

BACKGROUND PAPER ON HOUSING AFFORDABILITY

JULY 2006

MARION POWALL (Applied Economics Pty Ltd)
& GLENN WITHERS (ANU)

This Background Paper assembles latest available data and past trends on the essential elements of housing affordability in Australia. It focuses on measuring housing affordability and trends therein. An earlier wider-ranging paper examining explanation of trends and possible policy responses was provided in Powall and Withers (2004). This paper updates the affordability facts from this previous paper. The data used are taken from official sources wherever possible, supplemented by other selected data. Particular assistance in accessing official data was provided by the Reserve Bank of Australia, but the Bank bears no responsibility for the use made of that data in this paper. The paper was prepared at the request of Professor Julian Disney as Chair of the Meeting. But views expressed are those of the authors unless otherwise appropriately attributed.

Contents

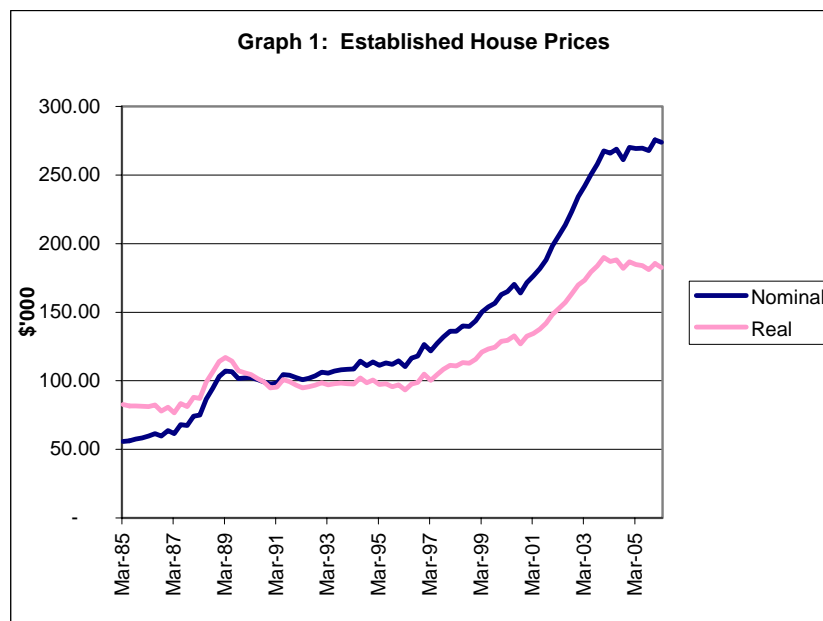
PART A : HOME PURCHASE AND OWNERSHIP	2
1. THE PRICE OF HOUSES	2
2. THE COST OF FINANCE	4
3. HOUSING AFFORDABILITY RELATIVE TO INCOME.....	5
4. OWNERSHIP AND AFFORDABILITY	7
5. FINANCE ACCESS AND AFFORDABILITY	9
PART B : PRIVATE, PUBLIC AND NON-PROFIT RENTAL	11
6. RENTER AFFORDABILITY	11
7. AFFORDABILITY FOR LOWER INCOME GROUPS.....	13
REFERENCES.....	19
ENDNOTES.....	20

Housing is a large part of Australian wealth and living standards. Its value underpins consumer confidence, its prosperity adds substantially to employment growth and the provision of secure, affordable and appropriate housing is central to community well-being. In this paper we examine trends in the provision of affordable and appropriate housing, initially doing so for purchase and ownership, and then for private, public and non-profit rental.

PART A : HOME PURCHASE AND OWNERSHIP

1. THE PRICE OF HOUSES

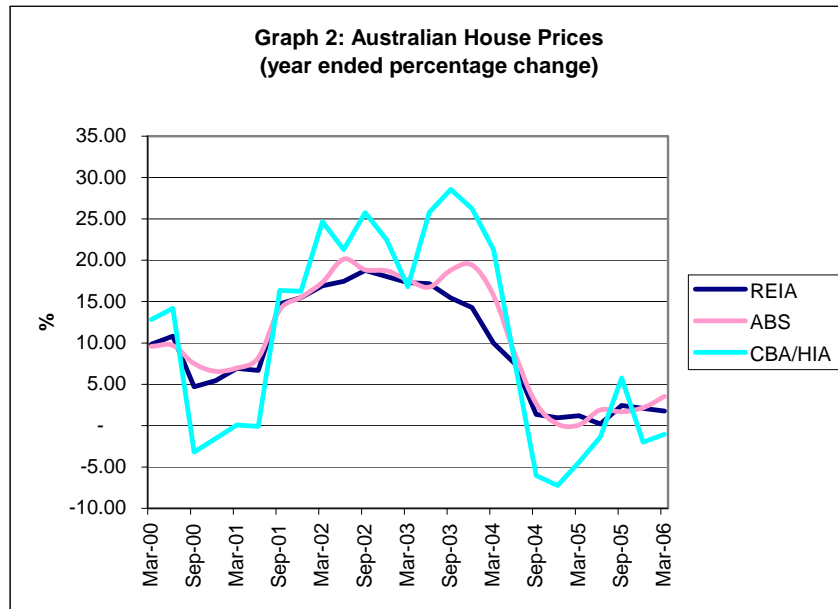
At its most basic level housing affordability refers to the price of houses. These have risen substantially in Australia over a long period of years. Graph 1 shows the major rise in prices from 1989 to 2003, followed by levelling thereafter at the level achieved by the long climb over almost fifteen years. Even if we express this movement relative to the general cost of living, it is apparent that this basic trend remains true for “real” house prices too. The long increase in Australian prices over this period has been ahead of the average increase for the industrial countries¹.



