

Submission to the Inquiry into Home Ownership

House of Representatives Standing Committee on Economics

June 2015

Introduction

The Reserve Bank has been invited to make a submission to this inquiry. The Bank recognises the importance of housing to the people of Australia. Shelter is a fundamental human need, and purchasing the home one lives in is usually the largest financial investment a household will make. The affordability of suitable housing is, appropriately, a central concern of government policy, and it has been the subject of several inquiries over the years, most recently the Senate Economics References Committee Inquiry (The Senate 2015). Housing tenure – whether a household owns or rents the home they live in – is an important aspect of people’s experience of their home.

The key messages of this submission are as follows.

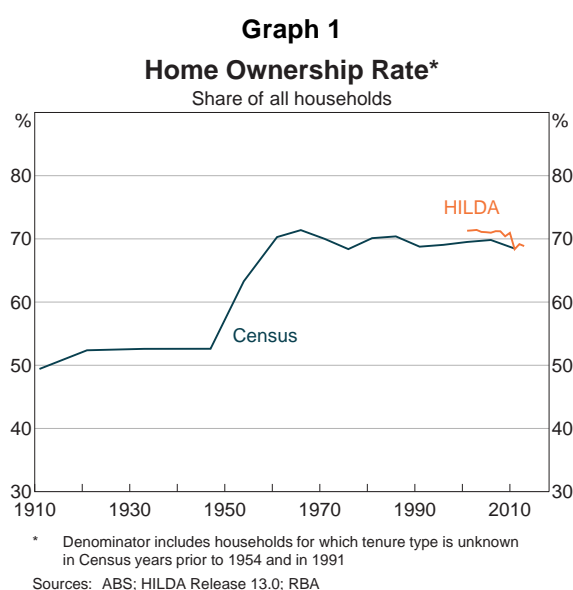
- The level of the home ownership rate varies across countries for a range of demographic and institutional reasons. It should not be presumed that the appropriate home ownership rate is 100 per cent, or that countries with higher rates than Australia have necessarily achieved ‘better’ outcomes. The important outcome to aim for is that all Australians can access housing that is appropriate to their needs.
- The aggregate home ownership rate in Australia has been broadly steady since the 1960s. Prior to that date, the rate was much lower. The home ownership rate for typical first home buyer age groups has drifted down over several decades. The pace of decline has not increased noticeably recently, but the underlying drivers of the decline might have changed. These trends have been roughly offset by the ageing of the population, so that the overall home ownership rate has been stable.
- Within the owner-occupier group, a larger proportion now has a mortgage. Older age groups are now less likely to own their home outright than in the past. This is an expected outcome of disinflation and liberalised access to finance, and it is unlikely to have affected accessibility of ownership for potential first home buyers.
- Demand for housing, particularly owner-occupied housing, was boosted in the 15 years or so to about 2005 by the effects of disinflation and financial sector deregulation. Finance was easier to obtain, but down payment requirements may not have eased by enough to fully offset the effect of rising housing prices, so this may have delayed or prevented first home purchases in some cases. More recently, strong population growth has added to demand.

- Housing supply is a stock that changes slowly, so in the short to medium term, increases in demand are only partly met by increased physical supply. Much of the initial response is in the price. In addition, there are geographic and regulatory constraints that slow or limit supply response.
- Housing, particularly owner-occupied housing, receives preferential taxation treatment in many countries, and Australia is no exception. Australia’s taxation system is also relatively generous to small investors in buy-to-let property compared with some other countries, because investors can deduct losses from their investments against wage income as well as other property income, and because capital gains are taxed at concessional rates. However, there are some other countries where the tax preference for investor property is even stronger than in Australia.

The remainder of this submission provides more detail on these themes.

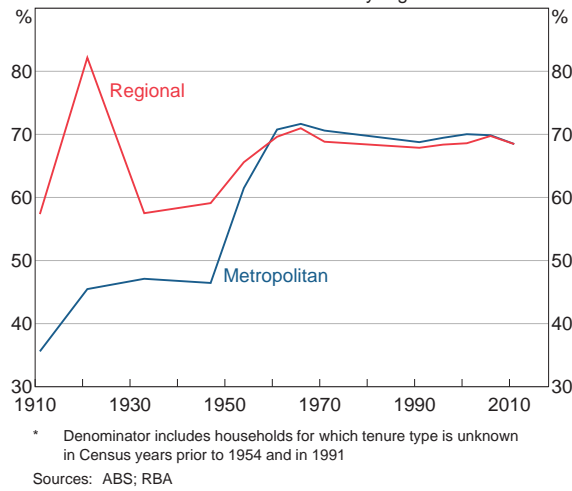
Home Ownership Rates

The Census is the best source of data on home ownership rates – the proportion of households that own the home they live in, whether with or without a mortgage – but it is neither frequent nor timely. The prevalence of home ownership in Australia increased considerably over the past century, but has been broadly stable at around 70 per cent since the 1960s (Graph 1). The increases were concentrated in the periods immediately after the two world wars, particularly World War II (WWII), as a result of significant government assistance including War Service Homes programs. According to the latest Census, around 68 per cent of Australian households owned their own home in 2011.



