by housing payments as % of average weekly spend by financial stress indicators

	None	One	Two	Three	Four or more	Total
Owner without a mortgage	40.8%	28.2%	25.6%	25.2%	15.3%	32.6%
Owner with a mortgage	37.7%	40.7%	37.2%	32.2%	27.8%	36.2%
Renter	18.6%	28.3%	34.0%	39.3%	54.4%	28.4%
Private landlord	17.1%	25.0%	30.3%	30.4%	39.0%	23.7%
Other tenure type	2.8%	2.8%	3.2%	3.2%	2.5%	2.8%
Total	100.0	100.0	100.0	100.0	100.0	100.0

Summary

Home ownership is the largest financial decision many Australians will make. Decisions about home ownership are largely based on life stage factors, including age, marital status, and income.

Home equity represents a significant portion of wealth and financial security in retirement for many Australians. Additionally, there has been much research on the benefits of home ownership to economic and social participation citing improved health for individuals and families, especially children, improved schooling and education performance and outcomes, enhanced life satisfaction, increased civic involvement and volunteerism, decreased social dislocation and crime, and other economic and social benefits for communities and neighborhoods.

However, mortgage stress is often cited to be the most significant contributor to financial stress suffered by many Australians. Data about mortgage stress shows possible differing perspectives, but there are some noticeable trends to show that financial stress indicators are correlated with an increase in housing costs.

Housing affordability is currently good based on data, economic indicators and affordability indices. However, home ownership is declining and younger people make the higher portion of renters. These facts mean we need to give consideration to housing policy and the impact of home ownership on pre and post retirement income, expenditure and wealth. Importantly, home ownership may not be suitable for all and housing policy should take account of alternative and complementary policies designed and implemented to ensure appropriate housing solutions for all. Improvements to housing policy could be made, but this will require a balanced approach.

The ABA believes that policies which facilitate affordable and sustainable home ownership must remain at the centre of Australia's housing policy agenda.

Housing policy should be supported by:

- Research into better understanding the changing dynamics of the housing market and home ownership, attitudes to home ownership by individuals, families and communities, effectiveness of existing housing assistance programs, etc. Public policies will need to recognise that while home ownership may be a goal and aspiration for many Australians, it will not necessarily be suitable for all, and therefore, alternative and complementary policies will need to support the rental market, affordable rental housing, and secure social housing options.
- Other economic policies that promote employment, job creation and income growth, especially for younger people, deliver improved land management, infrastructure and community services, and encourage long-term investment for residential property.
- Appropriate changes to State/Territory governments' planning controls, land management, and transaction conditions to improve land supply, accountability and transparency of development applications and consents, and improve financing for infrastructure and community services to support housing.

The ABA recommends the development of a National Housing Plan by the COAG Select Council on Housing and Homelessness, building on the National Affordable Housing Agreement.

Banking products and services have changed over the last two decades reflecting the changing home ownership and property market conditions across the cycles, evolving needs of owner-occupiers and investors, the changing funding environment for banks, and technological advances in retail banking.

In 2013, banks made an estimated 831,500 housing loan commitments consisting of 556,100 loans (67%) to owner-occupiers and 275,400 loans (33%) to investors. Banks accounted for 93% of lending commitments for housing in 2013.

Banks typically offer a wide variety of home loan options to suit differing customer preferences and needs across banking channels. For example, some banks have adjusted loan to value ratios (LVRs) – percentage of the property value being borrowed – to accommodate lending without compromising responsible lending obligations. A higher LVR (above 80%), matched with a capacity to service the loan and make repayments, coupled with other assessment factors, has enabled some borrowers to purchase a home which otherwise may not have been the case. Banks usually require a borrower to take out Lenders Mortgage Insurance (LMI) on home loans with a higher LVR.

Interest rates on home loans have remained in a tight range. Since 1997, the standard variable rate has generally been in the range 6.00% to 8.00%. The only time that it moved significantly out of this range, since 1997, was as the global financial crisis was building, and in particular, over the 14 months ending October 2008. In July and August 2008, the standard variable rate reached a high of 9.60%. Six months later, in February 2009, it was 5.85% as the height of the global financial crisis had taken effect on financial markets and the RBA had reduced the official cash rate by 400 basis points.

There have been a number of innovations in products and services reflecting customer demand for increased flexibility, certainty, accessibility, transparency, and changing preferences and needs of customers (individuals and businesses). The main changes in the availability of retail banking and lending products and services is summarised as follows:

- *Fixed rate loans*: A fixed rate loan is a home loan where the interest rate does not vary for an agreed period, typically between one and five years, with some banks offering 10 year fixed rate loans. Usually at the end of the agreed period, the loan converts to a standard variable rate loan. Some banks also enable the borrower to make additional repayments. In 2013, 17.2% of housing loan commitments made to owner-occupiers were for fixed rate loans, just over double what it was two years before in 2011 (8.3%).

- *Split loans*: A split loan enables the borrower to have their home loan repayments based partly on a standard variable rate and partly on a fixed rate. This loan allows borrowers to have a degree of certainty with their loan repayments for an agreed period, but also take advantage of potentially decreasing interest rates.
- *Mortgage offset accounts*: A mortgage offset account is where the borrower has their salary paid into the account to offset the repayment costs on their standard variable rate loan as interest is calculated daily. A mortgage offset account can help borrowers pay back their home loan faster.
- *Mortgage or portfolio facilities*: These facilities are a line of credit for home or investment purposes that the borrower can access any time, or all-in-one banking solutions that link a transaction account and personal, home and investment borrowing in one facility. These facilities enable the borrower to draw on the loan as needed, such as for home renovations, redirect their funds across their investment portfolio, etc. A mortgage or portfolio facility can help borrowers better manage all their investments.
- *Packages and discounts*: Borrowers are able to take advantage of discounts on interest rates and other products when bundled as a package with the one bank. Usually there is an annual fee for all the products, which is simpler and lower than fees on individual products. Some banks also offer discounts on advertised interest rates.
- *Special loans*: Banks offer a range of tailored loans to assist self-employed and other customers, such as Australian Defence Force members participating in the new Defence Home Ownership Assistance Scheme, with flexible documentation or repayment conditions. These loans include no or low doc loans and flexible repayment options. Additionally, some banks are working with customers to develop shared equity loans. These loans allow borrowers to secure higher finance for a purchase, but share the increase in value when the property is sold or refinanced.
- *Online and digital banking*: These services enable borrowers to access their loans and facilities 24/7 using their Internet banking account or an app on a smartphone, and tailor their account options.

The ABA and the banking industry are also committed to lifting the levels of financial literacy in Australia. At an industry-level, the ABA's financial literacy program – "Broadening Financial Understanding"[1] – is designed to work alongside and complement the programs and initiatives of individual member banks. The ABA's program has been running since 2004 and aims to help Australians make confident and informed decisions regarding their own finances. For example, to assist consumers better understand buying a home and make well-informed and well-prepared decisions, the program includes the consumer booklet "Planning for home ownership" freely available on the ABA's website[2] and in hard copy by request. At an individual bank level, there are a number of dedicated financial education programs and partnerships with government agencies and community organisations. In addition to money management programs, banks make available a number of materials and resources in their branches and on their websites to assist their customers to make decisions about the purchase of a home, the selection of a home loan, the maintenance and renovation of their home, and the eventual sale of their home, as well as other information and advice.

> The ABA notes that banking products and services have changed reflecting the home ownership preferences and needs of bank customers. The offer of new retail banking and lending products has been accompanied by changes in accessibility and transparency. It is anticipated that technology will continue to drive innovations in products and services.

[1] http://www.bankers.asn.au/Consumers/Financial-Literacy
[2] http://www.bankers.asn.au/Consumers/Financial-Literacy-Program/Booklets/Home-Ownership

Banks' experience with some existing policies for encouraging and supporting home ownership and residential investment property

The following provides an outline of some of the policies implemented by Federal and State/Territory governments to promote home ownership, and the banks' experience with these policies.

First Home Owners Grant (FHOG) and other Federal and State incentives

The First Home Owners Grant (FHOG) was introduced in 2000[3]. The grant generally ranges from $10,000 – $25,000 (varying across States and Territories and varying depending on transaction date) and is a one-off payment to assist eligible first home buyers purchase a new home, build their home, or in some jurisdictions purchase an existing dwelling.

Since the FHOG was introduced it has been temporarily increased, including most recently in 2008 in response to a concern regarding a slump in housing activity and/or a decline in house prices. The FHOG is now generally only available for new dwellings (not established homes).

State/Territory governments have also provided other financial assistance to first home buyers, including bonus, boost or relocation payments, including additional grants for a new dwelling or dwellings in certain areas, e.g. rural and regional areas, as well as other exemptions, including deductions on stamp duty for property and/or vacant land purchased for building a new dwelling and tax-free land tax thresholds.

The level of first home buyers qualifying for the grant has dropped in recent years largely due to a change in eligibility criteria with many State/Territory governments restricting the grant to only new dwellings. It should also be noted that banks meet responsibility lending obligations and potential borrowers must demonstrate debt serviceability. Genuine savings and capacity to make repayments, including in an increased interest rate environment, applies equally to first home buyers as other borrowers.

> The ABA believes that State/Territory governments should work with the banking industry to streamline the administration of the First Home Owners Grant (FHOG) to improve application and payment processes. Each jurisdiction has different forms and different rules.

First Home Saver Accounts (FHSAs)

The First Home Saver Accounts (FHSA) initiative was announced by the Federal Government shortly after the 2007 Federal election as part of the suite of initiatives to address housing affordability. While the banking industry welcomed the initiative and supported the policy to create a tax-preferred savings vehicle to assist people save and purchase their first home, there were some significant issues that impacted the banks' ability to deliver these new products in a straightforward, low cost and timely manner.

FHSAs commenced being offered on 1 October 2008. As at December 2013, APRA statistics show that 46,000 FHSAs have been offered by 18 ADIs and one RSE licensee. However, since the commencement of the FHSA initiative, two banks and a number of other ADIs have decided to cease offering FHSAs, but continue to maintain open accounts[4].

FHSAs have required a substantial investment by banks into developing and launching a new product with restrictions around offer and access making these products more complicated to market. Maintaining the systems and processes (including staff training, etc) for FHSAs has not proven commercially viable, especially across larger banks with national retail network distribution channels. Banks which did not offer a FHSA indicate the main reason was the overly complex product rules and better saving products within the market.

[3] http://www.firsthome.gov.au
[4] http://www.apra.gov.au/CrossIndustry/FHSA/Pages/default.aspx

The FHSA initiative and uptake by first home buyers has been disappointing. We consider that this is largely due to the inflexibility of the accounts in terms of restrictions on use of the FHSA monies towards a purchase of a home, where this purchase happens within four years of opening the account. First home buyers saving and borrowing behavior requires flexibility with access to their monies to use for their deposit or to use in making a purchase decision in line with their changing circumstances, including changes in the property market. For example, frequently first home buyers are taking advantage of the FHOG and other incentives for new dwellings with buying a home off the-plan requiring earlier access to their monies and in advance of the completion of their home.

Therefore, the ABA believes that more first home buyers may be encouraged to open a FHSA if the product rules and account conditions were more flexible. Specifically, we support the removal of the 4 year qualifying rule to make these products simpler and more customer-focused[5]. We also support other changes to account conditions to facilitate more flexible payment options for first home buyers, including provision for allowing FHSA account holders to keep their FHSA open until monies can be transferred to a genuine home loan without incurring additional costs or facing uncertain contractual obligations (i.e. at the end of an agreed period for a fixed rate loan).

The ABA believes the Federal Government should work with the banking industry on implementing changes to the FHSA initiative, such as:

- Provide flexibility for first home buyers and lifts savings for first home buyers (e.g. beneficial tax treatment for savings towards a deposit for a first home without product rule constraints);
- Streamline the administration for FHSA providers; and
- Improve consumer awareness and understanding and enhance the customer experience with FHSAs, and therefore, the uptake of FHSAs.

> The ABA supports the enhancement of the community's access to a greater range of affordable housing purchase options. FHSAs should be simplified to promote uptake and provide first home buyers with greater flexibility, which is more aligned with their saving and borrowing preferences and needs. Improved consumer awareness and understanding as well as streamlined account administration should encourage FHSA providers to expand their product offerings.

low-interest loans up to $10,000 – would be available to households with annual incomes up to $250,000. While the industry welcomed the scheme and supported the policy to create a home loan product aimed at assisting home owners make improvements to the energy efficiency and water conservation of their homes, there were some significant issues with the design, including program structure, product rules, loan subsidy, administration, interface with home assessments and other aspects of the policy, and expected implementation timing.

In February 2010, the Federal Government announced the scheme would be discontinued. There were a number of outstanding problems that resulted in only two banks being able to offer a 'Green Loan' product prior to the Government's announcement to discontinue the program. Having said that, we were disappointed with the announcement to redesign the 'Green Loans' scheme by discontinuing the loans component[6]. The decision to discontinue the loan component of the 'Green Loans' scheme was taken without consultation with existing financial partners or other banks and financial institutions.

The ABA provided a submission outlining our concerns with the announcement, implementation and discontinuation of the scheme to the inquiry into the Green Loans scheme conducted by the Senate Standing Committee on Environment, Communications and the Arts in April 2010. Overall, the lessons learned from the policy highlight the importance for early and considered consultation between the Government and the banking

[5] ABA member banks advise that the area of most complaint and confusion for customers is due to the minimum 4 year qualifying rule.
[6] ABA member banks, which became financial partners in the 'Green Loans' program, advise that consumer demand exceeded initial expectations. Therefore, while only two banks offered 'Green Loan' products as part of the Government's program by the time the announcement was made to discontinue the program, we consider given the higher than expected consumer demand (even through difficult market conditions due to the global financial crisis and the availability of other Government incentives and initiatives), that interest and uptake in 'Green Loan' products would have increased over time.

industry, and in particular, where programs focus on introducing new financial products and delivering policies via the banking system.

Some banks offer a retail product offering for personal and home loan customers to suit their preferences and needs and encourage energy efficiency and sustainable housing outcomes. These loan products are offered with competitive interest rates and discounts and reflect customers' interests in not just 'doing the right thing' for the environment, but taking advantage of the cost savings associated with environmentally-friendly design and more efficient energy and water use in their homes.

The ABA believes the Federal Government should work with the banking industry on identifying innovative products to encourage sustainable housing, such as:

- Beneficial tax treatment and/or incentives for people building new, more energy efficient and sustainable homes (e.g. stamp duty relief, land tax relief, negative gearing for qualifying properties, etc);
- Market-driven green loan products education campaign; and
- Property sale standards for existing homes (e.g. water/energy saving, etc).

The ABA supports the encouragement of the design, construction and renovation of energy efficient and environmentally sustainable housing. The Federal Government and the banking industry should investigate options for promoting access to information and services to support the development of market-driven green loan products. Furthermore, the Government, the banking industry, the insurance industry, and the property sector should work together to identify a pathway for the promotion and development of energy efficient and environmentally sustainable housing as part of a national plan on housing and infrastructure development and resilience.

National Rental Affordability Scheme (NRAS)

The National Rental Affordability Scheme (NRAS)[7] was announced by the Federal Government shortly after the 2007 Federal election as part of the suite of initiatives to address housing affordability. Approved participants are eligible to receive a NRAS incentive payment (including a Federal and State/Territory government contribution) for each approved dwelling where the conditions of allocation for the dwelling are met including the condition that the dwellings are rented to eligible low and moderate income households at a rate that is at least 20% below market value rent. The NRAS incentive payment is an annual, CPI-indexed tax subsidy paid over 10 years.

The NRAS is intended to increase the supply of affordable rental dwellings, reduce rental costs for low and moderate income households, and encourage large-scale investment (usually 100 or more dwellings) and innovative delivery of affordable housing. While the NRAS is linked to other social housing initiatives, it is a standalone initiative contained in legislation, regulations and guidelines.

The NRAS commenced on 1 July 2008 with the most recent application round held in August 2013. The program seeks to increase dwellings by up to 50,000. According to the latest NRAS performance report, there are 14,575 incentives allocated and a further 23,884 incentives reserved and 136 approved participants[8].