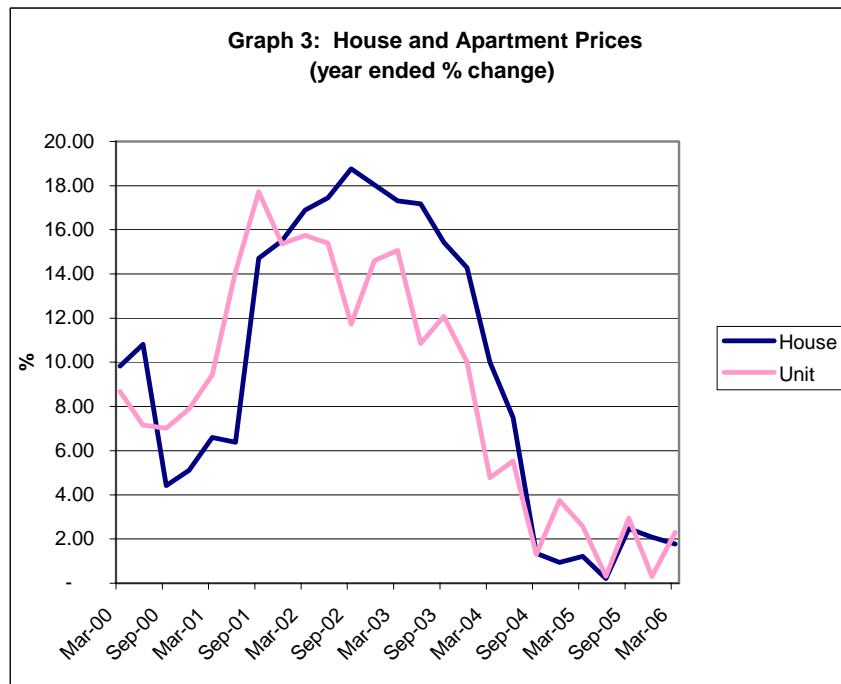
Source: RBA

The London *Economist* has commented in relation to current British and Australian house prices in relation to general inflation as follows: “Homes remain painfully expensive in relation to incomes; so if inflation remains low, almost a decade of stagnant prices may be needed to turn property to fair value”²

What is of recent interest however is the drop off in price increases from 2004. The reduction in house price inflation rates is especially evident if house prices are looked at in terms of percentage changes as presented in Graph 2. Prices have flattened rather than slumped, and are concentrated around zero percentage change since early 2004³. There are only modest differences between houses and apartments in tracking these trends (Graph 3).



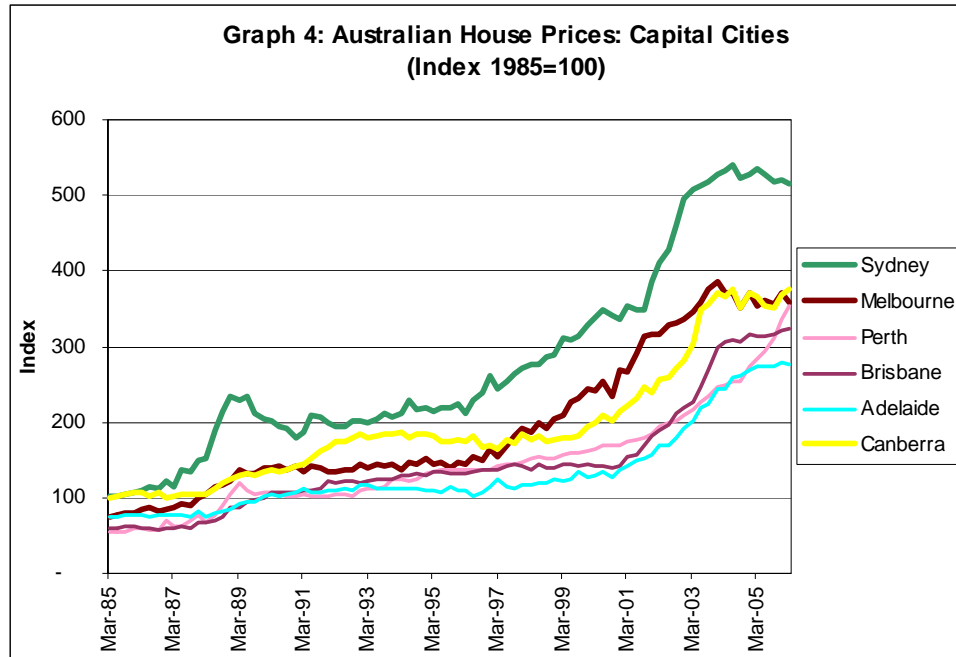
Source: RBA



Source: RBA

Australian house price rises originated strongly in more expensive areas of Melbourne and Sydney but soon spread across these capitals to the other capital cities and to

regional centres. Unlike some earlier booms in house prices this one has therefore been Australia-wide, and Perth, Brisbane and Adelaide house prices have in fact continued to rise since 2003. Sydney, Melbourne and Canberra are the source of price flattening. Trends in non-metropolitan locations also follow a broadly similar path, albeit at different levels of prices (Yates 2006).



Source: RBA

2. THE COST OF FINANCE

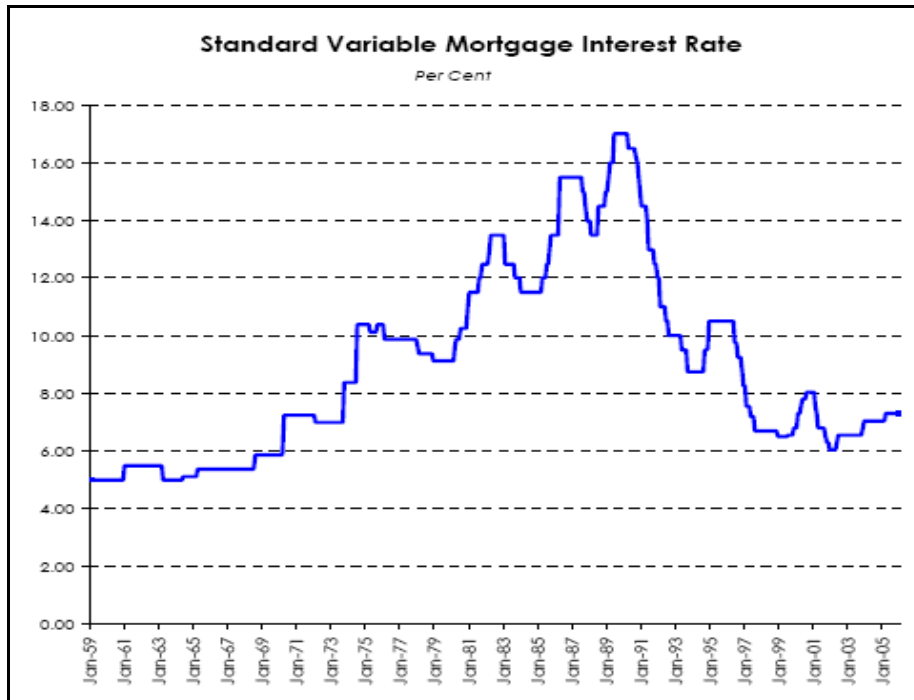
The house price alone is an inadequate measure of housing affordability. The cost of finance is also an important element. This may not seem relevant for established home-owners. And in Australia around 70% of households are home-owners. Of these some 32% have a mortgage but 38% do not. 25% are private renters and around 5% are in publicly provided housing.