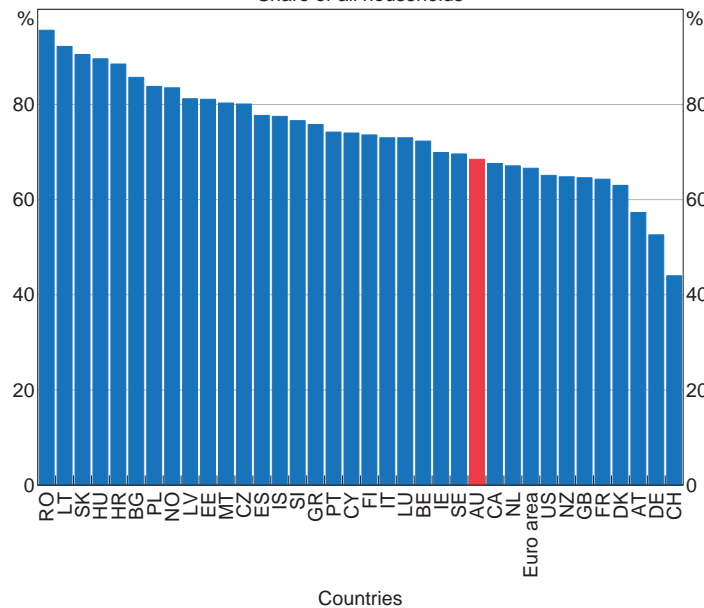
The first half of last century also saw a marked convergence in home ownership rates in metropolitan and regional areas (Graph 2). In the early 1900s, the rate was significantly higher in regional areas than in metropolitan areas, but this gap had closed by the late 1950s, with the post-WWII increase in home ownership much more pronounced in metropolitan areas. In the decades since, home ownership rates in regional and metropolitan areas have been very similar, even though housing prices are generally significantly lower in regional areas.

Graph 2
Home Ownership Rate*
 Share of all households by region



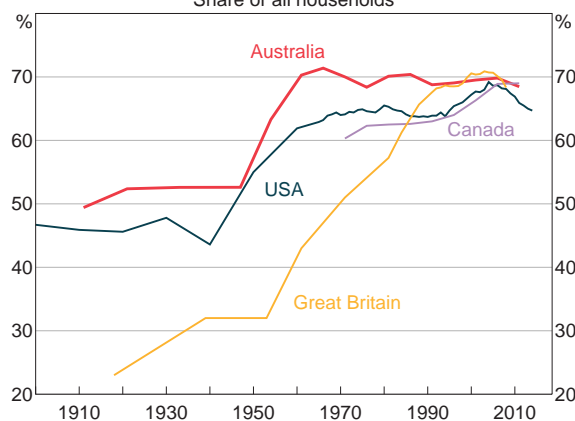
Home ownership rates vary significantly across countries, although most lie in the 60–80 per cent range (Graph 3). Australia’s home ownership rate appears neither unusually high nor unusually low compared with that of other countries. There are a range of demographic, economic and institutional factors that can affect the level of home ownership, both through time and across countries. For example, strong government support for rental housing can lead to lower home ownership rates, such as in many western European countries including Germany. The tax treatment of housing, such as the deductibility of mortgage payments or the extent of capital gains tax, can also affect the relative attractiveness of home ownership and influence its prevalence. Differences in financial regulation, household structure, housing affordability, the age structure of the population, cultural values and population growth are other drivers of cross-country variation in home ownership rates.

Graph 3
Home Ownership Rates by Country, 2013*
 Share of all households



Despite large differences across countries, home ownership rates have tended to increase in many OECD countries over recent decades, although in the United States some of this increase has since reversed (Graph 4). In an OECD study, Andrews and Caldera Sánchez (2011) find that the trend increase can be partly explained by population ageing and rising real household incomes. They also suggest that mortgage market deregulation and innovation has contributed to higher home ownership rates, by increasing the capacity of credit-constrained households to access finance for home purchase. The privatisation of former public housing has also played a role in raising home ownership rates in some eastern European countries (Clapham *et al* 1996); a similar policy shift also explained much of the increase in ownership rates in the United Kingdom in the 1980s.