The banking industry provided input into the development of the NRAS highlighting a number of issues with regards to the program structure, eligibility and mandatory requirements, administration, compliance and governance, taxation issues, consumer protection issues (i.e. subsequent retail investors), commercial lending issues, and expected implementation timing. These issues impacted the banks' ability to support the program by providing finance to NRAS projects. More recently, banks have provided finance to NRAS projects, but continue to face complicated application and administration processes.

Additionally, it should be noted that the NRAS program encountered a few implementation problems associated with taxation treatment and liabilities, joint ventures, and participation of charitable and not-for-profit organisations. These matters resulted in a number of ATO rulings and required changes to the regulations. We consider that tax treatment should not prevent not-for-profit organisations, such as community social housing providers, from participating in the scheme. The program also encountered some issues involving subsequent investors. The program structure means that it is not generally available to small-scale or individual investors in the rental property market. However, such investors may become involved in NRAS by investing in or purchasing properties from approved participants or as part of a consortium arrangement. Unfortunately, in October 2013, ASIC issued a consumer warning about advertising by self-managed superannuation fund (SMSF) promoters promoting the use of SMSFs to invest in NRAS residential properties. Misleading advertising has potentially indicated that NRAS incentive payments provide enhanced returns where there is no requirement for an approved participant to pass the NRAS incentive payment to subsequent retail investors[9]. We consider that investment in NRAS should be motivated by the aim of providing people with security of tenure in affordable housing, not financial incentives. Community social housing providers are committed to longer term management of the properties, whereas private investors may exit the market at or before the 10 year NRAS time horizon leaving the residents still in need of affordable housing.

These program design, implementation and other problems have, or are, being resolved. However, the program remains complex with substantial documentation and rules. Overseas experience suggests that these social housing programs take a number of years to attract large-scale investment and a financing track record. While we remain concerned about a number of aspects with the NRAS, provision of affordable rental housing, especially for key workers, is an important part of a national plan on housing.

The ABA supports the NRAS and after resolving outstanding problems and complexities (usually associated with certain projects), this program could offer significant benefits for addressing affordable rental housing. However, we consider that certain changes should be made to the program to simplify the administration and promote awareness of the program.

The ABA believes that the Federal Government should give further consideration to whether the NRAS should only be offered to sophisticated investors in the community social housing sector and not to 'mum and dad' investors (at least until the NRAS is embedded and outstanding problems are resolved). Furthermore, we consider that the Federal and State/Territory governments should give further consideration to complementary strategies for increasing the proportion of affordable dwellings. For example, a combination of tax incentives to encourage developers and private investors to allocate 'affordable' dwellings within developments, either for rent or subsequent sale.

Split loans

The Indigenous Business Australia (IBA) Split Loan program[10] is offered to IBA customers who can obtain a home loan from a bank or other lender for some of the funds required to complete a purchase, but not all of the funds necessary for the purchase.

The Split Loan program is designed to meet the gap between the amount the borrower is able to borrow and the purchase price of the dwelling. The borrower will have two loans, one with the bank or other lender at commercial interest rates, and the other with IBA initially at a 4% fixed rate for the first three years, and then indexed to increase by 0.5% over the following years, until the IBA Home Loan Rate is reached.

The Split Loan program aims to assist more Indigenous Australians to take advantage of IBA's Indigenous Home Ownership program and assist more Indigenous Australians establish a relationship with a bank or other lender that can offer a broader range of financial products.

> The ABA supports the Split Loans program. The program offers significant opportunities for Indigenous Australians to secure home ownership. We consider that assessment of new models, including guaranteed loans, different split structures, shared equity, grant supplements, could provide avenues for expansion of the program.

Affordable housing

The banking industry has been engaging with Federal and State/Territory governments on programs to build social and not-for-profit housing in Australia.

The community social housing sector in Australia is currently small due to a number of supply factors, including the reduction in subsidies to public housing and targeting of housing stock to people on low and moderate incomes and special needs (e.g. people receiving government benefit payments, i.e. people with a disability, unemployed, single parents) which has placed State/Territory housing authorities under significant financial pressure.

Additionally, there are a number of barriers to large-scale investment in social housing, including low returns, high investment risk (including planning, construction, tenancy management, policy inconsistencies and legal uncertainties, illiquidity, taxation issues, etc), poor market information, and small scale (availability of institutional investors and superannuation funds in the investment pool).

Therefore, the ABA believes that reshaping the community social housing sector in Australia will require consideration of a number of factors, such as:

- Leveraging existing assets to increase supply of affordable housing using a combination of government capital funding and private financing;
- Providing tax incentives, investment subsidies, institutional safeguards and protections for all participants, including banks and other financiers, tenants, home owners and investors;
- Fostering improved governance, management of public housing and efficiencies across the community social housing sector consistent with the national regulatory system for community housing (commencing on 1 January 2014, and being adopted over the next 18 months)[11];
- Recovering public housing stock by conducting housing improvement and urban renewal programs;
- Addressing social exclusion, disadvantage and marginalisation of public housing tenants and certain key workers;

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[10] http://www.iba.gov.au/home-ownership/iba-housing-loans/split-loan-for-eligible-customers/
[11] http://www.nrsch.gov.au/

- Encouraging interest from commercial operators as partners of not-for-profit housing providers or in their own right within the community social housing sector; and
- Other policies designed to increase the stock of social and affordable housing as well as encourage home ownership (including rent to buy schemes and schemes to assist people build up patterns of savings and/or equity).

Proposed responses

Risk sharing strategies

The ABA believes that supportive arrangements and risk sharing strategies should be contemplated to adjust the risk and return attributes of the community social housing sector. We consider that risk sharing strategies should include shared equity arrangements, tax incentives and investment subsidies for investors, protections and guarantees for financiers, and support arrangements for community social housing providers.

Attracting private investors, including institutional investors and superannuation funds, to the community social housing sector will require solutions to re-weight the relatively low yields and uncertain long-term capital growth prospects. Attracting banks and other lenders to the community social housing sector will require measures to address lending risks factored into lending decisions. It should be noted possible capital growth of underlying rental properties (asset) is less important to investors than pure rental yields (returns), and therefore, to financiers. The low yielding nature of these dwellings means that private investment might be limited in the absence of supportive arrangements and risk sharing strategies. Furthermore, the low yielding nature of these dwellings means that they can only support a modest level of gearing in order to maintain an acceptable debt servicing capacity.

Ultimately, tenancy and asset management and location of housing stock will be a significant determinant of interest from private investors and security and asset management from financiers. Therefore, financial risk should be shared with the Government and legal risk minimised. For example:

- *Shared equity:* Some low and moderate income borrowers otherwise unable to access finance will be able to purchase a home with financial support. For example, the Keystart Home Loans scheme[12] involves co-ownership with the Western Australian Department of Housing, up to 40% of the value of the property. Some banks are also working with customers on shared equity loans and registered community social housing providers and government agencies.
- *Asset transfer and security*: We believe that contracts will need to clearly stipulate asset transfer and security for banks and other lenders (usually in the form of a first-ranking mortgage over the assets). It is appropriate (even preferable) for State/Territory governments to retain an interest in transferred properties under an agreement. However, the financier's normal commercial rights as first mortgagee must be preserved.
- *Protections and guarantees*: We believe that if Government were willing to provide clear and explicit support to a community social housing provider in the event of default or insolvency, such an approach would assist providers secure finance, capital investment, and higher gearing levels. Government interests and caveats on housing security can have a material impact on 'mortgage valuation', which may differ from book value or construction cost. Whilst State/Territory governments may utilise interests and caveats to prevent a loss of community housing from the overall pool of social housing, an inability of lenders to realise security value in a timely manner after a default will reduce the mortgage value of that security and may restrict the level of finance available. Government participation in risk sharing with banks and other lenders can reduce risk.
- *Tax incentives and investment subsidies*: We believe that targeted tax incentives should seek to increase the proportion of affordable dwellings. For example, a combination of tax incentives to encourage developers and private investors to allocate 'affordable' dwellings within developments, either for rent or subsequent sale. This approach should complement other social housing initiatives, such as NRAS.

[12] http://www.keystart.com.au/

Community social housing providers adopting leverage should be viewed with caution. Commercial endeavours may expose these organisations to operational and business risks, and possibly insolvency risks (and the consequence of insolvency could be drastic for tenants, and therefore, should be avoided). Therefore, financial risk should be shared with the Government and legal risk minimised. For example:

- *Liquidity support*: Housing providers will be investing in non-income producing development sites and participating in property development. These activities expose the providers to liquidity risks that can arise from site value volatility, planning risk, and cost increases. We believe the Government should provide a short-term limited guarantee that providers can liquefy to assist with short-term liquidity management. Access to this form of support would provide an early warning indicator of financial stress.
- *Tenure support*: We believe, to provide ongoing occupancy to the tenant, the Government should undertake to provide a long-term lease over dwellings, so that mortgagees can sell the dwellings subject to the government lease. The structure of the lease should be consistent with, say the ADF leases, and contain the standard "make good" provisions. The Government could assign the lease to another provider to manage, subject to certain criteria and agreement of the bank or other financier.
- *Legal ownership and business structure support*: Ownership and structure models are likely to be viewed differently by banks and other lenders. However, a Government owned organisation is likely to be viewed as lower risk (and more creditworthy) than privately owned organisations. Having said that, LVRs can vary based on the terms of the transaction and the composition of the assets provided as security. A risk management framework including elements such as liquidity and tenure support would simplify the methodology and facilitate provision of capital investment. Competitive allocation of funding can also drive performance improvements within the community social housing sector.

Alternative financing models

The ABA believes that alternative financing models should be explored to potentially provide a mechanism for collective involvement in projects. The banking industry seeks to extend its involvement in financing affordable housing by working closely with the Federal and State/Territory governments to innovate and develop responsible self-funding models for social infrastructure via capital markets. This approach to raising finance has been used extensively and successfully in other countries. It should be noted that some banks are actively working with community housing providers to develop solutions to ensure the stock of social and affordable housing can be increased.

Joint venture arrangements may be a possible model for financing social housing projects. However, legal and ownership arrangements would need to be carefully structured and associated taxation issues resolved. From a bank perspective, a bank would need to be satisfied that development risk could be appropriately allocated and managed with a joint venture between a not-for-profit housing provider and a property developer. Sufficient liquidity would need to exist within the joint venture to manage any problems that might arise during construction and lease-up. However, given the community social housing sector is in its infancy in Australia, more complex structures like joint ventures are likely to increase financing risk (as has been experienced with a number of the NRAS projects).

Social benefit bonds may offer opportunities for financing social housing projects. Social benefit bonds are a mechanism for building partnerships between the government sector, non-government sector and investors to deliver outcomes-based and measureable services[13]. From a bank perspective, a social benefit bond (or similar debt instrument) embeds more accountable structures and governance, shares the investment risk across public and private investors, and leverages the capital markets (innovation within financial service providers, capacity of investors, expertise of service providers, etc).

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[13] The first social benefit bond in Australia was launched by UnitingCare, the NSW Government and Social Ventures Australia called the "Newpin Social Benefit Bond". The implementation agreement was finalised in March 2013 and $7 million has been raised in private capital. More recently, the Benevolent Society in partnership with Westpac and the Commonwealth Bank raised $10 million in private capital to establish "The Resilient Families Preservation Service".

For example, "Affordable Housing Supply Bonds" are an area where the Federal Government's strong balance sheet could sensibly be used to channel private capital into the community social housing sector and enhance the investment proposition for private investors. The underlying assumption of cost-effective government credit enhancement is fundamental to the commercial viability of affordable housing debt instruments and the ability for bonds to raise adequate levels of capital.

> The ABA supports the encouragement and development of a strong community social housing sector. We consider that the Federal Government should look to investigate regulatory and market barriers, assess risks and opportunities, assess asset transfer (i.e. process, timing, etc), establish appropriate risk sharing strategies (i.e. shared equity arrangements, incentives, subsidies, protections or guarantees), determine parameters needed for financing arrangements (debt and equity) and determine parameters needed for successful private investment (i.e. alternative financing models, e.g. 'Affordable Housing Supply Bonds'). Risk sharing strategies and alternative financing models should seek to establish credible business models and robust governance and utilise expertise from the banking and finance industry to build capacity in the community social housing sector. Government-business-community partnerships for social housing projects should leverage the capital markets. We also support quality, meaningful social impact reporting.
>
> The ABA recommends the establishment of a partnership approach between government and the banking industry to look for alternative models. The industry has the relevant expertise to ensure that solutions achieve the policy intent.

Indigenous home ownership

The ABA believes that Indigenous home ownership needs to be given separate consideration due to the complicated area of policy and practice. We support policies and strategies aimed at addressing Indigenous home ownership. However, we consider that home ownership is related to factors more broadly to do with social and financial inclusion for Indigenous Australians, including:

- Limited availability (of appropriate) housing stock;
- Relatively low household incomes for many Indigenous Australians, high cost of housing relative to income levels, and inability to save a deposit for a home loan;
- Relatively low levels of financial literacy for many Indigenous Australians;
- Limited access to mainstream financial institutions and understanding of borrowing requirements (security for a mortgage, credit risk assessment models, interest rate repayments, etc); and
- Low confidence in approaching banks and other financial institutions by many Indigenous Australians.

The ABA believes that the challenge for governments, the banking industry and other businesses, and the community sector will be to create long-term and sustainable strategies which enable opportunities for choice for Indigenous Australians, address the various underpinning reasons which result in social and financial exclusion for many Indigenous Australians, and promote pathways to home ownership, employment, education and financial literacy, and economic and social participation. Most importantly, any strategies designed and subsequently implemented must reflect what individual Indigenous Australians want and Indigenous communities want done.

In the 2011 Census, 548,400 people identified and were counted as being of Aboriginal and Torres Strait Islander (ATSI) origin, representing 2.5% of the Australian population. Almost a third (157,761 or 29%) of the total ATSI population live in three regions located on the eastern seaboard of Australia: Brisbane (53,271), NSW Central and North Coast (52,319) and Sydney–Wollongong (52,171).

Data from the ABS 2012-13 Aboriginal and Torres Strait Islander Health Survey provides a recent distribution of where ATSI people live. The distribution of ATSI people by geographic area is as follows:

- 35% live in major cities
- 22% live in inner regional areas
- 21% live in outer regional areas
- 8% live in remote areas
- 14% live in very remote areas

Additionally, according to the ABS, New South Wales had the largest resident population of Indigenous Australians (172,600 people or 32%), followed by Queensland (155,800 people or 28%), and Western Australian (69,700 or 13%), while the Australian Capital Territory had the smallest (5,200 people or 1%). The Northern Territory had a higher proportion of Indigenous residents (27%) than any other State or Territory.

Only 36% of Indigenous Australians are home owners.

The ABA believes that policies and strategies for addressing Indigenous home ownership cannot be 'one-size-fits-all' and some considerations should include:

- *Not all Indigenous Australians are the same or reside in similar geographic areas*. For Indigenous peoples living in very remote and remote locations, home ownership will necessarily require greater support through Indigenous-targeted strategies and public housing programs. For Indigenous peoples living in regional areas, home ownership will likely involve support promoting the engaged and informed participation of Indigenous peoples in the mainstream property market as well as promoting the capacity of Indigenous peoples to develop a real property market on Indigenous lands. For Indigenous peoples in urban areas and major cities, home ownership will likely involve support through Indigenous-targeted and non-targeted strategies and initiatives aimed at housing affordability.
- *Indigenous land councils and housing organisations may have differing views about home ownership*. The particular needs of individuals and communities should be accommodated within any national policy, and that the service delivery challenges due to remoteness should be carefully considered.
- *Home ownership carries risks*. Even though home ownership can offer many Australians housing and financial security and wealth creation opportunities, home ownership carries risk and ongoing costs, and other housing options (i.e. renting) may provide better housing solutions that do not involve ongoing financial commitment or personal sacrifice.

The ABA believes that it is essential for various legal issues, cultural issues and cultural preferences to be resolved, including land tenure, limitations on use of land, restrictions on ownership, housing standards, etc. We consider that identifying policies and strategies that support successful Indigenous home ownership and housing solutions will be vital in 'closing the gap'. Furthermore, while we believe that the national regulatory system for the community social housing sector should be universal, Indigenous home ownership carries different organisational, governance and implementation challenges that are likely to require additional (or different) standards and conditions. Service delivery challenges due to remoteness will need to be carefully considered.