These days our home ownership is not the highest and is similar to quite a few developed countries, but mortgage-free ownership is high (and public housing low). Nevertheless persons with no mortgage do forgo interest because of their investment, those with mortgages feel the interest burden directly and renters understand the cost of interest if they aspire to ownership or feel it in their rent as a cost to the landlord.

The trend in Australia since financial deregulation has been to cheaper housing finance because of lower housing interest rates. The respective trends in mortgage interest and housing prices is seen in the following chart, where the lower interest since the mid 1990s was accompanied by a strong rise in house prices. The latter rise steadily eroded the advantage gained for purchasers from lower interest in the mid 1990s. With pressure present for interest rate rises as of 2006, the present respite in

house price increase in the South East could begin to be offset by interest changes (Graph 5). Naturally, this remains to be seen.

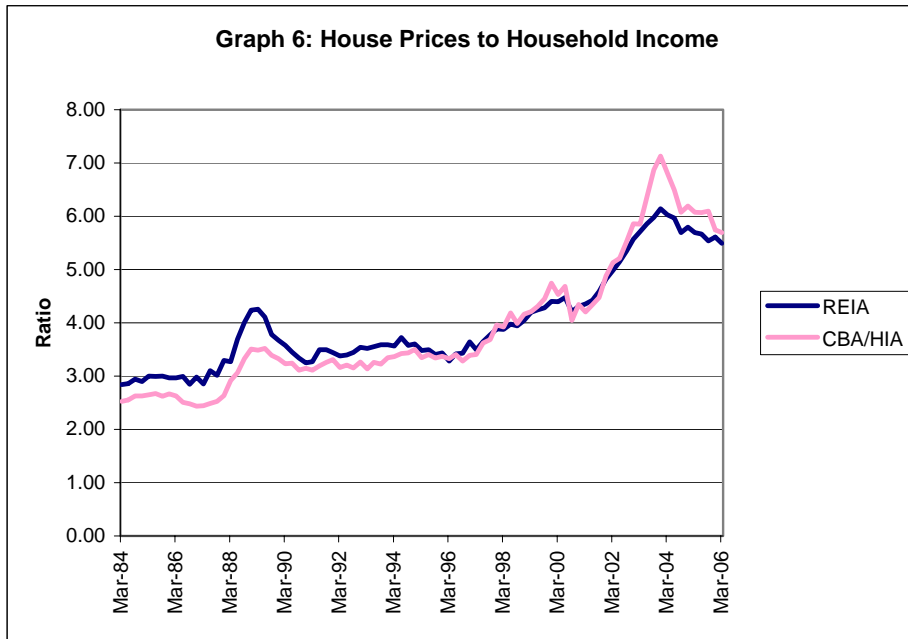
Graph 5: Mortgage Interest Rates



Sources: ABS; HIA

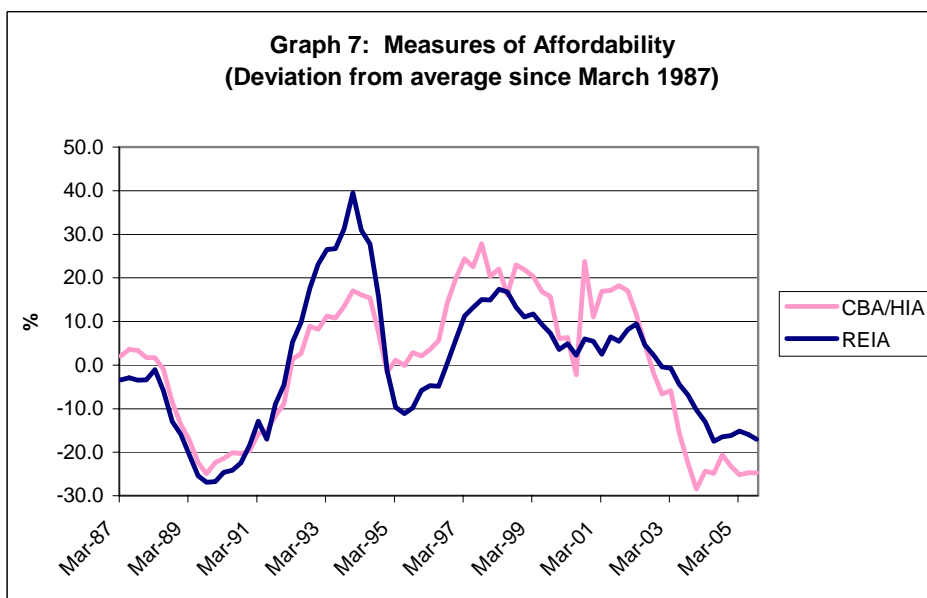
3. HOUSING AFFORDABILITY RELATIVE TO INCOME

With housing being the largest single purchase made by Australian households, creating a measure of affordability that relates house prices to income is also appropriate. Here we can say that median house prices remain at over five times greater than average per capita income, compared to three times at the beginning of the mid 1980s' upswing in house prices⁴. This trend is seen in Graph 6 in relation to average household income.



Source: RBA

If we further factor in the cost of finance, as flagged, several measures are in common use in Australia. They suffer from some methodological problems, including looking at different market segments such as renters vs owners, investors vs owner-occupiers, first vs established home-owners, capital cities vs regions etc. But they concur on the challenge to affordability that re-emerged in Australia and remains in place, though with some welcome recent adjustments toward improvement. Graph 7 shows several such long-term measures of housing affordability, and makes clear some recent adjustment towards the 1987 average, though with significant further adjustment required.