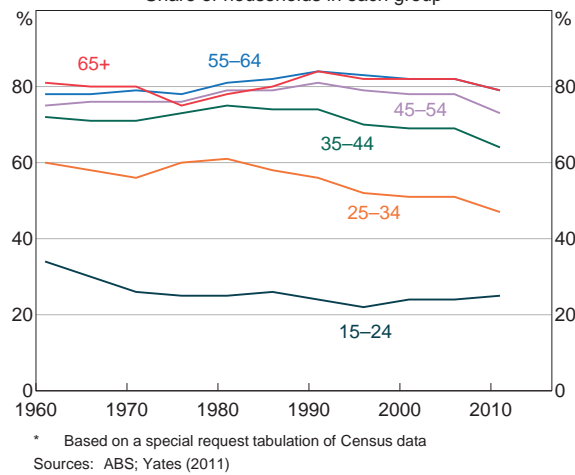
Graph 4
Home Ownership Rates for Selected Countries
 Share of all households



Sources: ABS; RBA; Statistics Canada; US Census Bureau

The general stability in home ownership in Australia over recent decades has masked some marked changes in home ownership among different age groups. In particular, there has been a pronounced decline in home ownership among younger households, particularly in the 25–34 and 35–44 age groups (Graph 5). Home ownership rates have generally been more stable among older households. The stability of the aggregate home ownership rate in the face of these trends has been driven by the ageing of the population. Given the clear tendency for home ownership to increase with age, consistent with the life-cycle theory of consumption and saving, the rise in the share of older age groups in the population will have tended to push up the aggregate home ownership rate, offsetting the reduced propensity of younger households to be home owners (Yates 2011).

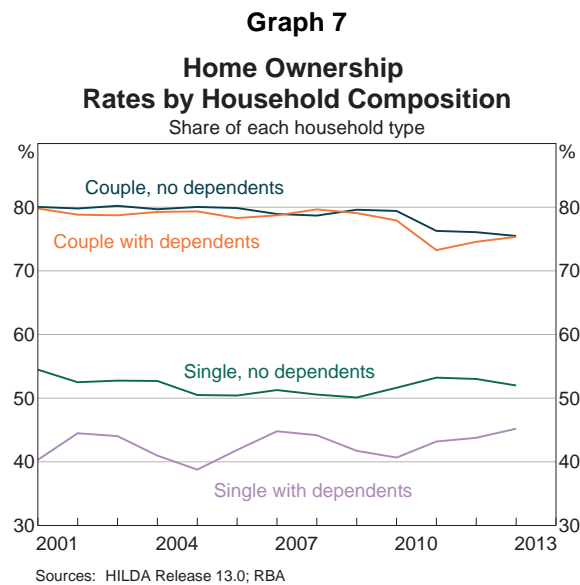
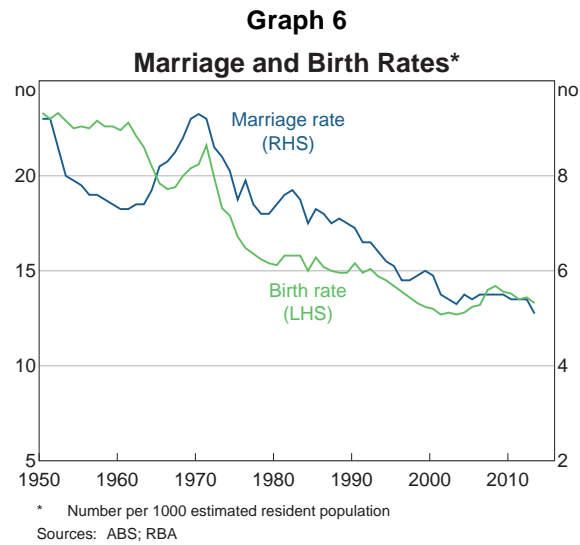
Graph 5
Home Ownership and Age*
Share of households in each group



The decline in home ownership among younger households has attracted considerable attention. In general, there are many interrelated factors that can affect the home ownership rate, whether at the aggregate level or for particular age groups (Yates 2011). These include:

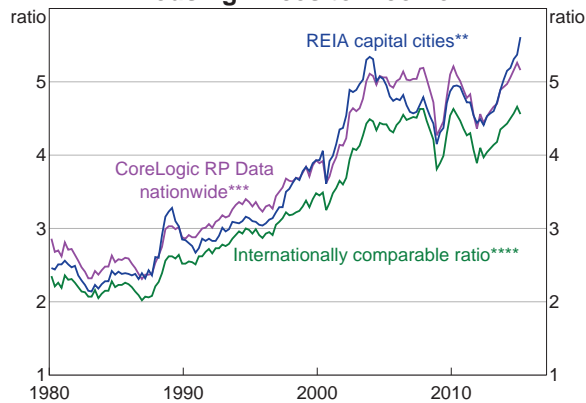
- demographic and social factors, such as the distribution of the population by age or household structure
- economic factors, such as the relative cost of renting and owning or the level and distribution of (current and expected) household income
- institutional factors and government policies, such as the taxation of housing or the provision of public housing.