Proposed responses

The ABA notes that the federal Government is currently reviewing Indigenous access to housing, including affordable housing, rent to buy schemes and 99 year leases. These alternative options should be carefully considered. We believe that the Federal Government should work with Indigenous communities and their leaders and other stakeholders (including the banking industry) to implement a multi-faceted policy approach to improving home ownership and housing options for Indigenous Australians. It is critical that the gap between market offerings and the position of potential home buyers is carefully considered in terms of insufficient deposit savings or poor credit history, where banks and other financial institutions would not normally lend due to the risk profile of the borrower.

Some possible policies and strategies to assist those Indigenous Australians who want to become home owners by helping them purchase a property or create equity in a property they currently rent could include:

- *Financial support*: Various forms of financial support could be provided by the Federal Government through Indigenous-targeted and non-targeted strategies, including subsidies (mortgage protection insurance, deposit), security guarantees, interest free loan schemes, interest repayment support schemes, rebates for real estate transaction costs, tax incentives for home savings accounts, first home buyer's grant, rent to buy and shared equity schemes, cost neutral refinancing options to transfer loans from the IBA home loans program to mainstream banks and other financial institutions, and additional investment in IBA Split Loans program.
- *Other support*: Various additional support mechanisms could be provided by the Government with support of banks and other financial institutions, businesses and community organisations, including financial literacy programs, business enterprise support activities, home purchaser counselling services, financial counselling services, mentoring programs, mortgage broker management services, community capacity building support activities, and cultural awareness programs.
- *Other issues*: Various issues unique to Indigenous housing will need to be resolved, including land tenure arrangements, appropriateness of dwellings, community governance structures and administration arrangements, property rights, security of tenure, valuation methodologies for housing stock (especially in remote areas), etc.

The ABA believes that the Federal Government, in consultation with banks and other financial institutions, Indigenous community organisations, and State/Territory governments, need to identify current impediments or constraints to Indigenous home ownership and identify appropriate strategies to overcome, address or minimise these constraints. For example, a shared response could involve:

- Governments need to make changes to land tenure legislation and implement appropriate risk sharing initiatives to facilitate mainstream lending and phased approaches to rewards for maintenance of, and improvements to, the property (i.e. rental rebates for consistent payment of rent and equity conversion for consistent repayment of a home loan) to facilitate home ownership;
- Banks need to assess their product offerings with a view to providing products which meet Indigenous peoples needs, banks' commercial interests (including cost recovery, credit assessment and operational risk management, corporate responsibility, etc) and banks' legal responsibilities (including responsible lending obligations); and
- Indigenous organisations need to assess their governance arrangements and land use restrictions. Additionally, cultural considerations should be taken into account, for example, cultural requirements to vacate a property for sorry business and the implications for expecting the continuation of rental payments or loan repayments during extended periods of time when the property is vacant.

The ABA notes that the Indigenous Financial Services Network (the former Indigenous Banking Reference Group and contributor to development of the National Indigenous Money Management Agenda (NIMMA) project), which the ABA and major banks are members, has undertaken extensive community consultation and research into financial literacy and financial services for Indigenous Australians[14]. This background information would be useful input into the development of future programs.

> The ABA believes that given the complexity of the factors surrounding Indigenous home ownership and social and financial inclusion, the Federal Government should task the Indigenous Advisory Council to develop policies on home ownership and housing options for Indigenous Australians, and more broadly strategies to address rental and housing affordability for Indigenous Australians across regions.

[14] http://www.reconciliation.org.au/home/projects/nimma/project-documents

Concluding comments

The ABA believes that promoting home ownership, increasing housing supply and improving housing affordability will take actions from across governments, the banking and finance industry, and the community sector. A shared response will involve a combination of market-driven responses and the continuing development of innovative mainstream banking and lending products and services; public policies and strategies and the encouragement of creative solutions to expand affordable housing for key workers and people on low and moderate incomes; and social housing programs which leverage the capital markets.

Yours sincerely,

Diane Tate

Appendix 3

Key truths on housing in Australia – Economic Report

AUSTRALIAN BANKERS' ASSOCIATION INC.

Key truths on housing in Australia

Economic Report

March 2015

Disclaimer

The Australian Bankers' Association's (**ABA**) Economic Reports are designed to promote public policy discussions by exploring topical issues that affect banks in Australia. They do not necessarily represent final policy views of the ABA or any member bank.

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Executive Summary

This Economic Report provides perspective on trends in the Australian housing market.

It looks at house prices in Australia at the national level and by state, and also compares Australian dwelling prices to those in other developed countries.

Additionally it considers some of the key drivers of house prices in Australia, including the supply of housing relative to demand, the role of domestic and foreign investment, bank lending policies and the stance of monetary policy.

Finally the paper assesses household finances by looking at measures of debt-to-income, debt-to-assets, interest payments-to-income, repayment buffers and housing affordability.

The key findings are as follows.

Prices

House prices in Australia exhibit marked cycles. Periods of strong rises are not unusual. Up to the time of the global financial crisis (**GFC**) there were episodes of strong price gains but no significant episodes of nationwide price falls. Since the GFC there have been two episodes of quite marked national declines in prices, followed by strong rebounds. These recent periods of rising prices have not exceeded the peak growth rates of the pre-GFC era.

The latest acceleration in prices is consistent with this historical cycle.

Recent price rises have been most marked in Sydney and to a lesser extent in Melbourne and Brisbane.

Australian prices are elevated in terms of historical ratios of prices-to-incomes and rents but are not out of line with countries which might be regarded as logical peers such as Canada and New Zealand. These measures are not of themselves an indicator of a boom or a predictor of a bust.

The drivers of house prices

The primary driver of the recent acceleration in house prices is historically low interest rates. This relationship between interest rates and house prices is broadly in line with previous cycles.

There are signs the rate of growth of prices may have already peaked as the boost to demand from earlier falls in interest rates begins to dissipate. The recent further reductions in interest rates are likely to provide some additional impetus to prices.

Financial intermediaries have maintained high lending standards. The proportion of high loan-to-valuation ratio (**LVR**s) loans and low doc loans continues to fall, and the ratio of non-performing housing and business loans is well below its post GFC highs. Recent rigorous stress testing of banks' balance sheets by APRA showed they are well placed to withstand any likely economic or financial disturbance.

Borrowing by investors for housing is more volatile than borrowing by owner occupiers, rising more quickly in the upswings in credit growth and decelerating more quickly in the downswings. The recent surge in investor borrowings since mid-2011 is in this respect nothing unusual, though the upswing has been particularly marked in Sydney and to a lesser extent Melbourne. Investors' share of housing loans outstanding has been relatively stable at around one third over the past decade after rising steadily over the decade and a half prior to that, although it is now edging a little higher. Investors are not increasing their use of high LVR loans.

There is no evidence of a surge in non-resident purchases although it is possible official Foreign Investment Review Board (**FIRB**) data do not capture all transactions.

There is no evidence of a sudden increase in the shortage of dwellings as a driver of the recent surge in house prices.

Household finances

Household finances are robust. Borrowers, on average, are well placed financially to withstand an increase in interest rates or other event that may cause increased financial pressure.

Households are not, as a group, significantly increasing their leverage. Gross debt-to-income and debt-to-asset ratios are little different from their pre-GFC peaks.

Those households with the highest debt have the highest capacity to service that debt and have the most assets.

Interest payment-to-income ratios are declining.

Households are almost two years ahead in repaying their home loans.

The household savings ratio remains elevated at around 9 per cent.

Housing affordability is the best it has been since 2009.

Contents

1. Introduction

This Economic Report has been prepared by the Australian Bankers' Association to gain a better understanding of recent trends in house prices in Australia, the key influences on house prices, and the state of household finances.

Owning a home is a quintessential Australian dream. A house is both a shelter and an asset. For many Australians a house represents their single biggest investment and a significant proportion of their wealth.

The prices of houses can rise but they can also fall. While stakeholders in the residential property market are generally happy with rising property prices, society as a whole is less sanguine about property price falls. Significant property price falls are destructive of wealth and can have substantive negative impacts on economic growth, employment and national prosperity.

Negative economic impacts can also arise when the health of household finances is compromised by changes in economic conditions, such as when rising interest rates in an already highly geared environment or a decline in income, such as through unemployment; reduce households' capacity to service existing debt.

For this reason there is ongoing public debate both in Australia and overseas as to whether Australia is experiencing a housing bubble and on the health of Australian household finances.

2. Overview of the Australian residential property market

2.1. Property prices

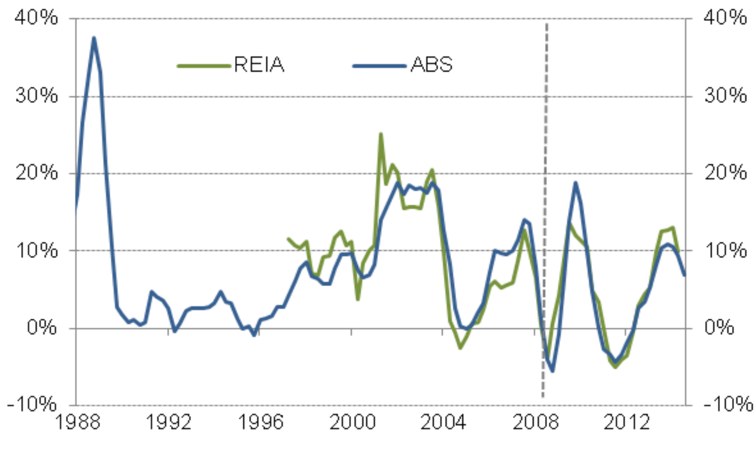
2.1.1 National house prices

House price growth in Australia exhibits strong cycles. Periods of strongly rising prices are not unusual.

The period since the mid-1980s can be divided into two eras (Figure 1). Up to the time of the GFC there were episodes of strong price gains but no significant episodes of price falls, at least not on average across the nation as a whole. Prices did fall from time to time in individual cities (Figures 2 and 3).

Figure 1: House price growth

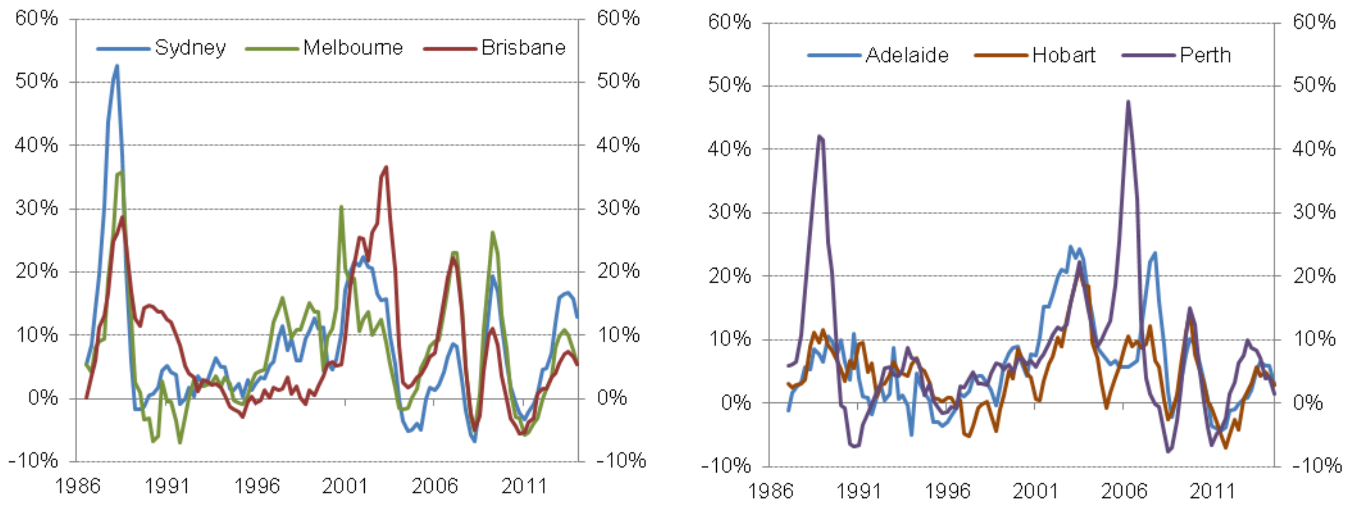
per cent, annual



Source: ABS, REIA

Figures 2 and 3: Established house price growth by capital city

per cent, annual



Source: ABS

Since the GFC, volatility in the growth of house prices has increased, with two episodes of quite marked national declines in prices. These have been followed by strong rebounds in prices, although these periods of rising prices have not exceeded the peak growth rates of the pre-GFC era.

The most recent data up to December quarter 2014 suggests the rate of growth in prices on average nationwide has already peaked.

Taking a longer perspective, property price appreciation has been a key driver of wealth creation for many Australians. This has been especially true during surges in prices such as in the late 1980s and the early years of the 2000s.

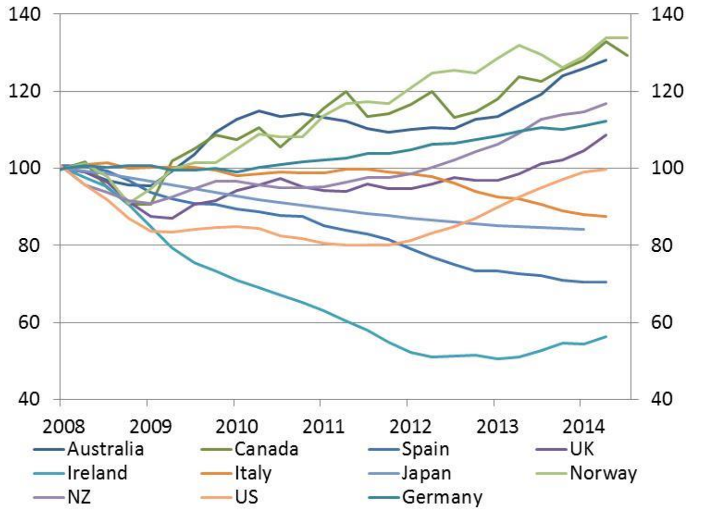
2.1.2 International house prices

The Bank of International Settlements (**BIS**) and *The Economist* magazine provide international comparisons of house prices. There are differences in the countries included and in the data used.

BIS data shows the overall increases in Australian residential prices since the GFC are not out of line with those in some other developed countries (Figure 4). Since March 2008, property prices have risen by almost 28 per cent in Australia; about the same as in Canada and Norway, where property prices grew by 29 per cent and 34 per cent respectively. Overall, of the 18 countries analysed by the BIS, only 10 have experienced house price growth since 2008.

Figure 4: International property prices*

Index: March Quarter 2008 = 100



* All property types, non-seasonally adjusted, 'whole country'. Except Australia which is the weighted average 8 cities and US which is seasonally adjusted.

Source: BIS

In contrast, property prices in the USA have only recently returned to their 2008 levels while prices in some other countries continue to be depressed. In Ireland and Spain property prices are down 54 per cent and 30 per cent, respectively, on March 2008 prices.

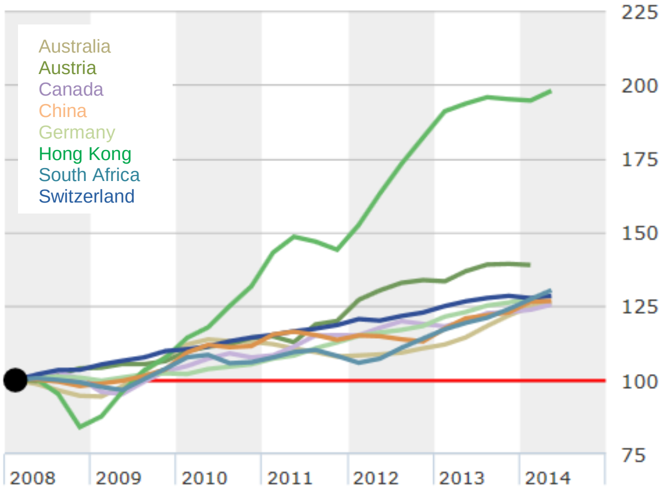
The Economist data show since the first quarter of 2008 nominal house prices have increased more quickly in Austria and Hong Kong than in Australia (Figure 5). The increase in Australian house prices has been broadly in line with increases in a range of other countries, including Canada, China, Germany, South Africa, and Switzerland.[1]

The differences in property price growth over this period have been influenced by the disparities in the wider economic conditions in the individual countries during and following the GFC. Australia did not suffer the extreme economic dislocations experienced by other developed economies including the USA, UK, parts of Europe, and Japan.