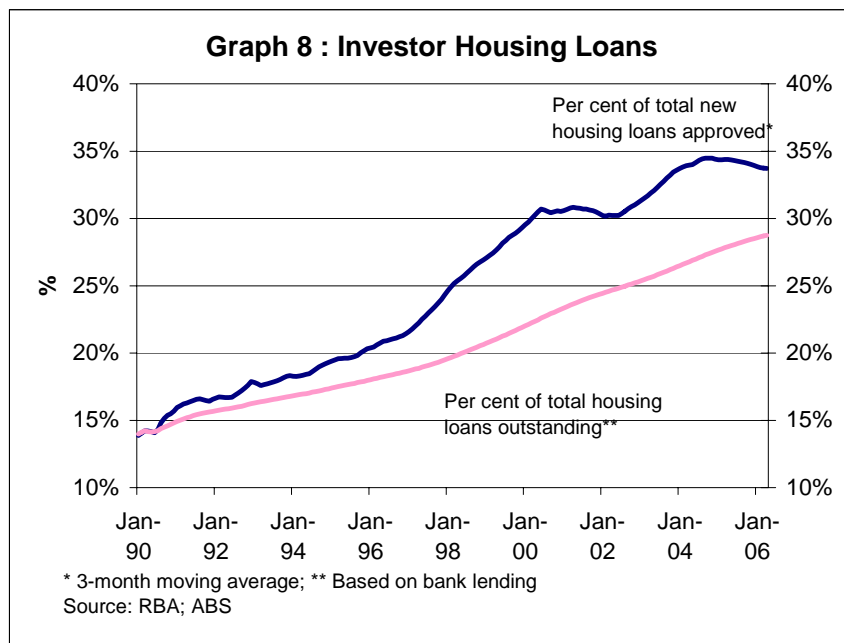
Source:

RBA

4. OWNERSHIP AND AFFORDABILITY

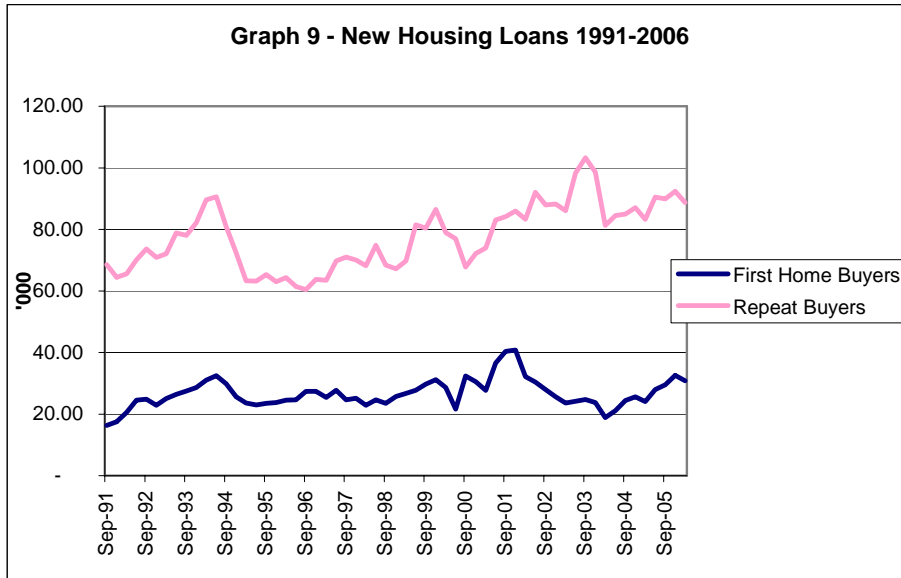
A different way to approach affordability is not to look at costs and capacity to pay, but to look at actual outcomes of home-buyers' decisions. One such outcome often discussed and of great political significance in Australia is home ownership rates. Australia has long had high home ownership rates, in common with other "New world" democracies but well ahead of the older European developed countries. In 1911 half of Australians owned their home, a figure reached by Britain only in the 1970s. More recent years however have seen a levelling out of ownership in Australia with no increase since 1990 and with what may now be a falling share, particularly for the younger age-brackets.

On the finance side, the share of housing finance for owner occupation has been trending downwards. This is in part due to a very strong past increase in investment by owners into rental properties. The number of Australians owning investment property rose from around 8% in the early 1980s to over 12 % by 2001- with the increases being largest in the upper income groups. The increased share of housing finance that underpinned this is seen in Graph 8. It has levelled too, but not reduced towards earlier levels.

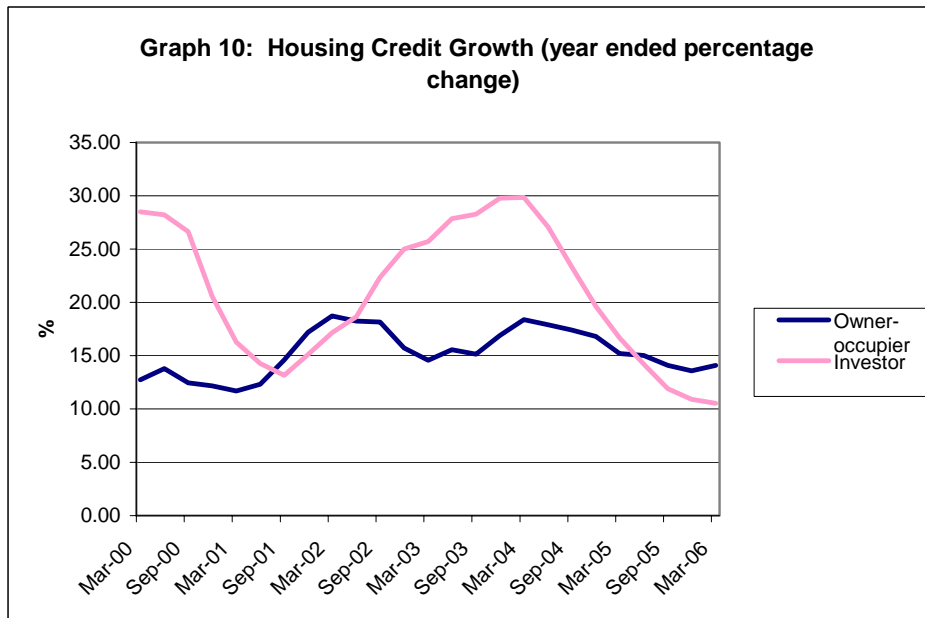


The issue that then arises, given this level of investor buying plus changes too by owner-occupiers in established homes, is what is the position of first home-buyers? And here, despite prolonged and sustained low interest rates, first home buyers are still finding the purchase of a new home difficult. This is seen in Graph 9, which shows how the absolute number of first home buyers halved after 2001-and their share of new loan approvals fell from over 30% to only 15% in 2004. This

exceedingly low base has now given way to some return toward the 2001 levels, though with some way to go.