Demographic change has been an especially important driver. In particular, the pronounced trend towards later marriage and family formation over the past 40 years or so would be expected to have reduced ownership rates (Graph 6). For example, the median age at first marriage for women rose from 20.9 years in 1974 to 27.9 years in 2010. Although this shift was probably driven in part by increasing labour force participation by women, it also reflected a reversal of the anomalously low average age at first marriage in the decades following WWII; in the first half of the 20th century and in earlier centuries, the average age at first marriage in a range of Western countries was generally higher than it was in the post-war period (Elliott *et al* 2012). Whatever the cause, a trend to later marriage is likely to have resulted in deferred home purchase among younger people. Over recent decades there has also been an increase in the prevalence of single adult households, particularly single-parent households, in part driven by significantly higher divorce rates since the 1970s. This trend is also likely to have weighed on the home ownership rate, as single adult households have a much lower tendency to own their own home (Graph 7).



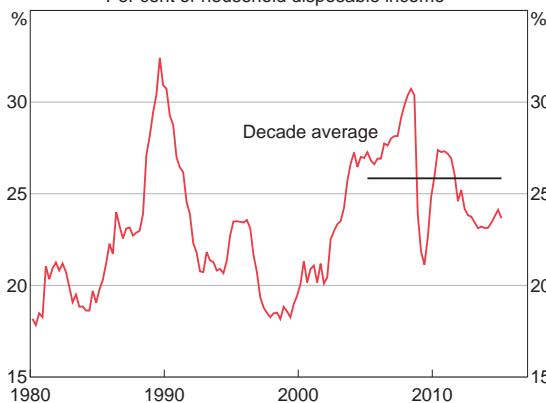
Of the possible *economic* causes of declining home ownership rates among younger households, the most obvious would be the sharp rise in housing prices in Australia since the mid 1990s. Housing prices rose significantly, including relative to income, between the mid 1990s and mid 2000s (Graph 8). However, this mainly was driven by the structural downward shift in consumer price inflation and thus nominal interest rates. As a result, housing ‘affordability’, measured as the share of average household income required to service a loan on a median-priced dwelling, has continued to cycle between 20 and 30 per cent, and is currently well below previous peaks (Graph 9).

Graph 8
Housing Prices to Income*



* Ratio of dwelling price to average household disposable income; income is before the deduction of interest payments
 ** Excluding income of unincorporated enterprises; median dwelling prices
 *** Excluding income of unincorporated enterprises; mean dwelling prices
 **** Including income of unincorporated enterprises; mean dwelling prices
 Sources: ABS; Core Logic RP Data; RBA; REIA

Graph 9
Repayments on New Housing Loans
Per cent of household disposable income*



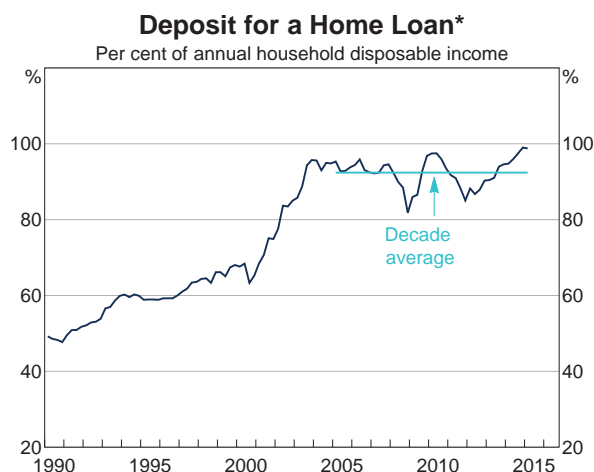
* Housing loan repayments calculated as the required repayment on a new 80 per cent LVR loan with full documentation for the nationwide median-priced home; household disposable income is before interest payments
 Sources: ABS; CBA/HIA; CoreLogic RP Data; RBA; REIA

On the other hand, the rise in housing prices relative to income has also increased the size of a deposit of any given fraction of the purchase price. At first glance, this would seem to imply that housing ‘accessibility’ has declined (Graph 10); previous studies have found that the savings required for a deposit seems to be more important for the transition to home ownership than the ability to service a mortgage from current income thereafter (Bourassa 1995). However, financial deregulation and increased competition in the mortgage market has partly offset this effect, by reducing minimum down payment (deposit) requirements. The maximum loan-to-valuation ratio (LVR) available in the Australian mortgage market has increased noticeably over recent decades, from the 80 per cent typical in the pre-deregulation period to around 95 per cent at present.¹ Equivalently, the deposit

1 Mortgages in Australia with an original LVR above 80 per cent typically require lenders mortgage insurance (LMI), which is an additional up-front cost for the borrower. Although LMI premiums can cost thousands of dollars on a typical first home buyer’s loan, the amounts are much lower than the additional deposit that would be required to provide a 20 per cent down payment (80 per cent LVR).

required of a first home buyer is no longer necessarily around 20 per cent of the purchase price, but rather, more often in the 5–10 per cent range. This shift would have eased the accessibility constraint imposed by the deposit requirement more than would be apparent from a simple comparison of a fixed percentage of the median purchase price over time. The latest data from mortgage lenders suggest that around 15 per cent of new lending to owner-occupiers involves LVRs above 90 per cent; most of these borrowers would be first home buyers. That said, lower deposit requirements have probably only partly offset the general increase in housing prices relative to incomes, so the net effect of all the forces described above has probably been to delay or prevent home purchase in some cases.