[1] The Economist

Figure 5: International property prices in nominal terms

Index: March Quarter 2008 = 100



Source: *The Economist*, using data from ABSA; Australian Bureau of Statistics; Bundesbank; CEIC; Census and Statistics Department; *The Economist*; National Bureau of Statistics of China; OECD; Ratings and Valuation Department; Swiss Federal Statistics Office; Swiss National Bank; Teranet and National Bank; vdpResearch

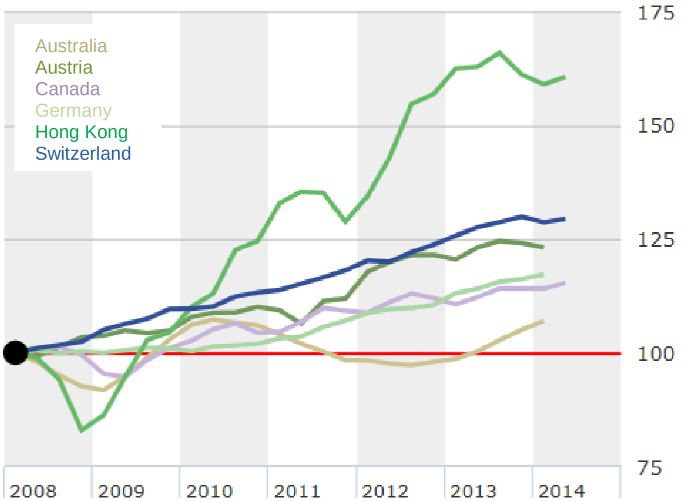
There have also been significant differences in inflation.

After adjustment for inflation, in real terms price rises in Australia have ranked behind Hong Kong, Switzerland, Austria, Germany and Canada (Figure 6).[2]

Overall these metrics suggest that Australia has recorded solid increases in both nominal and real house prices since the GFC but it has by no means been the strongest market in global terms.

Figure 6: International property prices in real terms

Index: March Quarter 2008 = 100



Source: *The Economist*, using data from ABSA; Australian Bureau of Statistics; Bundesbank; Census and Statistics Department; *The Economist*; OECD; Ratings and Valuation Department; Swiss Federal Statistics Office; Swiss National Bank; Teranet and National Bank; vdpResearch

2 *The Economist*

2.1.3 House price growth across cities

Much of the public discussion on house prices has been centred on the most recent quarterly or monthly change in Sydney and Melbourne. However, focusing on very short-term changes in these two markets can provide a misleading perspective on longer-term trends and conditions across Australia.

Sydney has been the strongest market over the past 12 months, with increases in established house prices of 12.8 per cent in the 12 months to December 2014 (Figure 7).[3] This was well above the rate of inflation. Brisbane has ranked equal second with Melbourne.

Sydney has also been the strongest market over the past five years although the outperformance has not been as marked.

But over a ten year timeframe Sydney has been around the middle of the capital cities, with price increases similar to Brisbane and Adelaide.

The standout performers over the past decade have been Darwin and Perth.

In addition to having the highest house price growth rate in Australia over the past year, Sydney currently has the highest median house price at $723,000, well above Melbourne on $561,000.[4] With higher house prices growth over the previous 10 years, median house prices in Perth and Darwin, at $525,000, no longer trail so far behind. However, median prices in Adelaide and Hobart remain much lower at $410,000 and $341,000 respectively.

Figure 7: Established house prices (per cent change)

Average annual change to Dec 2014:	12 months		5 years		10 years	
	Nominal	Real	Nominal	Real	Nominal	Real
Sydney	12.8	11.1	6.9	4.4	4.7	2.0
Brisbane	5.4	3.7	1.4	-1.1	4.6	1.8
Melbourne	5.4	3.6	3.4	0.9	6.6	3.8
Adelaide	2.9	1.2	1.3	-1.2	4.7	2.0
Hobart	2.8	1.1	0.4	-2.0	3.7	1.0
Canberra	2.6	0.8	1.4	-1.1	4.2	1.4
Perth	1.5	-0.2	2.3	-0.1	7.3	4.6
Darwin	0.1	-1.6	3.1	0.6	8.5	5.8
Weighted average	7.0	5.3	4.0	1.5	5.4	2.7

Source: ABS

2.2. Rental yields

Rental yields on residential properties have fallen since the mid-1980s (Figures 8 and 9). Rents have increased on average, but not as quickly as prices.

The decline in the rent-to-price ratio has been very broadly in line with the fall in the nominal rate of return on alternative investments, reflecting lower inflation and easier monetary policy.

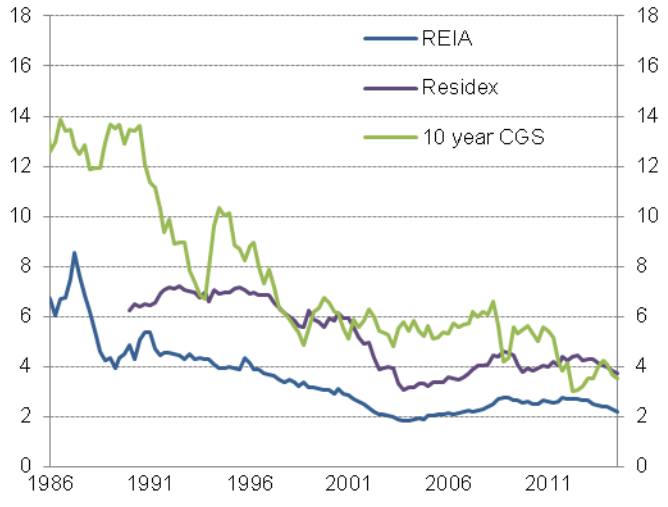
However, for significant periods the risk free return has been *higher* than the rental yields on housing. Under this scenario it would only make financial sense to purchase dwellings as an investment to rent if there were expectations of capital gains on housing.

3 ABS Catalogue number 6416.0

4 As at 31 January 2015. *CoreLogic RP Data January 2015 Hedonic Home Value Index Results*, 2 February 2015

Figure 8: Sydney rental yields and risk free rate

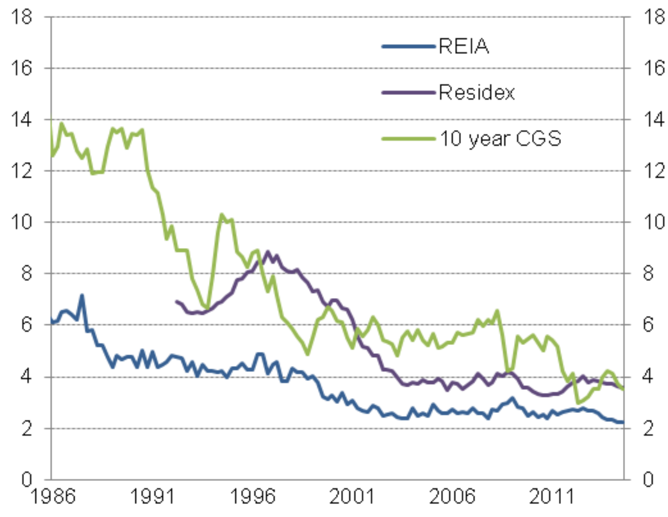
per cent



Sources: REIA, Residex, RBA

Figure 9: Melbourne rental yields and risk free rate

per cent



Sources: REIA, Residex, RBA

Focusing on the more recent past, rental yields in Sydney drifted up in the four years to 2010. They have subsequently drifted down towards the 2004 lows. The most recent declines in rental yields in Sydney and Melbourne have not been as marked as the fall in the risk free rate.

2.3. Is Australia's residential property market experiencing a bubble?

2.3.1 What is an asset price bubble?

Determining if a bubble is forming, or has formed, is difficult and often only obvious after the bubble has 'popped'. Even if the existence of a bubble can be determined, deciding what to do is not straightforward. The US Federal Reserve approach has traditionally been to 'clean up' after a bubble has popped.[5] In contrast, the Australian approach has been more to 'lean against the wind', that is to actively work to stop bubbles forming/expanding.[6]

An asset price bubble, or speculative bubble, is generally accepted to be a departure of an asset's price from its economic fundamentals.[7] In the context of residential property, a bubble occurs when buyers push up the prices of properties based on their assumptions that the value of those properties will continue to rise into the future. As such, they are not purchasing the properties primarily as shelter or as income producing assets but are betting on strong future asset price appreciation to generate a return.

This is akin to placing bets at a casino. Risk is two sided – it has already been shown that house prices can rise but they can also fall. Speculation on price gains increases the risk of a sudden and damaging reversal.

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5 Greenspan A (2002), 'Opening Remarks', in *Rethinking Stabilization Policy*, A Symposium sponsored by the Federal Reserve Bank of Kansas City, Kansas City, pp 1–10.

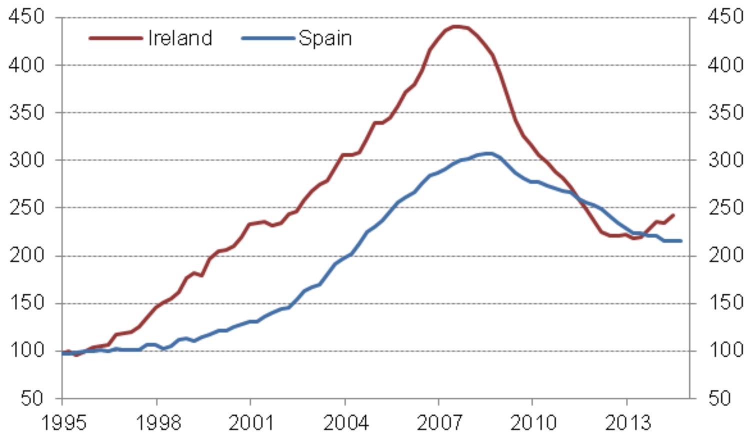
6 Analysing which approach is most appropriate (and when) has been the focus of research by not only academics but also by Central Banks. The RBA has termed this question as "the 'lean' versus 'clean' debate". See Mishkin, F.S. (2011) *How Should Central Banks Respond to Asset-Price Bubbles? The 'Lean' versus 'Clean' Debate After the GFC*, RBA Bulletin June Quarter
An analysis of this important issue is beyond the scope of this paper.

7 Scherbina, A. (2013) *Asset Price Bubbles: A Selective Survey*, IMF working paper

Asset price bubbles, including house price bubbles, can quickly destroy wealth once the bubble 'pops'. This destruction of wealth can have a major impact on economic activity as well as consumer and investor confidence. Spain and Ireland are recent examples of the emergence and popping of real estate bubbles (Figure 10).

Figure 10: International property prices*

Index: 1995 = 100



* All property types, non-seasonally adjusted, 'whole country'.

Source: BIS

2.3.2 Is the Australian housing market 'overvalued'?

Some commentators, particularly internationally, have raised concerns that Australia's residential property market is overvalued and that a correction is due. These include the BIS, the International Monetary Fund (**IMF**) and *The Economist*[8]. The main arguments supporting this position tend to be that house prices have drifted unsustainably above their long run average. These arguments are assessed below.

Property price-to-rental income

One measure of the sustainability of an asset's price is the return it generates (relative to its risk). The return on housing is a combination of rental returns and capital gains. The measure often used to evaluate rental returns is the property's yield - the rental income divided by the property's value. Continued high investor demand in a low rental yield environment could imply that investors are betting on strong future capital gains.

The inverse of rental yield is the 'price-to-rent' ratio.

This measure is used by the BIS as part of its assessment of international housing markets in its September 2014 Quarterly Review. By the BIS' measure, the current ratio in Australia (over the 12 months to Q1 2014) is approximately 50 per cent higher than the long run average (Figure 11). This gives Australia the 5th highest ratio (out of the 29 countries presented), behind Canada (80 per cent), Sweden (70 per cent), Norway (65 per cent) and in line with Belgium (50 per cent).[9]

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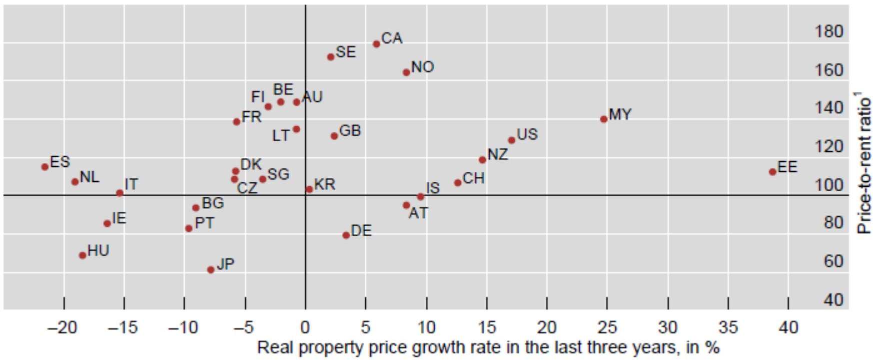
8 For example, *The Economist* (29 August 2010) *Froth and stagnation: House prices in parts of Asia continue to soar*, despite efforts to slow them, 8 July and *The Economist* (2014) Location, location, location,

9 Figures approximate, based on Graph 2 (page 72) of the BIS' Quarterly Review, [Special Report: Residential property price statistics across the globe](), September 2014.

Figure 11: International property price-to-rent ratios



AU = Australia; AT = Austria; BE = Belgium; BG = Bulgaria; CA = Canada; CH = Switzerland; CZ = Czech Republic; DE = Germany; DK = Denmark; EE = Estonia; ES = Spain; FI = Finland; FR = France; GB = United Kingdom; HU = Hungary; IE = Ireland; IS = Island; IT = Italy; JP = Japan; KR = Korea; LT = Lithuania; MY = Malaysia; NL = Netherlands; NO = Norway; NZ = New Zealand; PT = Portugal; SE = Sweden; SG = Singapore; US = United States.

[1] In Q1 2014; full sample = 100.

Source: the BIS' Quarterly Review, *Special Report: Residential property price statistics across the globe*, September 2014, using data from: OECD; AMECO; national data; BIS long series and selected property price database; BIS estimates

The BIS concludes that a ratio greater than 20 per cent above the long run average suggests "*potential downward pressures on real house prices*"[10]. Eleven of the 29 countries presented breached this threshold, including Australia.

Three observations on this measure are:

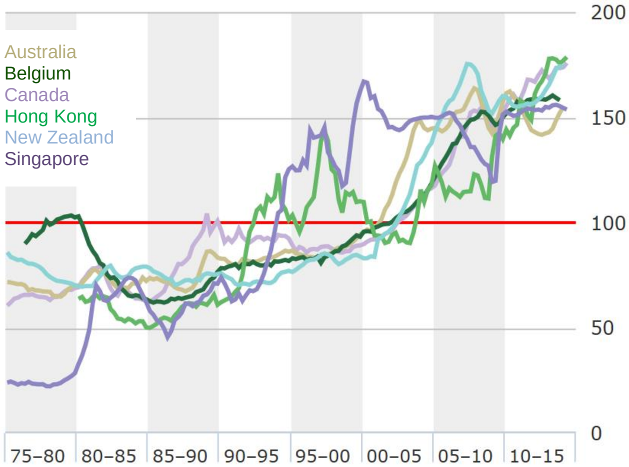
- The price-to-rent ratio is based on the previous 12 months, compared to the long run average. As such, it may in part reflect very short-term movements rather than sustained movements in housing prices.
- Some of those countries with higher ratios, including Australia, experienced moderate or negative real property price growth in the previous three years, which suggests recent price growth was not the source of the problem.
- The property prices in a number of the countries with lower ratios were dragged down during the GFC and are yet to recover. These depressed house prices, when compared against relatively sticky rental prices, would naturally result in lower ratios.

The Economist also provides measures of prices relative to rents compared with long run averages (Figure 12). Using this measure, Australia looks expensive but by no means the most expensive. The most expensive countries are Hong Kong, Canada and New Zealand with Australia in a group of second ranking countries with Belgium and Singapore.

[10] BIS Quarterly Review (September 2014) *Special Report: Residential property price statistics across the globe*, p73

Figure 12: International property price-to-rent ratios

Long-term average = 100



Source: *The Economist*, using data from: Australian Bureau of Statistics; Census and Statistics Department; *The Economist*; OECD; Quotable Value; Ratings and Valuation Department; Statistics New Zealand; Teranet and National Bank.