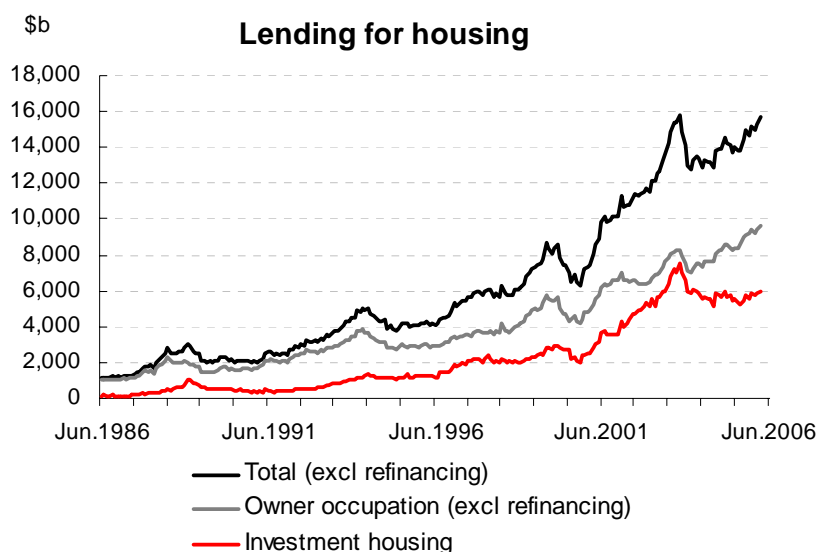
Source: RBA



Source: RBA

Graph 10A shows the actual dollar amounts of housing credit growth.

Graph 10A : Housing Credit Growth (\$b)

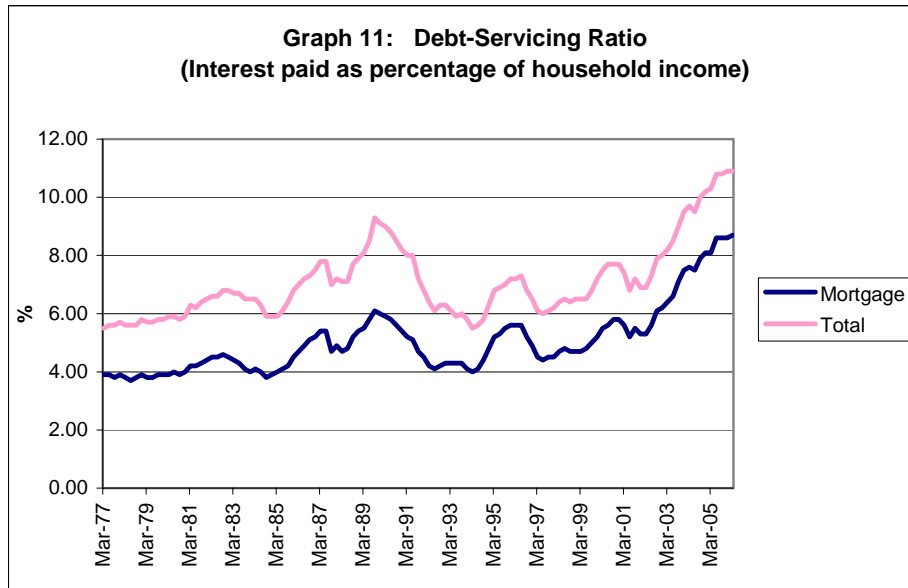


Source: ABS AusStats Cat. No. 5609.0 Table 11

5. FINANCE ACCESS AND AFFORDABILITY

An additional approach to affordability is to look at various measures relating to up-front deposits. A “deposit gap,” for instance, measures the difference between the price of a typical house and the maximum amount of loan that can be repaid by a household on average weekly earnings or average household income. A related measure compares actual incomes against the income required to repay a home loan on an average house and land package with a given level of deposit.

In fact regardless of which approach is employed to measure accessibility, all rely on some combination of house prices, interest rates and incomes, and so all show similar trends. Graph 11 indicates that the substantial rise in debt-servicing ratio, for instance, has actually increased substantially since 1995, with major increase particularly since 2002.



Source: RBA

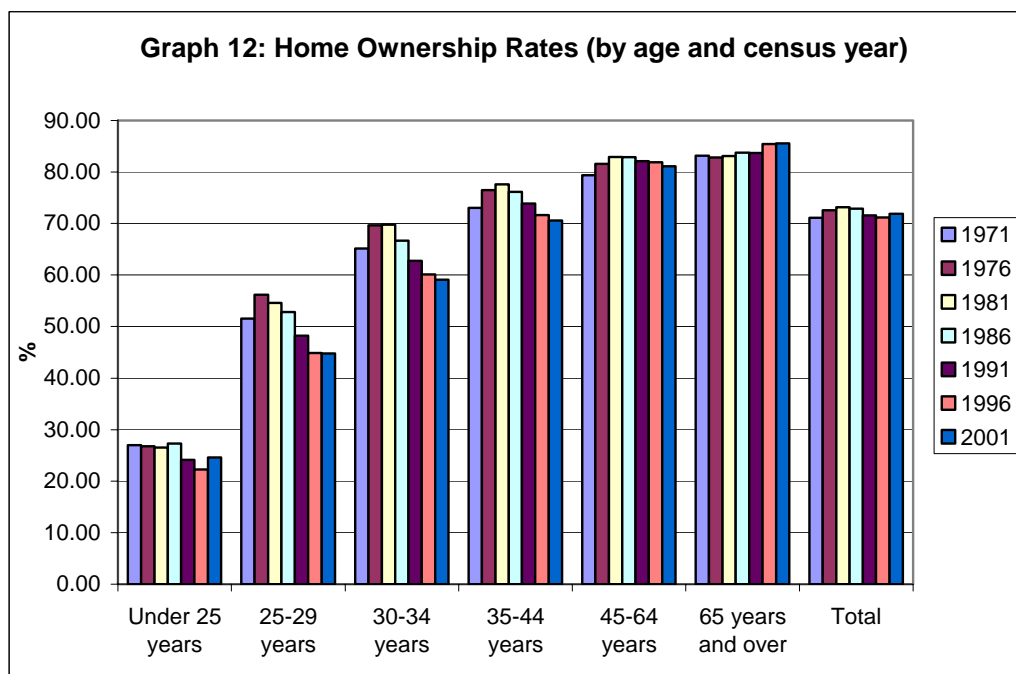
Has this been affected by government assistance? Table 1 shows that while direct assistance to home buyers through the First Home Owners Grant increased in the first three years of operation, it has declined in recent years.

	No. of grants Provided	Total Budget Outlays (\$m)
2000-01	142,300	1056.1
2001-02*	203,300	1760.6
2002-03*	135,629	1005.9
2003-04 (est.)	113,143	798.6
2004-05 (est.)	110,743	775.2

* Mar-Dec 2001: a total grant of \$14,000 was payable.
Jan-June 2002: a total grant of \$10,000 was payable.

Source: *Final Budget Outcome 2000-01 to 2002-03*
Budget Paper No.3, 2004-05

This grant has not fully offset the fall in home ownership rates for the younger age groups over time (Graph 12).