Graph 10



* Calculated as 20 per cent of the nationwide median-priced home; disposable income excludes unincorporated enterprises and is before the deduction of interest payments; uses current NSW stamp duty rates and abstracts from any FHOG payments

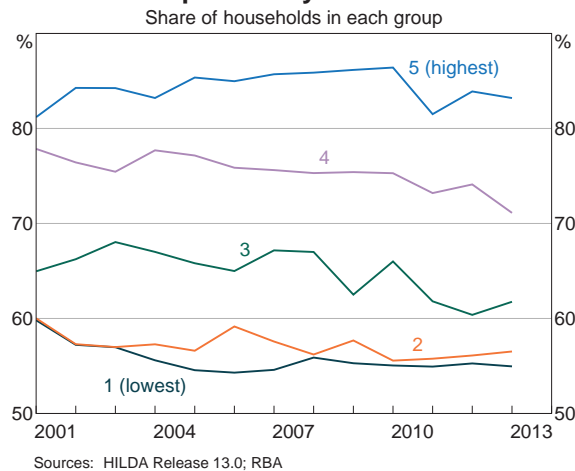
Sources: ABS; CoreLogic RP Data; RBA

So it seems at least plausible that the rise in housing prices since the mid 1990s has contributed to declining home ownership rates among younger households. But the Census data suggest that the downtrend in home ownership for the 25–34 and 35–44 age groups started in the early 1980s, with much of the decline occurring by the mid 1990s, before the sharp increase in housing prices relative to income. In fact, Census data imply that home ownership rates were relatively stable across these younger age groups between the mid 1990s and mid 2000s when housing prices were rising most rapidly relative to incomes (Graph 5 above). And the subsequent dip in the home ownership rate between the 2006 and 2011 Censuses was apparent across nearly all age groups, not just for these younger households. This suggests that other factors are also likely to have been important contributors to the decline in home ownership among younger households, including the demographic trends discussed above.

Other factors that have been put forward in the literature as contributing to lower home ownership rates among younger households include the following (Yates 2011).

- An increase in income inequality over recent decades, in part reflecting the simultaneous rise of two-income households with increasing workforce participation by women as well as the rise of single adult households (with or without dependents) discussed above. This led to increased borrowing capacities for households with high home ownership propensities, which will tend to have advantaged older households over younger ones. Accordingly, the decline in home ownership rates over the past decade or so has been concentrated in the third and fourth income quintiles, while that of the top income quintile – the top 20 per cent of households by income – has been little changed (Graph 11).

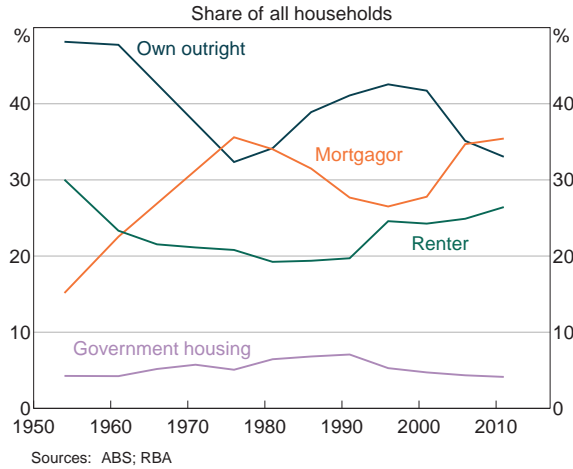
Graph 11
Home Ownership Rates by Gross Income Quintile



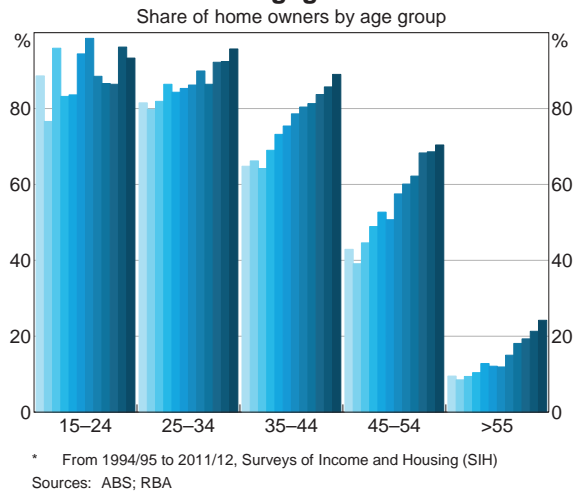
- Financial innovation in the 1990s and the 2000s arguably led to greater relaxation of restrictions on borrowing for higher-income households than for lower-income households. In particular, the shift from traditional rules of thumb based on debt-servicing ratios for assessing mortgage serviceability to more sophisticated net income surplus models, discussed in Laker (2007) and elsewhere, probably had the effect of advantaging higher-income earners (lower-risk borrowers), who are often older.
- Increased labour market flexibility, accelerated technological change and other factors may have increased employment and income insecurity and so reduced the willingness of some households to take on the long-term financial commitment of owning a home (or the ability to service a loan) and the capability of some to remain in home ownership.