Overall this data suggests that Australian prices-to-rents are high but not the highest on a global basis. This elevated ratio cannot be interpreted as a sign of a boom or a predictor of a forthcoming bust. Key qualifications are:

- The big increase in prices-to-rents occurred from the mid-1980s to the early 2000s. Since then the ratio has trended sideways.
- The long term increase in prices-to-rents (or the decrease in Australian rental returns) has been (very) broadly in line with the long term decline in the risk free rate.

Having said that, there is no getting away from the fact that Australian houses are expensive relative to the investment returns that can be generated. Current rates of return may be economically viable only if expectations of further price gains are fulfilled.

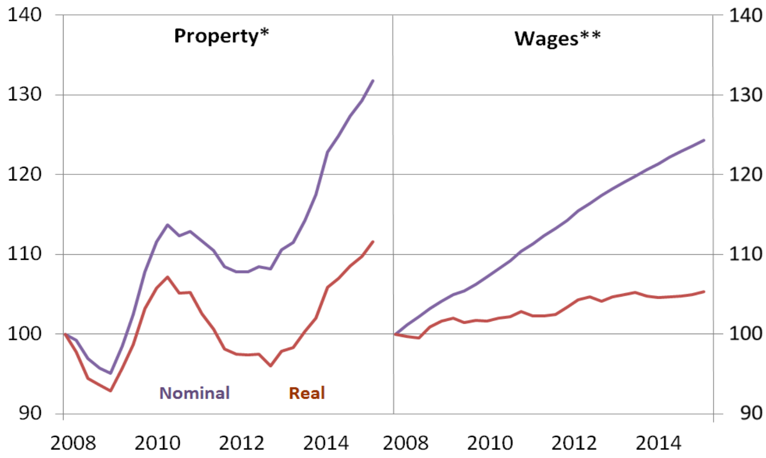
House prices-to-household income

Another measure of the 'stretch' in housing prices is the price-to-income ratio.

Since the GFC – taking the March quarter 2008 as the base period – nominal property prices in Australia have increased by almost 32 per cent (Figure 13). Over the same period wages have increased by 24 per cent.

Figure 13: Property prices and wage growth

Index: March Quarter 2008 = 100



* Established house prices. Weighted average 8 capital cities.

** Total hourly rates of pay excluding bonuses; Australia; Private and Public; All industries

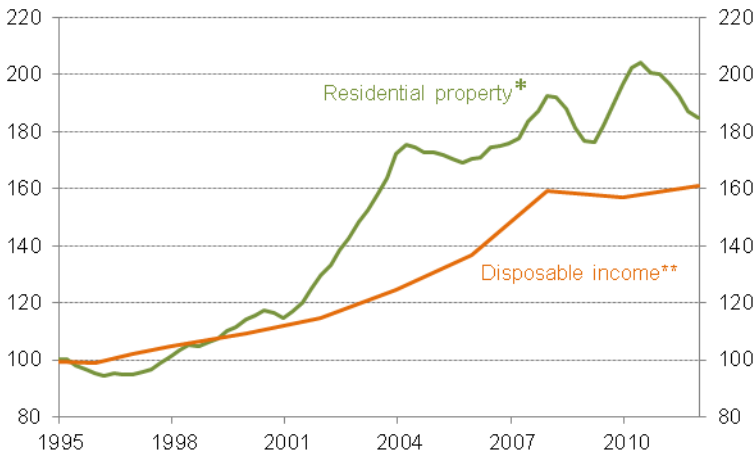
Source: ABS

Another perspective is provided by household disposable income after taxes. The ABS produces estimates of equivalised household disposable income which adjust for differences in the number of individuals and the adult/child mix per household to provide an indicator of the economic resources available to a standardised household.[11] The data are adjusted for inflation and are only available up to 2011-12.

Taking a longer time frame shows that real house prices have risen more quickly than real household disposable income since the late 1990s (Figure 14).

Figure 14: Real house price and household disposable income growth

Index: December 1994/March 1995 = 100



* Established house prices. Weighted average 8 cities.
** Equivalised disposable household income
Source: ABS

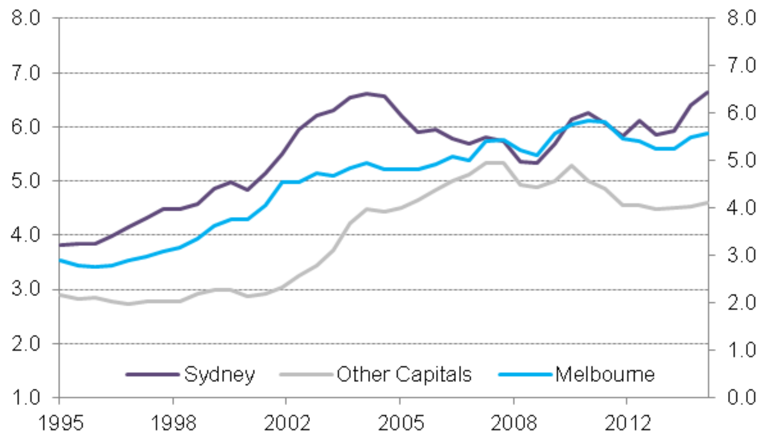
[11] ABS Household Income and Income Distribution, Cat No 6523.0.

The Housing Industry Australia (**HIA**) provides an alternative perspective by adjusting household income for the number of income earners.[12] It shows that price-to-income ratios overall increased through the late 1990s and early 2000s (Figure 15), but have subsequently shown no clear national trend.

For Sydney, the price-to-household income ratio fell from 2004 to 2009, but then subsequently increased and is currently around the level previously seen in 2004. In Melbourne, the price-to-income ratio trended upwards from 1995 to 2010, but then fell through to mid-2013. While the ratio has since increased, it remains below the level seen in 2010.

For the other capital cities, the ratio has remained relatively stable since late 2011, having fallen in the preceding four years.

Figure 15: Dwelling price-to-income ratio in Australia



Assumes number of earners per household increased from 1.50 in 1994 to 1.65 in 2014 at constant rate

Source: HIA (2014) *Economics Research Note: A Portrait of Australian Home Prices*, October, uses data from RP Data and ABS.

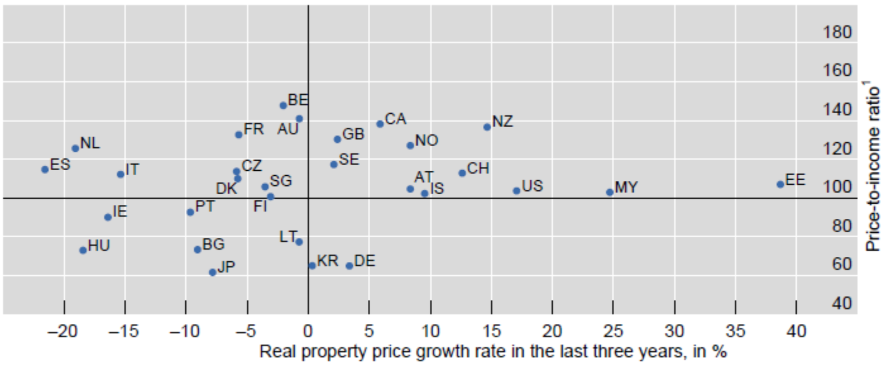
Overall it would seem that over the longer term house prices have become more expensive relative to the purchasing capacity of both individuals and households.

International comparisons of price-to-income ratios suggest that Australia is relatively expensive.

The BIS compares the current ratio to its long-run average (vertical axis of Figure 16).

[12] HIA (October 2014) *Economics Research Note: A Portrait of Australian Home Prices*,

Figure 16: International property price-to-income ratios



AU = Australia; AT = Austria; BE = Belgium; BG = Bulgaria; CA = Canada; CH = Switzerland; CZ = Czech Republic; DE = Germany; DK = Denmark; EE = Estonia; ES = Spain; FI = Finland; FR = France; GB = United Kingdom; HU = Hungary; IE = Ireland; IS = Island; IT = Italy; JP = Japan; KR = Korea; LT = Lithuania; MY = Malaysia; NL = Netherlands; NO = Norway; NZ = New Zealand; PT = Portugal; SE = Sweden; SG = Singapore; US = United States.

[1] In Q1 2014; full sample = 100.

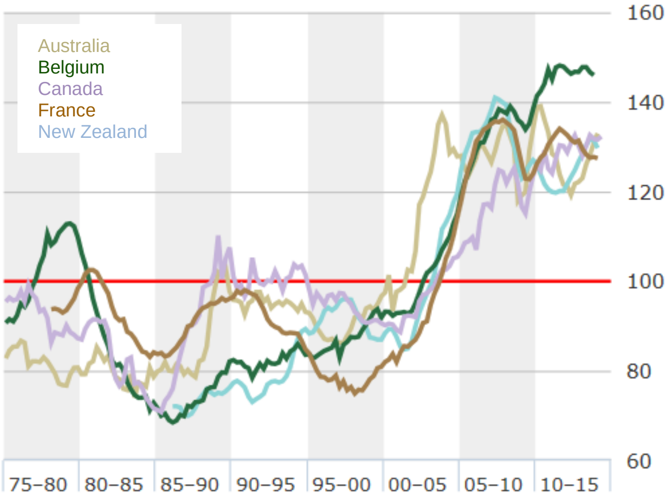
Source: the BIS' Quarterly Review, [Special Report: Residential property price statistics across the globe](), September 2014, using data from: OECD; AMECO; national data; BIS long series and selected property price database; BIS estimates

By this measure Australia has the equal second highest ratio, slightly above 40 per cent. It is below Belgium, at approximately 50 per cent, and broadly similar to Canada, New Zealand, France and Great Britain. Using the benchmark that a ratio greater than 20 per cent points to heightened risks of a downward correction in prices, the BIS suggests that 8 of the 29 reported countries are at risk of a price 'bust'.

The Economist also provides measures of prices relative to household after-tax income (Figure 17). Australia looks expensive but by no means the most expensive. Australia ranks roughly equal second behind Belgium, in line with Canada, New Zealand and France (data for Hong Kong is not included).

Figure 17: International property price to average income ratios

Long run average = 100



Source: *The Economist*, using data from: Australian Bureau of Statistics; Bundesbank; INSEE *The Economist*; OECD; Quotable Value; Statistics New Zealand; Teranet and National Bank.

As such, international comparisons must again be tempered by the state of the economic cycle. It has been shown previously that house prices fell sharply in a number of countries during the GFC. Where prices fell more than wages, the price-to-income ratio would be depressed. The BIS itself acknowledges that predictions of downward pressure on property prices would "*be more compelling for markets where prices have grown rapidly in the recent past, and where income growth is projected to be rather moderate*"[13]. In this context, the BIS analysis shows that Australia's real property price growth in the three years to March 2014 was slightly negative (the horizontal axis in Figure 16). This may be balanced by a slowing in the growth of real wages.[14]

Overall it seems fair to conclude that Australian prices are elevated in terms of historical ratios to incomes and rents, but are by no means out of line with countries which might be regarded as logical peers such as Canada and New Zealand.

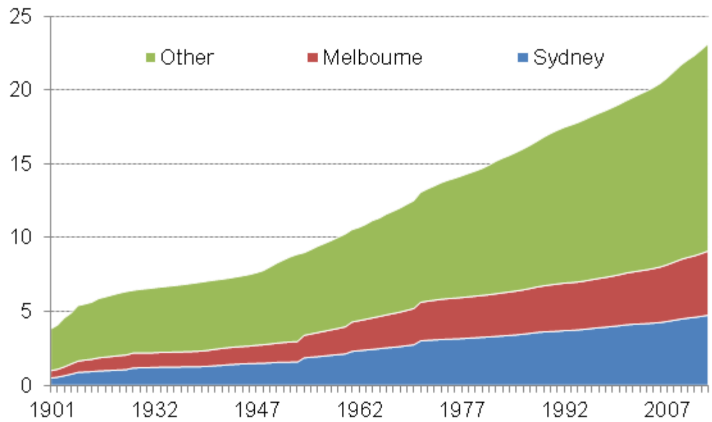
3. What is driving residential house prices in Australia?

3.1. Demand and supply factors

The demand for new houses is largely driven by population growth and the rate at which existing dwellings are demolished and replaced.[15]

Australia needs to progressively increase its housing stock to shelter its growing population. Australia's population increased by over 5.5 million, or 31 per cent, over the 20 years to 2013 (Figure18).[16] Over this period, the population in Sydney grew by approximately 1 million, or 28 per cent, while Melbourne's population increased by 1.1 million, or 35 per cent. Australia's population currently stands at around 23.7 million.

Figure 18: Australia's population (millions)



Source: ABS

13 BIS Quarterly Review (September 2014) *Special Report: Residential property price statistics across the globe*, p72

14 Australian Government Budget Paper No. 1: Budget Strategy and Outlook 2014-15

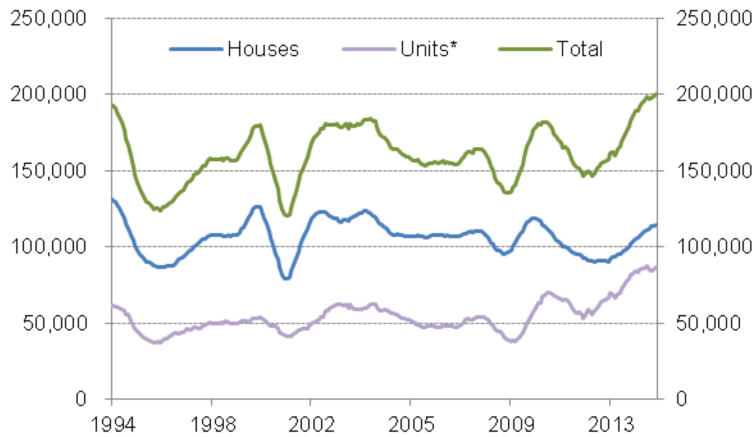
15 HIA (October 2014) *Housing Australia's Future: Demographic Analysis of Australia's Housing Requirements*

16 Data to December 2013 based on ABS population estimates.

A number of reports have suggested that the supply of housing has not been able to keep up with this growing demand[17] and it is widely held that in certain cities and regions of Australia there is a shortage of housing. This shortage has been identified as one of the drivers of elevated property prices, particularly in Sydney and Melbourne.

Looking forward, it is estimated that Australia may need to construct up to 250,000 homes per year to meet future needs, a figure which does not take into account the claimed backlog in the shortage of housing.[18] National approvals to construct new dwellings are running at 200,000 per year and that is after a recent lift (Figure 19). This suggests the housing shortage will remain chronic for some time to come.[19]

Figure 19: Australia building approvals



* Units include all non-house approvals

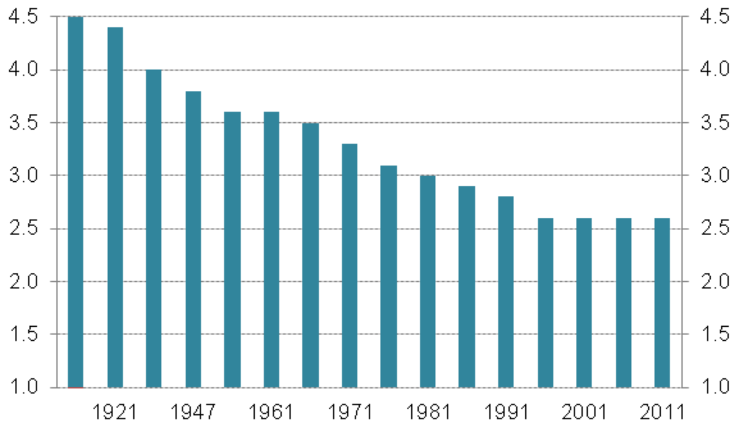
Source: ABS

However, these claims of structural and ongoing housing shortage as a driver of prices should be viewed with a critical eye.

If the housing stock is really that deficient then we might expect the number of persons per household to increase, but Census data suggests the average household size for private dwellings has been stable for 15 years (Figure 20).

[17] For example the HIA's 2010 report *Housing to 2020: The state of Australian housing to the year 2020.*
[18] HIA (October 2014) *Housing Australia's Future: Demographic Analysis of Australia's Housing Requirements*
[19] CBRE Global Research and Consulting (June 2014) *Australia Residential MarketView*

Figure 20: Average persons per private household



Source: ABS Census

Also, it is not clear that movements in house prices reflect these perceived imbalances between supply and demand. It has long been claimed that Sydney suffers the most marked and persistent shortfall in supply, yet Sydney house prices essentially flatlined through the middle of the last decade.