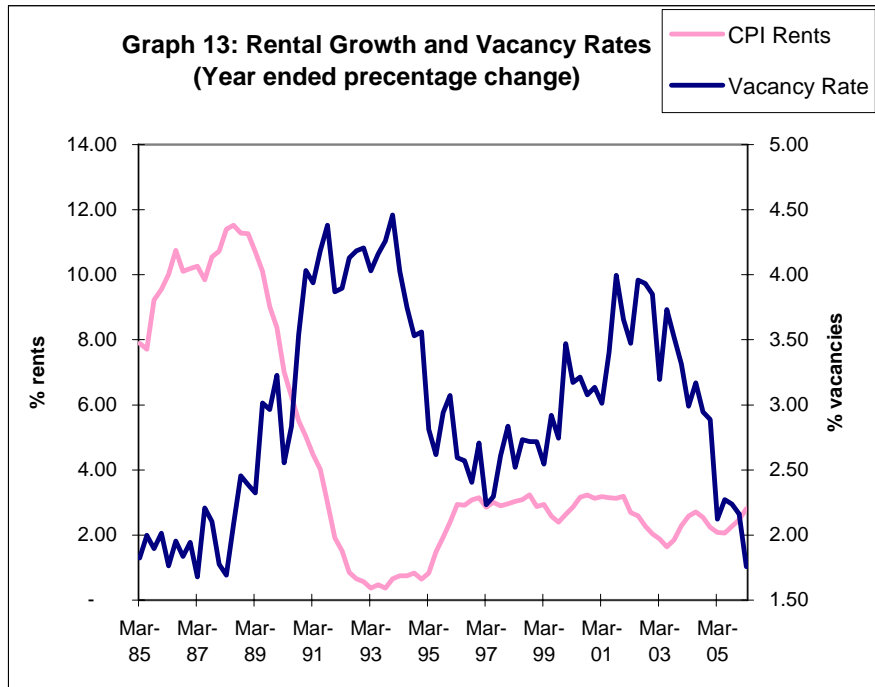


Sources: ABS; RBA

PART B : PRIVATE, PUBLIC AND NON-PROFIT RENTAL

6. RENTER AFFORDABILITY

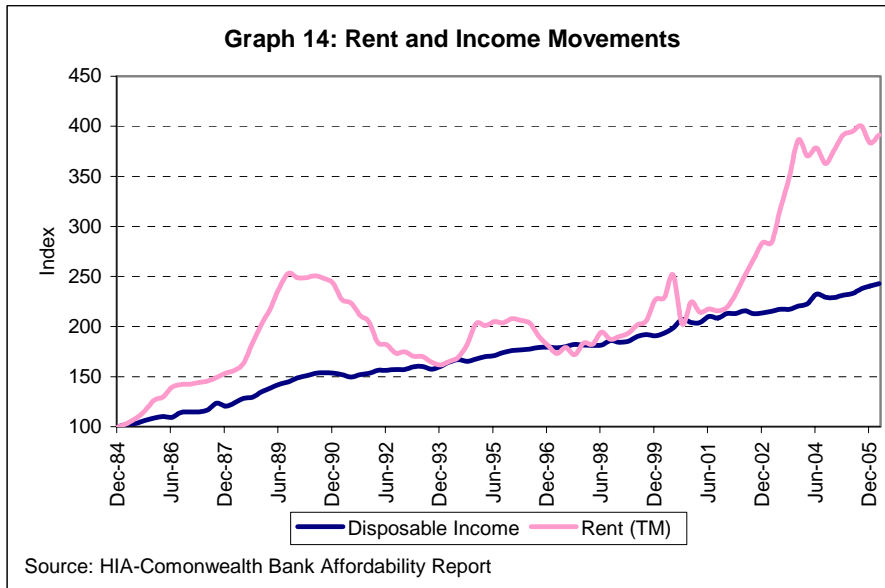
It is also recognised that whilst most Australians aspire to owning their own homes, for many renting is appropriate at various stages of their life cycle and for others the ownership dream is there but will never be a reality. In terms of averages, renters did not experienced the same degree of price escalation as home-buyers over the period of the recent housing cycle. From the early 1990s to 2003 rents grew at 2.5% per annum - and averaged 1.9% from 1996, using the rent component of the ABS consumer price index as an indicator (Graph 13). Vacancy rates have also risen over this period, though the regional pattern is more diverse here than for housing prices. For instance, Canberra, Brisbane and Adelaide have all had low vacancy rates relative to Sydney and Melbourne.



Source: RBA

These rental price trends have meant a long period of deteriorating rental yield trend for investors in housing, since the modest growth in rents has been well behind the trend in house prices. For recent investors or, in terms of current opportunity cost for earlier investors, the yield has been quite low - both historically and compared to overseas rental yields which have averaged 7-12 per cent in the major Anglo-American economies. In Australia earlier yields of around 8 per cent in the mid to late 1980s fell to around 3 per cent in the early 2000s.

But the period 2001 to 2003 did see a major rental price increase relative to inflation, an increase that has slowed since but which has remained at the higher level then established. Thus while house prices have stabilised there has been some corresponding increase in rental levels, making renting less affordable than before 2001 (Graph 13).



Graph 14, using data from ABS consumer price and income series, shows the index of rent prices and household average disposable income since 1984. The main problems in the rental market to 2001 related to rental affordability for those sub groups who have not shared in the average income increase and of access by renters seeking ownership to the much more expensive housing ownership market where, as seen above, affordability has deteriorated very substantially. Since 2002 a new affordability issue has arisen for renters.

BIS Shrapnel was recently reported as saying that rents will take off soon: “With vacancy rates set to tighten further to below 2% over 2006-07 in a number of capital cities, rental growth is set to accelerate over the next three years. Rental growth of 10 per cent per annum could easily occur in Sydney, while Melbourne and Brisbane could experience growth of between 6 per cent and 8 per cent”⁵. Naturally this is a forecast which may or may not actually work out.

7. AFFORDABILITY FOR LOWER INCOME GROUPS

The emphasis in the measures above has been upon average indicators of affordability and their trends. The distribution of housing costs load across income groups is seen in Table 2.