Within the broadly stable aggregate home ownership rate, over recent decades there has also been a marked increase in the tendency for home owners to have a mortgage (Graph 12). In the early 1990s, the share of households that owned their own home outright was larger than the share of households with a mortgage, but now the reverse is true. This change has been visible across all age groups, but is particularly marked in the 45–54 age group (Graph 13). It is most likely a consequence of the structural decline in inflation in the early 1990s, and associated falls in nominal interest rates and nominal income growth. The result of those changes is that the real value of a household's outstanding housing loan is eroded at a slower rate (RBA 2003a).

Graph 12
Composition of Housing Tenure



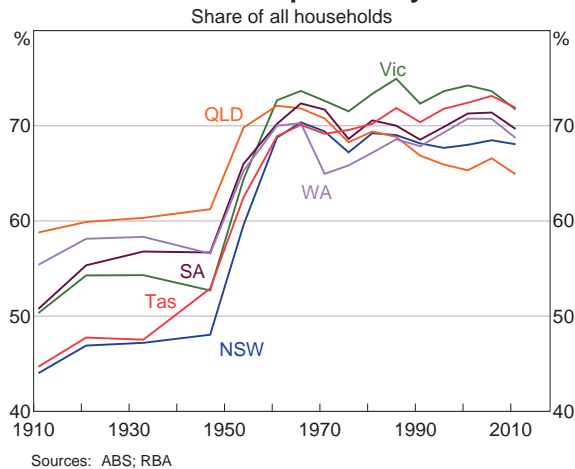
Graph 13
Mortgagors*



Another potentially important driver of the increasing prevalence of mortgagor households is the financial deregulation and innovation that has occurred over recent decades. Due to the emergence of products such as home equity loans, home owners can now easily borrow at a relatively low cost against the equity in their home, so that mortgages can now be used to finance many other types of purchases. Reverse mortgages also now allow older households to access the equity in their home, which forms the bulk of most households' wealth, to support consumption during retirement.

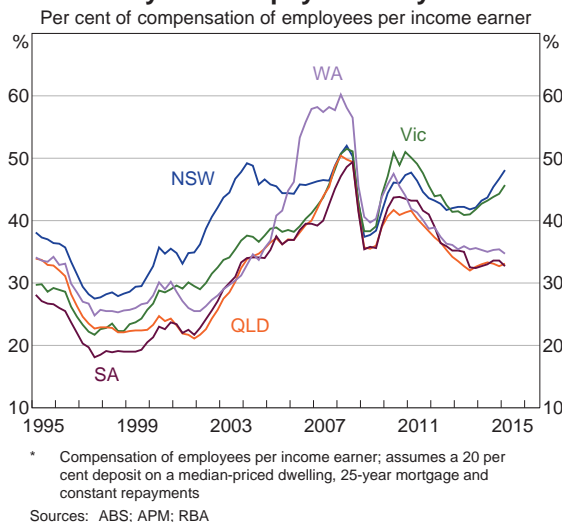
Across the states, long-run trends in home ownership have been broadly similar, although there are noticeable differences (Graph 14). For instance, the home ownership rate in most states remains above levels seen in the interwar period, in line with the national aggregate, but the difference is much smaller in Queensland, where much higher home ownership rates prevailed in the first half of the last century relative to the other states, and where the rate has drifted down more in recent decades. And while all states had home ownership rates between 65 and 75 per cent as at the latest Census, there is still considerable variation across states, with home ownership ranging from a low of around 65 per cent in Queensland to a high of almost 72 per cent in Tasmania and Victoria.