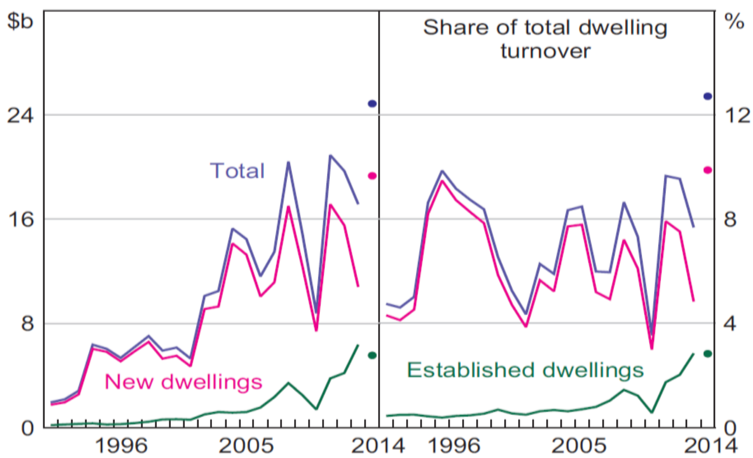
Finally, there is no evidence of a sudden increase in the shortage of dwellings as a driver of the recent surge in house prices.

3.2. Foreign investment

Foreign investment in Australian real estate is not a recent phenomenon. It is volatile and has broadly shown an upward trend over the past three decades although there is no evidence of a recent surge (Figure 21). In the 9 months to March 2014, foreign investment in Australian real estate was over $25 billion, up from over $17 billion in the 2012/13 financial year.[20]

Figure 21: FIRB residential approvals*

Value, financial year



* Data for 2013/14 are for nine months to March 2014

Source: RBA (2014) *Bulletin article: Foreign Investment in Residential Real Estate*, June Quarter, using data from: FIRB, RBA, RP Data-Rismark

[20] RBA (2014) *Bulletin article: Foreign Investment in Residential Real Estate*, June Quarter

The recent House of Representatives' Standing Committee on Economics report on foreign investment in residential real estate concluded:

> *"… foreign investment is not causing the market distortions that have been advocated in some quarters, particularly for first home buyers. This is because foreign investment levels are not large enough to do so overall and because overseas buyers mainly operate at a different price bracket from first home buyers and buy different types of properties.*[21]

This is a position supported by the Reserve Bank of Australia (**RBA**) which has also downplayed the role of foreign investment in driving house prices. RBA Assistant Governor Chris Kent concluded that the *"rise in [housing] prices has primarily reflected increased housing demand from Australian residents and citizens"*[22].

Additionally, the RBA concluded that "*foreign residential purchases have fluctuated a bit from year to year but remained relatively low as a share of housing turnover measured by value and number*"[23]. The RBA also found that *"[o]n balance, foreign residential demand has probably resulted in an increase in the supply of dwellings in Australia… [h]owever, the inherent sluggishness of the housing supply response suggests that some of the increase in foreign demand for housing may have spilled over into higher prices"*.

Nevertheless, the Federal Government has recently suggested that *"[t]here does need to be better enforcement of the rules for foreign purchases of existing homes so that young people are not priced out of the market*" [24]. On 25 February 2015, the Government released an options paper on *Strengthening Australia's Foreign Investment Framework*.[25] Some of the options considered in the paper are:

- Creating a new compliance and enforcement area in the Australian Taxation Office;
- Introducing new civil penalties and increased criminal penalties for foreign investors and third parties who breach the foreign investment rules;
- Ensuring foreign owners that are forced to divest illegally purchased property do not profit; and
- Implementing application fees for foreign purchases (starting at $5,000 for properties worth less than $1 million).

If there were any significant impacts from foreign investment in residential housing they are most likely to be felt in NSW and Victoria, as foreign investment in real estate has been concentrated in those two states (Figure 22).[26] The RBA concludes that foreign purchases *"appear to be most concentrated in new rather than established dwellings, in higher-rather than lower-priced dwellings, in medium-and high-density dwellings rather than detached dwellings, and in inner-city areas of Sydney and Melbourne"*.[27] Such a narrow focus of foreign investment in real estate further supports the view that it is not a key driver of *aggregate* property prices.

---

[21] House of Representatives Standing Committee on Economics (November 2014) *Report on Foreign Investment in Residential Real Estate*

[22] Dr Kent's comments were made at his appearance to the Standing Committee on Economics' inquiry into foreign investment in residential real estate on 27 June 2014.

[23] *Ibid*.

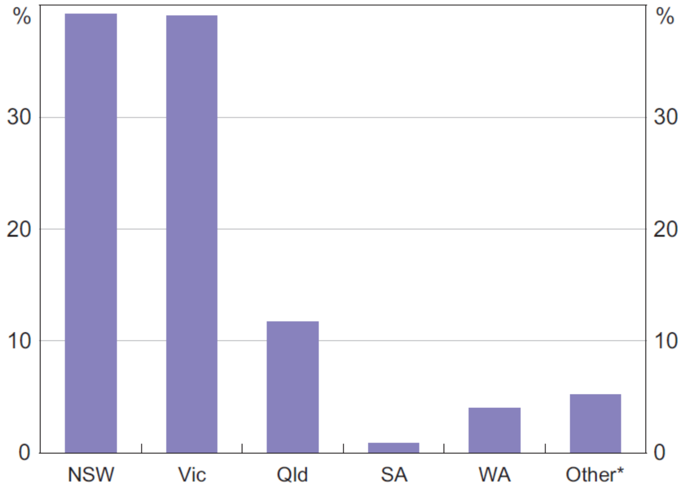
[24] Media release: 1 February 2015, Prime Minister - Government Tightens Rules on Foreign Purchases of Agricultural Land

[25] The Australian Treasury, 25 February 2015, *Strengthening Australia's Foreign Investment Framework*

[26] Dr Kent's comments were made at his appearance to the Standing Committee on Economics' inquiry into foreign investment in residential real estate.

[27] *Ibid.* p.11

Figure 22: Distribution of FIRB approvals for the purchase of new dwellings (2012-2013)



* Includes FIRB approvals where the proposed investment is to be undertaken in more than one state or territory.

Source: RBA (2014) *Bulletin article: Foreign Investment in Residential Real Estate*, June Quarter, using data from FIRB and RBA

There are some caveats to this.

The data on foreign investment in Australian real estate, provided by the FIRB, is only available for the period until March 2014 so it cannot provide insights on more recent dynamics.

Additionally, some commentators suggest that the FIRB figures under-report foreign investment as the foreign investment restrictions[28] are being avoided by some foreign investors. The accuracy of these claims cannot be assessed.[29]

3.3. Domestic demand

3.3.1 Owner occupiers and investors

The rate of growth of borrowing for housing is much slower today than it was prior to the GFC (Figure 23). The low point was in May 2012 with an annual growth rate of 4.1 per cent.

Over the past two years or so the growth rate has gradually accelerated to 7.1 per cent in December 2014. This is the highest rate since January 2011, but is well below the average rate of growth in the pre GFC era. The recent historical high point was in August 1994 at 22.5 per cent with similarly elevated growth rates in early 2004.

[28] Restrictions on foreign investment in real estate include that:

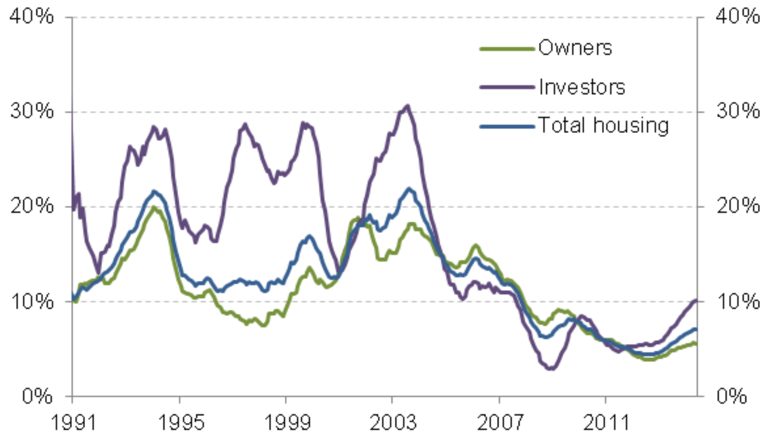
- Foreign non-residents are not permitted to purchase an established property;
- Foreign non-residents must seek approval to purchase vacant land or a new property; and
- Any established dwelling purchased by temporary residents cannot be rented.

If effectively applied, these restrictions should limit the pressure on the prices of dwellings, especially existing dwellings, and support the Government's policy that foreign investment in residential real estate should be directed to increasing Australia's housing stock.

[29] Kelly O'Dwyer, 16 September 2014,quoted in The Sydney Morning Herald (2014) *Punish foreign property cheats, says Coalition MP Kelly O'Dwyer*,

Figure 23: Housing loans outstandings

per cent change, annual



Source: RBA

There has been considerable focus on the role of investors in the recent housing price upswing. Some observations:

- Borrowing by investors is more volatile than borrowing by owner occupiers. Investor borrowing tends to accelerate more quickly in the upswings and to decelerate more quickly in the down turns.
- The recent cycle has been no different, with investor borrowing rising more quickly than owner occupier borrowing since mid-2012.
- Investor loans rose to around one third of total housing loans outstanding in the early 2000s and subsequently stabilised at around that share (Figure 24). There has been an upward drift over the past two years to 34.3 per cent.
- The stock of investor loans outstanding is $488 billion, just over half the stock of loans for owner occupation.

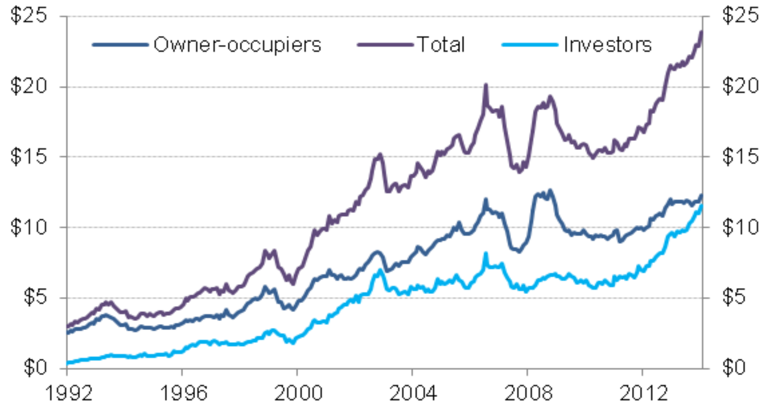
Figure 24: Investor share of total housing loan outstandings

Source: RBA

Another perspective on recent developments in borrowing is shown by new finance commitments.

Figure 25: Housing loan commitments

$bn, monthly



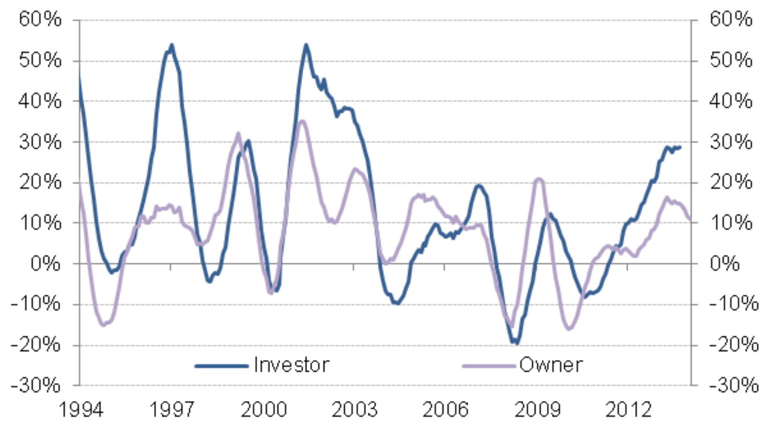
Sources: ABS, RBA

The figures show:

- The monthly flow of new commitments for owner occupiers has been consistently larger than for investors over the past 20 years though the gap has narrowed (Figure 25).
- There has been a surge in both since 2011.
- The upturn has been stronger for investor finance, with growth over 2014 of 24 per cent compared with 11 per cent for owner occupiers (Figure 26).
- The share of investors in total housing finance commitments has increased over the past 5 years from 31 per cent to 40 per cent but the ratio today is only a little above the 2003 peak (Figure 27).
- An increasing proportion of this investor interest is focused in NSW, where investor housing loan approvals have increased by 24 per cent over 2014 and by 56 per cent over the past two years (Figure 28).

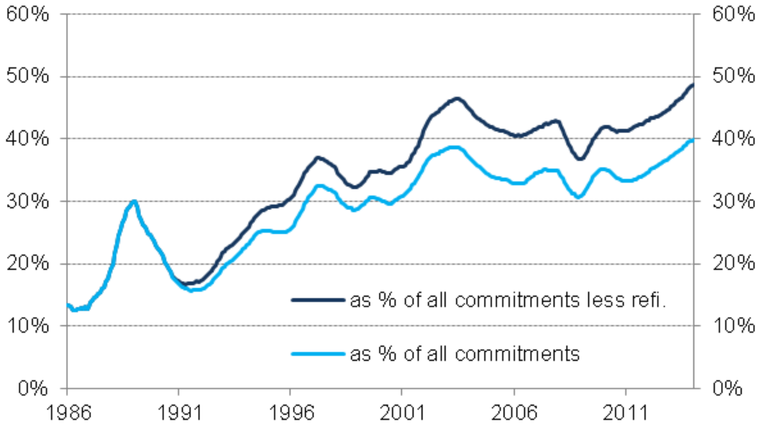
Figure 26: Growth in housing loan commitments

per cent change, annual



Source: ABS

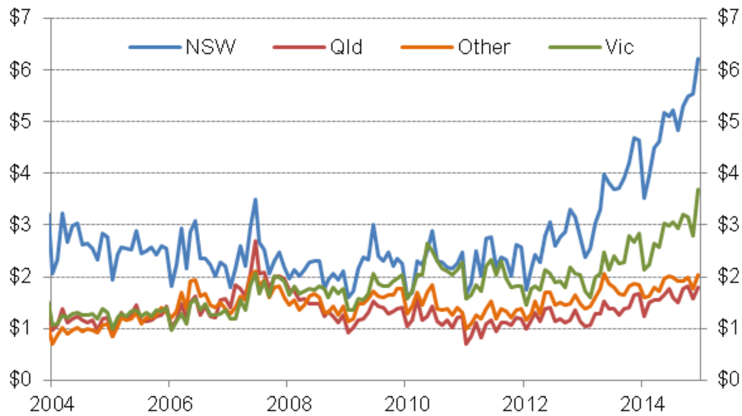
Figure 27: Investor share of housing loan commitments



Source: ABS

Figure 28: Investor housing loan commitments

$bn, monthly



Source: ABS

The regulatory authorities remain concerned about the role of investors in the recent acceleration in home prices.

RBA Assistant Governor, Malcolm Edey recently noted that the *"rate of growth of investor finance is significantly outpacing the growth in household incomes" and that the RBA is aiming to "rein in lending to the highly speculative part of the market, which is where the risk concentrations are being built up"*.[30]

Additionally, the RBA signalled in its September Statement on Monetary Policy that the risks associated with the credit growth in investor housing and house price increases in larger cities "*warranted ongoing close observation*" and "*that additional speculative demand could amplify the property price cycle and increase the potential for property prices to fall later*".

30 Response to Senate Economics References Committee Inquiry into Housing Affordability

In response, APRA and ASIC have signalled that they are increasing their scrutiny of property lending. This has been supported by the RBA Governor Glenn Stevens:

> *APRA has announced its supervisory approach to managing the potential risks posed by the rise in lending to investors in housing. This involves more intense scrutiny of investor loan portfolios growing at over 10 per cent per year, with the possibility, ultimately, of additional capital being required if APRA deems it necessary. APRA has also reiterated its expectations for other elements of lending standards such as interest rate buffers and floors. And ASIC has begun a review of interest-only lending in the context of consumer protection legislation. The Bank welcomes these steps and will keep working with other regulators in these areas.*[31]

3.3.2 First home buyers

There has also been focus on the participation of first home buyers in the housing market.