Table 2: Housing Costs as a % of Gross Income

		1994-95	1995-96	1996-97	1997-98	1999-00	2000-01	2002-03	2003-04
Housing costs as a proportion of gross income									
25% or less	%	79.4	79.6	79.7	78.6	79.9	79.3	78.2	77.9
More than 25% to 30%	%	5.8	5.5	5.7	5.7	5.5	5.7	6.3	6.4
More than 30% to 50%	%	9.1	9.6	9.6	10.3	9.3	9.6	9.7	10.6
More than 50%(d)	%	5.7	5.3	5.0	5.4	5.2	5.3	5.8	5.1
All households	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source :ABS, *Housing and Occupancy Costs 2003-04*, Table 4

The role of the full range of government fiscal measures in addressing the housing cost issue is seen in Table 3 as follows.

Table 3: Value of Direct and Indirect Assistance to Households, 1999 (\$)

	Household quintile (by weekly income from all sources)					All
	1st quintile	2nd quintile	3rd quintile	4th quintile	5th quintile	
Recurrent expenditure						
Private renter—CRA amount	1,645	1,694	1,709	1,342	979	1,655
FHOG 'one-off' amount ^(b)	7,000	7,000	7,000	7,000	7,000	7,000
Capital expenditure						
Public renters subsidy	3,550	3,990	3,710	3,325	..	3,698
Tax expenditure						
Outright owners	0	2,100	2,500	4,600	8,800	4,400
Home purchasers	0	400	100	500	2,100	900

(a) Annual average amount.
(b) First Home Owners Grant (FHOG): Represents the lump sum one-off payment of \$7,000 and is not an annual recurring benefit. Estimate of FHOG value for 1999 based on value at time of introduction on 1 July 2000.
Source: AIHW 2004e.

Particular concern arises as to the position of the least advantaged. One source of information here on affordability is from the impact of the federal rent assistance program, since this is specifically targeted at income support beneficiaries⁶.

Overall, for the 943,877 low income Australians receiving Rent Assistance, FaCS data for 2001-02 shows⁷ that:

- 35% (around 330,360 people) spend more than 30% of their income on rent; and
- 9% (around 85,000 people) spend more than 50% of their income on rent.

The number of rent assistance recipients had risen to 949,700 as of mid 2004.

Low income earners that pay more than 30% of their income in housing costs can be said to be in “housing stress”. Those households who pay more than 50% of their income in rent can be said to be in “extreme housing stress”. Therefore amongst the group receiving rent assistance, itself a subset of the less advantaged, affordability is not achieved even in the presence of assistance for over a third of recipients, and nearly one in ten of all recipients spend over half their total income on rent. The

overall outcome for housing stress nationally is revealed by AIHW as at June 2004 as shown in Table 4.

Table 4: Income Units in Housing Stress 2004

	Owners		Renters		Other tenure	Total
	Without mortgage	With mortgage	Public	Private		
Number of income units						
In housing stress	38,000	231,000	23,000	590,000	0	883,000
Not in housing stress	3,114,000	2,233,000	433,000	2,249,000	1,143,000	9,173,000
Total	3,152,000	2,464,000	456,000	2,839,000	1,143,000	10,056,000
Per cent of tenure						
In housing stress	1.2	9.4	5.1	20.8	0.0	8.8
Not in housing stress	98.8	90.6	94.9	79.2	100.0	91.2
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total in housing stress (%)	4.3	26.2	2.6	66.8	0.0	100.0
<i>Note: Cell numbers may not add to total due to rounding.</i>						
<i>Source: Harding et al. 2004: table 3.</i>						

Source: AIHW *Australia's Welfare 2006*, Table 6.2

To put real dollar figures behind these stress data, average rents for Rent Assistance recipients in 2004 ranged from \$241 per fortnight for people receiving the Age Pension and \$405 per fortnight for people receiving Family Tax Benefit Part A.⁸ For comparison purposes, in 2005 the Age Pension was \$506.40 per fortnight for a single person, while Family Tax Benefit Part A was \$137 per fortnight for each child under 18⁹. There is also the issue of affordability in public and community housing,¹⁰ with Table 5 showing a decline in government expenditure even in nominal terms, though total rent assistance has increased.

Also, at the lower end of the income distribution, as opposed to average income, the income base for housing affordability has increased somewhat less than for others. Unless there is increased relative supply at the cheaper end of the housing market, this means that an even greater housing affordability problem exists at the low income end of the housing market.

Table 5: Government Expenditure on CSHA, Rent Rebate and CRA (\$'000 FY)

Fiscal Year	CSHA	Rent Rebates	CRA
1991	1505	903	841
1992	1572	985	1012
1993	1639	853	1323
1994	1549	935	1529
1995	1625	1144	1564
1996	1568	1272	1633
1997	1401	1262	1705
1998	1234	1232	1517
1999	1301	1256	1534
2000	1331	1175	1538
2001	1342	1210	1638

Source: AIHW 2004

Details of recent trends in CSHA itself are given in Table 6, which shows the program components and the state matching grants. The position for lower income groups receiving Commonwealth Rental Assistance across the different states and territories as of 2004 is seen in Graph 15, which shows income units receiving CRA. Maximum effectiveness applies in Tasmania, South Australia and Western Australia, but less so in ACT and NSW in particular.

Table 6: CSHA Funding¹¹

	2002-03 (\$m)	2003-04 (\$m)	2004-05 (\$m)	2005-06 (\$m)	2006-07 (\$m)	2007-08 (\$m)	Total (\$m)
Federal funds							
Base	824.2	725.2	733.7	740.9	748.2	757.8	3706.0
Community housing	64.0	64.0	64.7	65.4	66.0	66.9	327.0
Indigenous housing	100.0	100.7	102.1	93.0	93.8	95.0	485
Crisis accommodation	39.7	39.7	40.1	40.5	40.9	41.4	202.6
Total Federal funds	1027.9	929.6	940.7	939.8	949.0	961.1	4720.6
State funds	359.5	355.0	355.879	359.388	362.909	367.544	1797.5
TOTAL	1387.4	1284.5	1296.6	1299.2	131.0	1328.7	6518.1