Graph 14
Home Ownership Rates by State



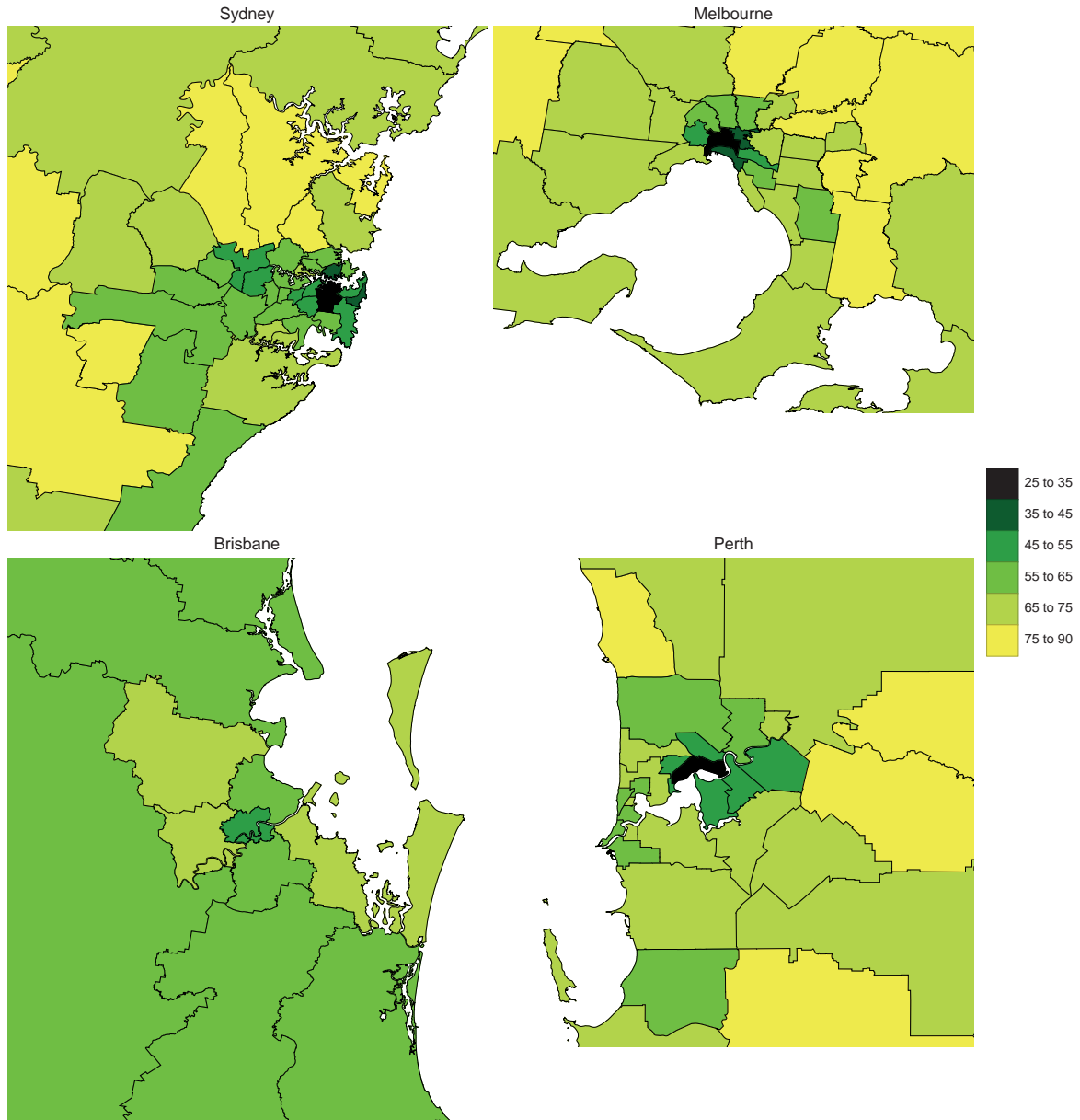
Differences in housing affordability do not, on their own, seem to explain this variation. While New South Wales currently has both low affordability and low home ownership relative to other states, Queensland has both the lowest home ownership rate and the highest affordability (equal with South Australia) (Graph 15). Victoria also has a higher home ownership rate than other states despite noticeably lower affordability.

Graph 15
Monthly Loan Repayments by State*



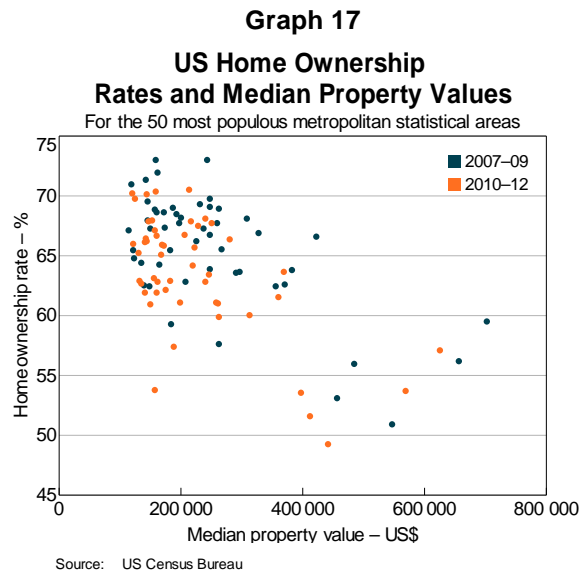
Looking at an even further disaggregated level, home ownership rates display a fairly common pattern within major Australian cities (Graph 16). In general, home ownership is lowest in the city centre – the CBD and surrounding areas – and is highest on the urban fringes (although Brisbane is a notable exception). This pattern is likely to reflect two key factors. First, the relative preference among renters, particularly younger people, for rental housing located close to job opportunities and other amenities, which are concentrated in inner-city areas. And second, the tendency for the most affordable housing to be located on the urban fringe, as the value of land tends to fall with increasing distance from the city centre (Kulish, Richards and Gillitzer 2011).