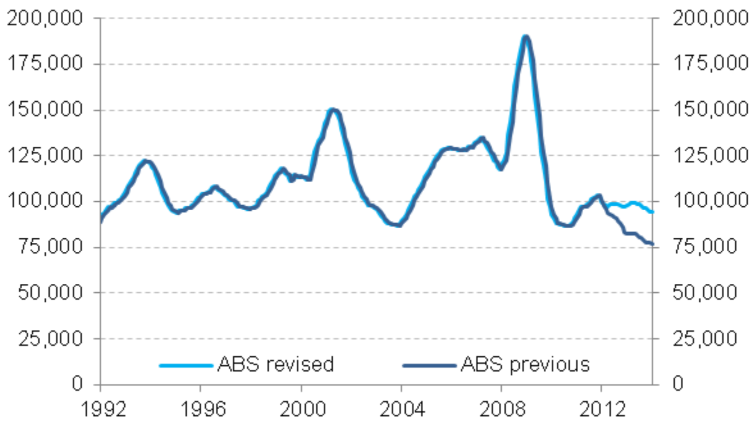
A number of commentators have suggested first home buyers are being priced out of the market. Until recently, this view appeared to be confirmed by ABS data on approvals of housing loans to first home buyers, which showed approvals of only 78,000 over the year to August, the lowest level since June 1992 (Figure 29).

However, revised data from the ABS show that housing loan approvals to first home buyers have remained relatively stable since 2011.

In addition, the volume of first home owner grants for new dwellings has increased over the past four years (Figure 30). This further supports the conclusion that first home buyers are still able to access the housing market.

Figure 29: First home buyers – number of commitments

annual

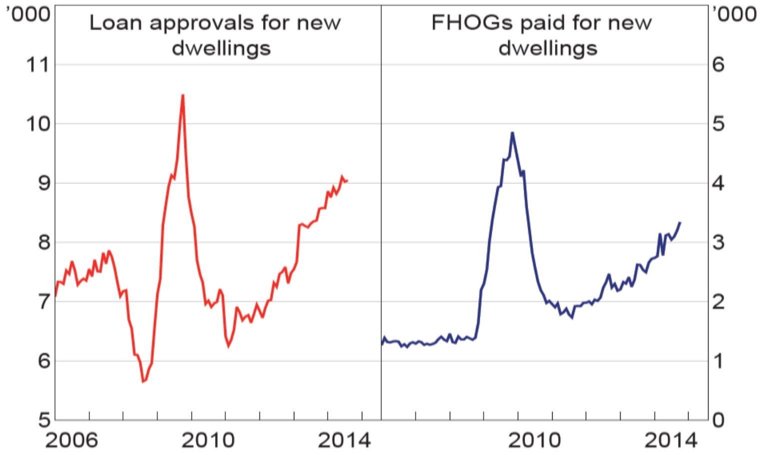


Source: ABS

[31] Statement to House of Representatives Standing Committee on Economic, 13 February 2015

Figure 30: Owner occupiers selected indicators

monthly



* Includes both new construction and newly erected dwellings

Source: RBA (2014) *Statement of Monetary Policy*, November, using data from: ABS, NSW Office of State Revenue and RBA

3.4. Lending standards

House prices could be affected by an increase in competition between providers of home loans. This could encompass more aggressive pricing of loans or a relaxation of lending standards, including the relaxation of covenants and a lowering of the eligibility criteria for accessing finance. The latter could include an increase in LVR or the issue of more 'low doc' loans.

Interest rates on home loans are at low levels. The average advertised standard variable mortgage rate fell to 5.95 per cent in August 2013 and remained at that level until February 2015 when a further 0.25 per cent reduction to 5.70 per cent occurred.[32] Today's discounted rate is even lower at under 5 per cent.

These low rates compare to the 17 per cent peak recorded between June 1989 and March 1990.

These low rates charged to home borrowers are in part a reflection of the intense competitive environment faced by bank and non-bank lenders.

Mostly however, they are a product of the globally low interest rate environment. The RBA's cash rate was reduced to 2.25 per cent in February 2015 - the lowest in a generation.

There is no evidence that finance providers have relaxed their lending standards.

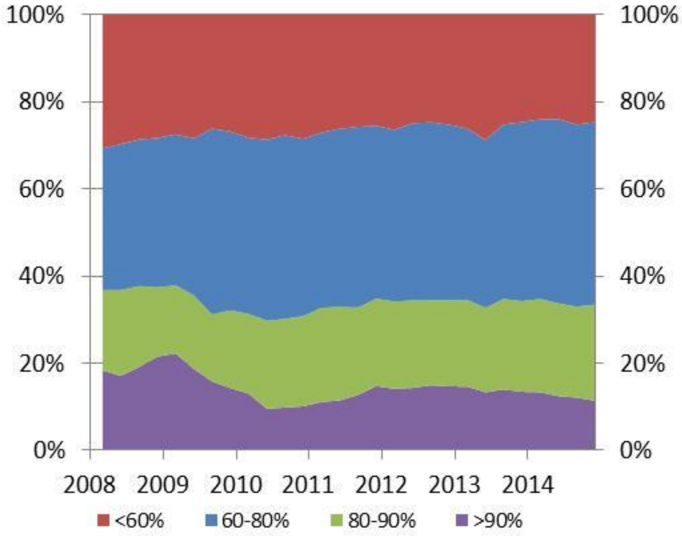
The proportion of new loan approvals to high LVR borrowers, i.e. LVRs more than 90 per cent, has fallen since 2009 for all borrowers (Figure 31) and remains below 10 per cent for investor loans (Figures 32 and 33).

Low doc loans have fallen to very low levels.

32 Reserve Bank of Australia

Figure 31: LVR of home loan commitments

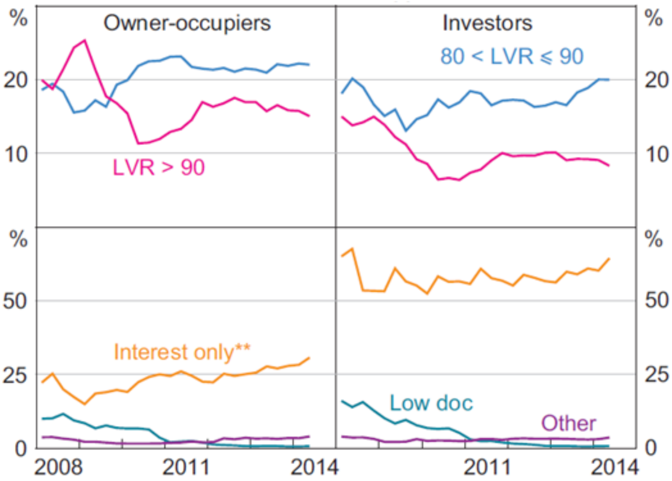
per cent of total



Source: APRA

Figure 32: Banks' housing loan characteristics*

share of new loan approvals



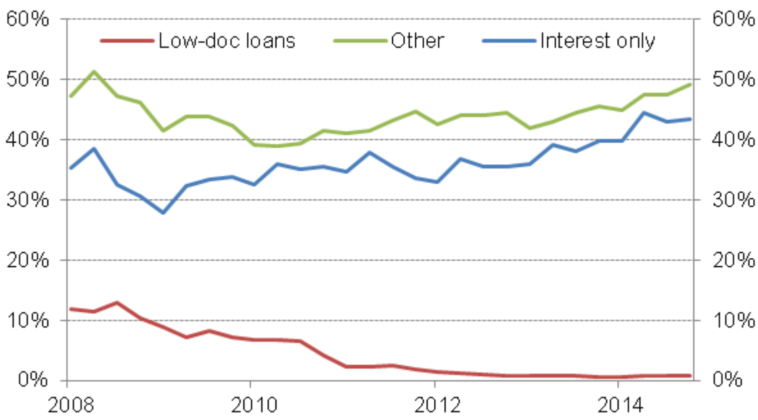
* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal debt-serviceability policies, and other non-standard loans

** Series is backcast before December 2010 to adjust for a reporting change by one bank

Source: RBA (2014) Financial Stability Review, September, using data from APRA and RBA

Figure 33: Banks' distribution of housing loans by type

per cent of total number of loans



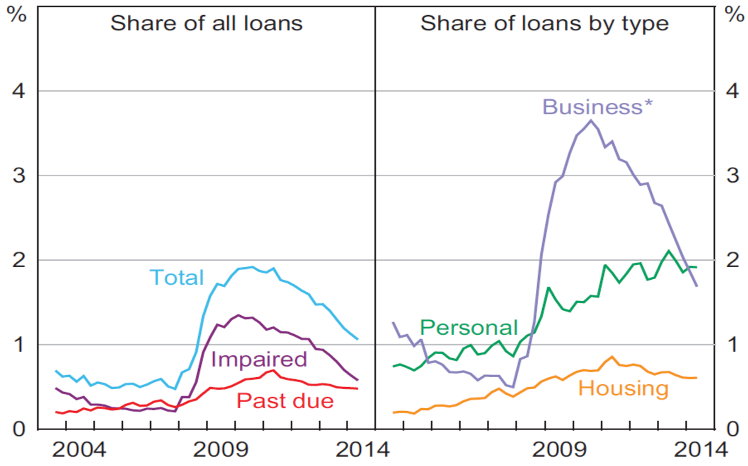
Source: APRA

Another indicator of relaxed lending standards would be a deterioration in banks' asset quality. However, the quality of Australian banks' assets continues to improve (Figure 34). The RBA has said:

> *"Over the first half of 2014, the asset performance of Australian banks continued its steady improvement of recent years. In the banks' domestic portfolio, the ratio of non-performing assets to total loans was 1.1 per cent at June 2014, compared with a peak of 1.9 per cent in mid 2010… This decline mostly reflects a reduction in the share of loans classified as impaired (those not well secured and with repayments doubtful), while the share of loans classified as past due (in arrears but well secured) has fallen modestly since its peak in 2011."*

Figure 34: Banks' non-performing assets

domestic books



* Includes lending to financial businesses, bills, debt securities and other non-household loans

Source: RBA (2014) *Financial Stability Review*, September, using data from APRA

The RBA has confirmed that banks have not relaxed their lending standards, concluding that "*mortgage lending standards remain firmer than in the years leading up to the financial crisis*."[33]

Overall there is no evidence that a lowering of lending standards is a factor in the recent surge in house prices.

3.5. The role of monetary policy

House prices are quite sensitive to adjustments in interest rates.[34] House prices accelerate when housing loan rates fall and decelerate when housing loan rates increase. This reflects the predominance of variable interest rate loans in the Australian housing market.

The most recent acceleration in house prices follows the reduction in interest rates (Figure 35) commencing November 2011. As pointed out by the RBA, changes in housing prices are "*an important channel of the transmission of monetary policy*".[35] Low interest rates stimulate economic activity by boosting construction, investment, employment and spending.[36]

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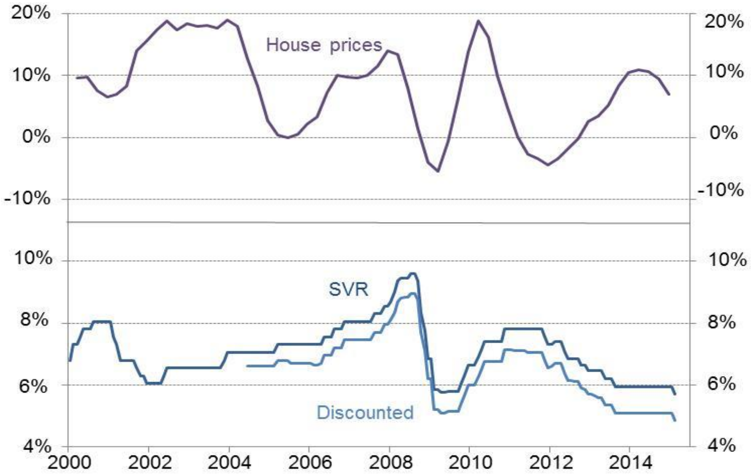
33 RBA (2014) *Financial Stability Review*, September, pp1-2
34 RBA (2014) *Statement on Monetary Policy*, February, p.38
35 *Ibid.*
36 *Ibid.* p.39

Figure 35: House price growth and interest rates

per cent change, annual and per cent



Sources: ABS and RBA

Interest rates are the primary macroeconomic tool for managing demand in Australia. Monetary policy is considered a 'blunt tool'. The RBA cannot set interest rates for different sectors, states or industries. Movements in the cash rate impact all Australians, regardless of where they live, what industry they work in or if they are a net saver or a net borrower.

It is a balancing act to provide sufficient stimulus to the economy overall without overheating a particular sector.

While the RBA has started to indicate some concerns with recent increases in housing prices, it has also clearly indicated that this will not be an impediment to maintaining an expansionary monetary stance for a while longer.[37]

4. Household finances

4.1. Key features of Australian household finances

Household finances are in good shape.

Households continue to borrow, but they also continue to save and invest. The value of household assets is much greater than the value of household debt so that on average households have a positive net worth (Figure 36).

[37] This position has been maintained in numerous minutes of the monetary policy meetings of the Reserve Bank Board.

Figure 36: Household finances

per cent

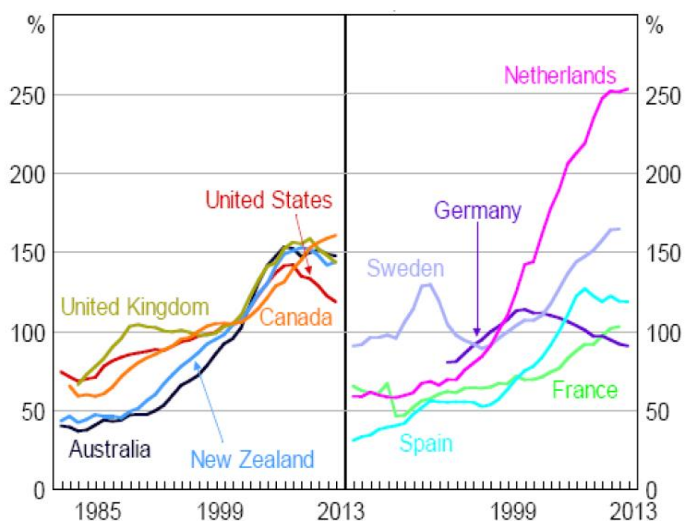
Source: RBA

Australia's household debt–to-income ratio rose strongly from the early 1980s as progressive deregulation of financial intermediation facilitated greater competition between banks on product and price and provided greater choice for consumers. It reached a level broadly similar to that of other developed countries such as the USA, UK, Canada and New Zealand, but well below that of the Netherlands and Sweden (Figure 37).

Following the GFC the ratio dipped slightly but has subsequently begun to rise again. Nevertheless, the ratio remains slightly below its pre GFC peak.[38]

Figure 37: Household debt to household disposable income

per cent



* There are differences in definitions across countries

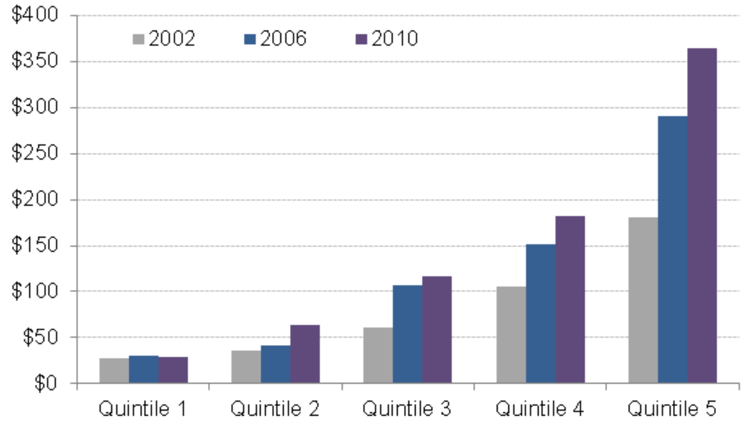
Source: CBA Global Markets Research *Economics:* Issues, 25 September 2014, using data from national sources

38 This position has been maintained in numerous minutes of the monetary policy meetings of the Reserve Bank Board.

The level of household debt rises with income and with wealth. That is, those households with the highest debt have the highest capacity to service that debt (Figure 38) and have the most assets.[39] Households in the lowest fifth of incomes have average debt of $30,000 while households in the highest fifth of incomes have average debt of $364,000.