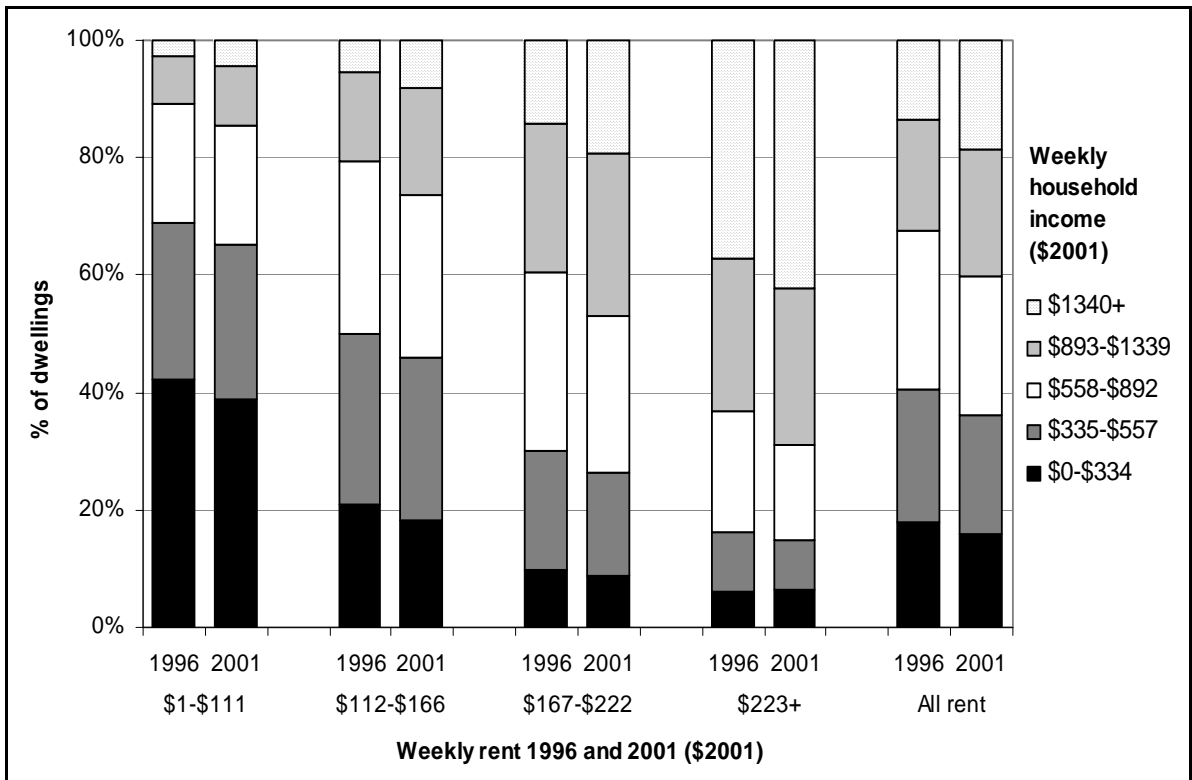
Sources: Budget Paper No.3, 2004-05; PC, ROGS 2006

Graph 15: Income Units receiving CRA, paying more than 30% of income on rent, with and without CRA 2004



Source: AIHW *Australia's Welfare 200*, Figure 6.7

Graph 16: Distribution of Weekly Household Income by Weekly Rent Paid



Source: Yates, Wulff and Reynolds (2004, Figure 2.1), in turn from ABS *Special Matrix Tabulations, 1996 and 2001 Censuses*.

Graph 16 illustrates the extent to which higher income households in 2001 occupied stock that is the only stock affordable for households on lower incomes. In 1996, 58 per cent of the limited supply of low rent dwellings was occupied by households in the top 4 income categories. By 2001, 61 per cent of a reduced supply of low rent dwellings was occupied by households in the top 4 income categories. In part, but only in part, this arises because of the improved income circumstances of renter households¹².

REFERENCES

- Australian Bureau of Statistics (ABS) 2006, *Housing Occupancy and Costs 2003-04*, cat. 4130.0.55.001, Canberra
- Australian Institute of Health and Welfare (AIHW) 2003, *Measuring the Distribution of Direct and Indirect Housing Assistance*, Canberra
- Australian Institute of Health and Welfare (AIHW) 2006, *Australia's Welfare 2005*, Canberra
- Centrelink 2006, *A Guide to Australian Government Payments 2005*, Canberra
- FaCSIA (Department of Families, Community Services and Indigenous Affairs) 2006, *Statistical Paper No. 3: Income Support Customers 2004*, Canberra
- Housing Industry Association (HIA), *House Prices*, Media Release 25 May 2006
<http://www.economics.hia.asn.au>
- Housing Industry Association (HIA), *Standard Variable Mortgage Interest Rates 1959-2004*, 2006, <http://www.economics.hia.asn.au>
- Powall M and Withers G 2004, *National Summit on Housing Affordability: Resource Paper*, <http://www.housingsummit.org.au>
- Productivity Commission 2004, *First Home Ownership*, Inquiry Report no. 28, Melbourne
- Productivity Commission 2006, *Report on Government Services 2005*, Melbourne
- Reserve Bank of Australia 2003, *Submission to the Productivity Inquiry into First Home Ownership*, Sydney
- Sydney Morning Herald 2006, *Real estate slump has three years to go*, June 18 2006, Sydney
- The Economist 2006, *News from the Home Front*, June 10th-16th 2006, London
- Treasury (Department of the Treasury), *Budget Paper No. 3, 2004-05*, Canberra
- Yates J, Wulf M and Reynolds M 2004, *Changes in the supply of and need for low rent dwellings in the private rental market*, Australian Housing and Urban research Institute, Final Report, Melbourne.
- Yates J 2006, *Housing Markets and changing socio-demographics in Australia*, paper presented to Australian financial Review Housing Congress, Sydney, 30-31 March 2006

ENDNOTES

¹ See R.Gittins and R. Tiffin, *How Australia Compares*, Melbourne: CUP< 2004, pp.208-9.

² *The Economist*, June 10 2006.

³ There are alternative measures of house prices, including from the Australian Bureau of Statistics, Real Estate Institute of Australia and (jointly) the Commonwealth Bank of Australia and the Housing Industry Association. All measures show broadly similar movements. Graph 3 uses the REIA measure as reported by the Reserve Bank of Australia (2003 and updated 2006).

⁴ Reserve Bank of Australia, 2003 and updated 2006

⁵ *Sydney Morning Herald*, June 19 2006, quoting from BIS Shrapnel's recently published *Residential Property Prospects, 2006 to 2009*

⁶ However there are some issues of horizontal coverage eg low-waged childless. Also Austudy allowance recipients are excluded.

⁷ FaCS (2001): Table 39 'Ratio of housing costs to income, before and after Rent Assistance'.

www.facs.gov.au/annreport_2001-02/volume2/part1/outcome2/2.1.html

⁸ FaCSIA, *Statistical Paper No. 3*, 2004, Table 66

⁹ Centrelink, *A Guide to Australian Government Payments*, 2005.

¹⁰ AIHW, *Australia's Welfare 2003*

¹¹ Totals may not add up exactly due to rounding

¹² Yates (2004)