Figure 38: Average household debt by income quintile

'000



Source: RBA, Household, Income and Labour Dynamics in Australia Survey

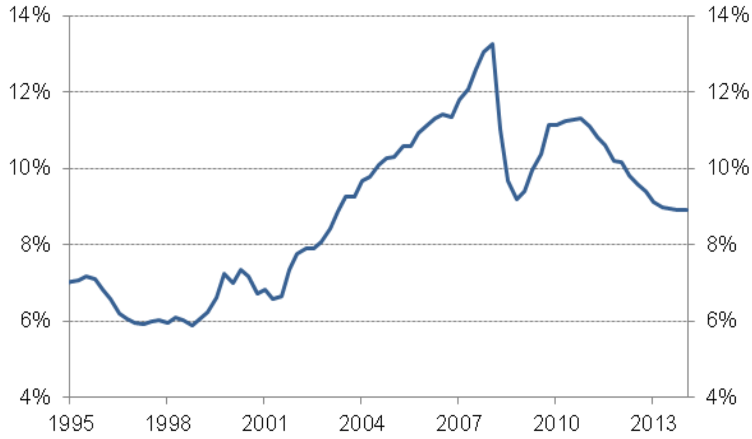
The ratio of household debt-to-assets more than doubled over the two decades from the late 1980s, from just under 8 per cent to just under 19 per cent in early 2009. Subsequently the ratio has stabilised and eased slightly to just under 17 per cent. That means that every $1 of debt is matched by almost $6 of assets.

Owner occupied dwellings are the single largest component of household wealth. The ratio of housing debt-to-housing assets is around 28 per cent, with every $1 of debt being matched by over $3 in house value.[40]

Interest payment burdens are low (Figure 39). Over the year to June 2014, households paid $71 billion in interest on housing and other consumer debt.[41] The proportion of household disposable income consumed in interest payments is currently around 9 per cent, well below the September 2008 peak of 13.2 per cent and the lowest level in 11 years.[42] Within that, the proportion of household disposable income consumed in interest payments on housing loans is 7.2 per cent; again well below the September 2008 peak of 10.9 per cent.

39 ABS 6554.0 Household Wealth and Wealth Distribution
40 Reserve Bank of Australia, Table E2 Household Finances
41 ABS 5206.0 Australian National Accounts
42 Reserve Bank of Australia, Table E2 Household Finances

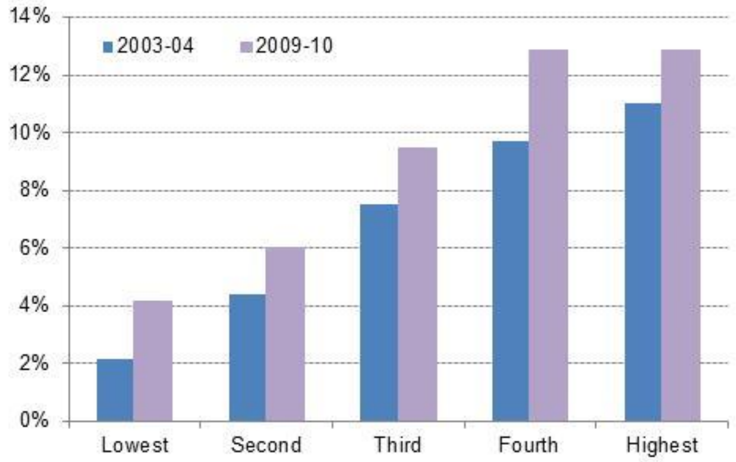
Figure 39: Interest payments-to-income



Source: RBA

Mortgage repayments (principal and interest) are highest for those earning the highest incomes. Mortgage repayments are about 13 per cent of the average weekly spend for the highest income quintile, but only 4 per cent for the lowest income quintile (Figure 40).

Figure 40: Mortgage payments as per cent of average weekly spend (by income quintile)



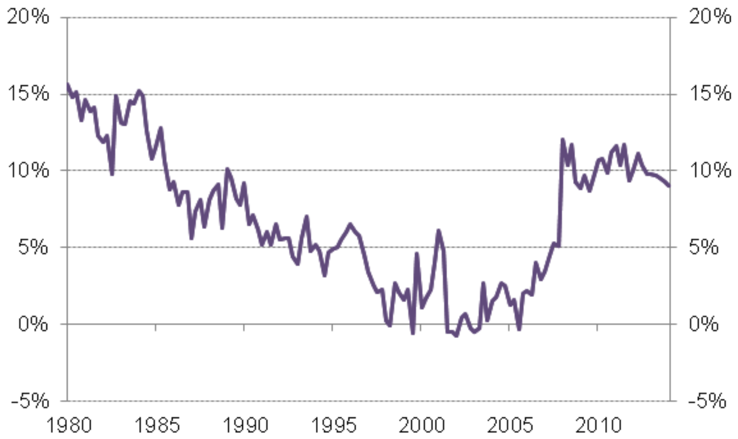
Source: ABS Household Expenditure Survey

The RBA concludes that on average, household debt serviceability remains comfortable. In its most recent *Financial Stability Review*, the RBA said that "*[a]ggregate indicators suggest that household financial stress is generally low, despite the increase in the unemployment rate over the past year*".[43]

Households also continue to show considerable capacity to save money, with the household savings ratio still high at around 9 per cent (Figure 41).

[43] Reserve Bank of Australia (September 2014) *Financial Stability Review*, p43

Figure 41: Household savings ratio

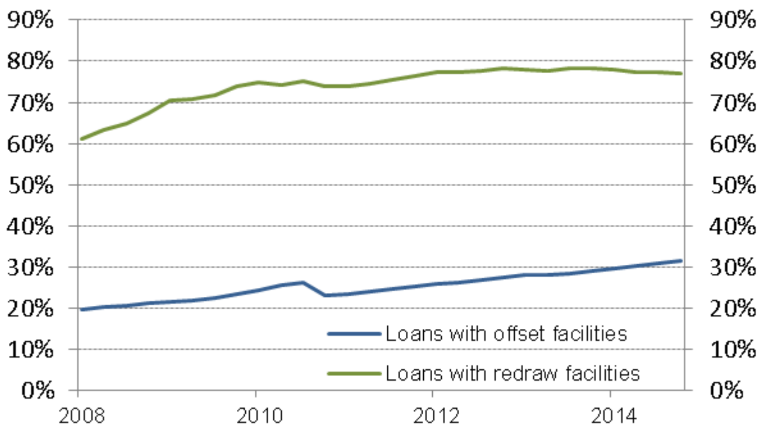


Source: ABS

4.2. Repayment buffers

Households are able to build additional buffers against their home loans by repaying the principal on the loan more quickly than required by the minimum payment (Figure 42). This can be done by putting extra money into mortgage offset or redraw accounts. This money can then be drawn upon at times of stress, such as unexpected unemployment. Additionally, this buffer may be used when interest rates, and the required repayments on variable home loans, increase.

Figure 42: Proportion of bank housing loans with offset and redraw facilities



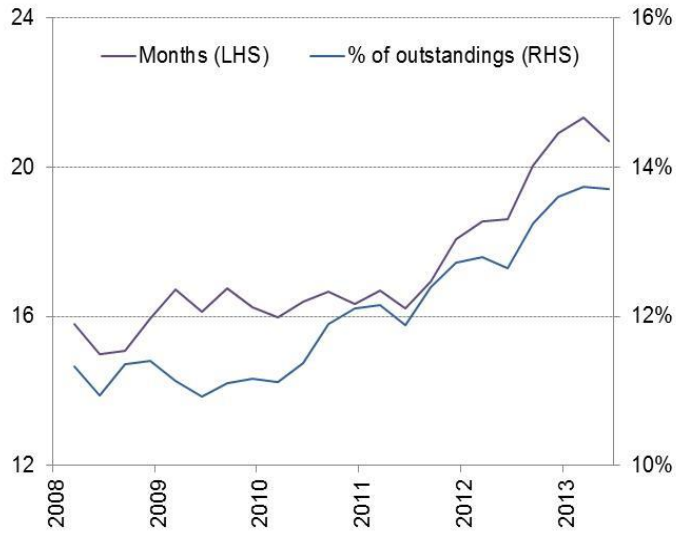
Source: APRA

As of June 2013 (the latest data available) households were, on average, 21 months ahead of their scheduled repayments, which equates to approximately 14 per cent of outstanding mortgage balances (Figure 43).[44] This buffer, which has grown since 2008, when the data series began, supports the proposition that households are not financially stretched overall but have sufficient surplus in their financial position to be able to contribute more than the minimum payment on their housing loans.

[44] The repayment buffer measures the balances in mortgage offset and redraw facilities.
More detailed information on household repayment buffers can be found on the RBA's website at: http://www.rba.gov.au/publications/fsr/2012/sep/html/box-b.html

The existence of such a large buffer implies that borrowers, on average, are well placed financially to withstand an increase in interest rates or other event that may cause increased financial pressure.

Figure 43: Mortgage pre-payment buffers



Source: APRA, RBA

4.3. Housing affordability

Owning a home remains an important lifestyle and financial goal for many Australians.

Housing tenure has changed since the mid-1990s in Australia.

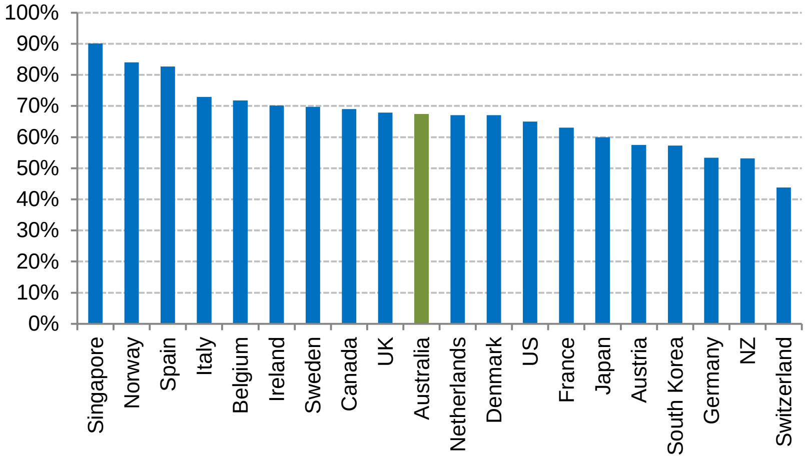
The proportion of households owning their house outright (that is, without a mortgage) has fallen from around 43 per cent in the mid-1990s to 31 per cent in 2012. This fall has in part been offset by an increase in purchasers (that is, with a loan), rising from 28 per cent in the mid-1990s to 37 per cent in 2012. Combining home owners and home purchasers provides an overall measure of home ownership. This has declined, from 71.4 per cent in the mid-1990s to 67.5 per cent in 2012. The proportion of households renting has increased from 26 per cent to 32 per cent.[45]

Abstracting from the precise figures we can broadly say that around two thirds of households own their home and about one third are renting.

Australia's home ownership rate is around the middle of many of its peers in the Organisation for Economic Co-operation and Development (Figure 44).

[45] ABS 6554.0 Household Wealth and Wealth Distribution

Figure 44: Home ownership rates (selected countries)



Sources: Eurostat, US Census Bureau, Turkish Statistical Institute, Statistics Canada, Singapore Department of Statistics, Australian Bureau of Statistics, Statistics New Zealand, Ha'aretz, Housing Finance Information Network, Journal of Housing and the Built Environment

The proportion of households with a mortgage increases with income, that is, the incidence of mortgages rises with the ability to service the debt. Almost 60 per cent of the highest income households have a mortgage, compared to only 12 per cent of the lowest income households.

Conversely, the proportion of households who own their home outright declines with income. Half of the lowest income households own their own home, which includes many retirees on lower incomes who have paid off their homes. This compares with only a fifth of the highest income households who own their own home.

The proportion of households who are renting tends to be highest for lower income households although the difference between income groups is not as marked. For example, a bit over a third of the households in the lowest three-fifths of incomes are renters, but even in the highest fifth of incomes there are still one-fifth of households who rent.

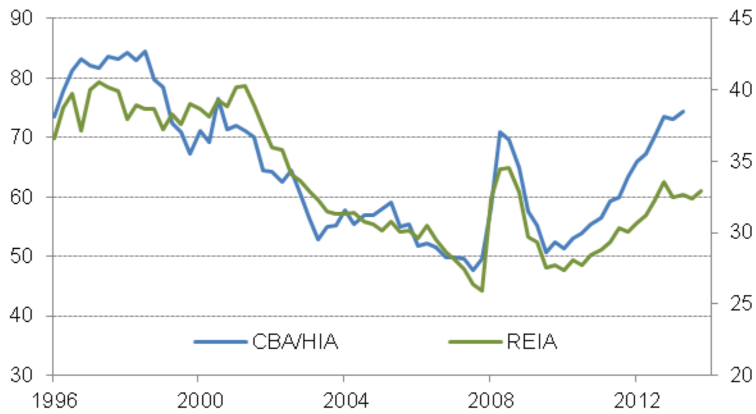
Housing affordability is a function of house prices, household incomes and borrowing rates.

Home affordability declined over the decade to 2008 (Figure 45), but has subsequently improved. This improvement reflected continued growth in household incomes and a significant decline in the cost of borrowings.[46]

Overall, data up to September 2014 suggests that housing affordability is the best it has been for around five years.

[46] RBA Statistical Tables, Table F5

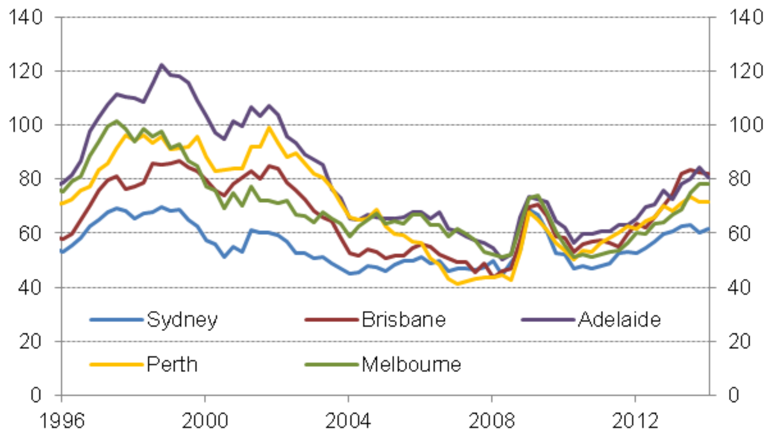
Figure 45: Housing affordability index, Australia



Source: Bloomberg: CBA-HIA Index, REIA

One feature of the affordability story has been the compression across Australian capital cities (Figure 46). Sydney has historically been the least affordable capital, with Adelaide and to a lesser extent Perth the most affordable. By 2010 the gaps had substantially narrowed, with all capitals displaying similar levels of affordability. Subsequently some greater variation has emerged with Sydney again clearly the least affordable city.

Figure 46: Housing affordability index, capital cities



Source: Bloomberg: CBA-HIA Index

4.4. Risk factors for household finances

A recent RBA study[47] looked at the factors associated with mortgage-related financial difficulties in Australia. It found that the probability of entering into loan arrears for mortgages is lower for loans that are repaid relatively quickly but is higher when LVR ratios are high, when interest rates are higher, for low doc loans or when borrowers' debt service ratios are high.

47 Mortgage-related Financial Difficulties: Evidence from Australian Micro-level Data, RBA, November 2014

This paper has found that these risks factors have diminished in recent years. In particular, home borrowers are well ahead on their repayments, the proportion of high LVR loans and low doc loans has fallen, interest rates are at historic lows and the interest servicing burden is declining.

This provides further support that household finances are currently very sound.

5. Conclusion

House prices in Australia are currently in a period of strong growth. There is insufficient evidence to conclude that house prices are unsustainably overvalued or that Australia is currently experiencing a speculative 'bubble'. Within this broad observation there are regional variations, with more intense activity in Sydney and, to a lesser extent, Brisbane and Melbourne.

The primary factor behind rising prices is the low level of interest rates. This is in line with the historical relationship between cycles in interest rates and house prices.

There is no evidence that banks have contributed to the stronger house price growth through a relaxation of lending standards.

Household finances are encouragingly robust. Housing affordability is the best it has been for around five years and those households with the highest debt have the most assets as well as the highest capacity to service that debt. Borrowers are well placed financially to withstand an increase in interest rates or other event that may cause increased financial pressure.

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