Graph 16
Ownership Rates by Region*



* Regions are LGAs except for Brisbane's which are SA4 areas.
 Sources: ABS; RBA

In keeping with the Australian experience, there can also be significant variation in home ownership rates within other countries. For example, home ownership rates across the 50 largest US cities vary from around one half to nearly three-quarters (Graph 17). This variation may, in part, reflect differences in housing affordability, as home ownership tends to be negatively correlated with housing prices (with New York at one extreme with very high housing prices and a low home ownership rate). However, there are many cities, such as Las Vegas (Nevada) or Austin (Texas) where both home ownership and housing prices are relatively low, highlighting the importance of other factors in determining the level of home ownership.



Drivers of Demand

The main drivers of demand for owner-occupied housing replicate in most respects the drivers of the home ownership rate described in the previous section. In particular, the transition to a low-inflation regime, implying lower nominal interest rates, has significantly increased households' borrowing capacities relative to their current incomes, and therefore their capacity to service debt on owner-occupied housing. As also noted above, the effect of increased availability of finance would have been only partially offset by the corresponding increase in the down payment that must be accumulated, because maximum LVRs permitted on mortgages have increased relative to the situation a few decades ago.

In addition, as real incomes rise, households have more discretionary income left over after basic expenses are covered. Some of this additional discretionary income can be used to consume more housing, though this seems to have taken the form of larger and better-appointed dwellings rather than more households owning a dwelling (Jääskelä and Windsor 2011).² In any case, survey evidence suggests that total housing costs of owner-occupiers have not moved much relative to incomes over the past couple of decades.

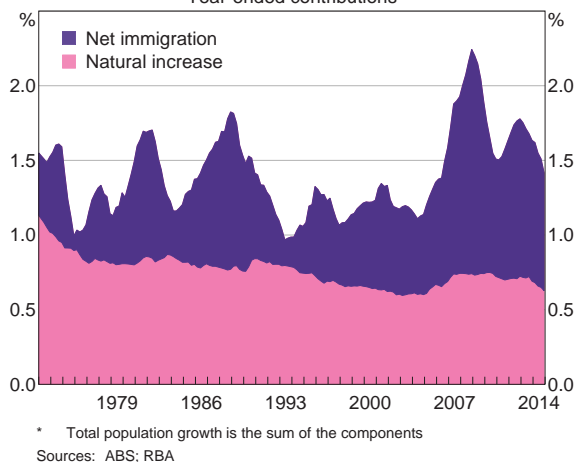
Alongside the other demand drivers, one fundamental determinant of housing demand will be the rate of new household formation, which is in turn dependent on the interaction between population growth and developments in average household size. After relatively stable growth from the early 1990s through to the mid 2000s, Australia's population growth stepped up significantly owing to higher net immigration and, to a lesser extent, a slightly higher rate of natural increase (Graph 18).

Average household size, the other component of household formation, has declined markedly since the 1960s and, all else equal, has generated an increase in demand for housing for a given level of population. Much of this downward trend has been attributed to demographic changes resulting from falling fertility rates (Graph 6 above), an ageing population and rising household incomes. Since the early 2000s, however, average household size has been little changed. To the extent that this levelling

² Alternatively, households might use the additional income to compete for the best locations, thereby driving up the relative price of properties in those areas.

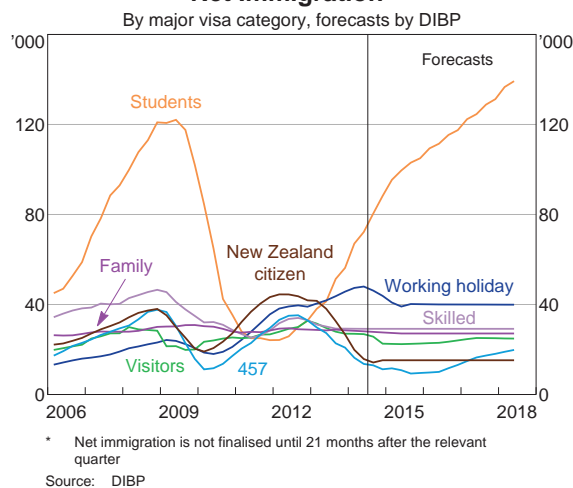
off has in part been a response to rising housing prices, average household size may rise further to offset some of the increase in demand from population growth.

Graph 18
Population Growth*
Year-ended contributions



The composition of population growth can also influence housing demand. Much of the fluctuation in population growth rates over the past decade has been driven by fluctuations in net arrivals of people on student visas (Graph 19).³ Recent rule changes have made it easier for students to remain in Australia after graduation, including by becoming permanent residents.

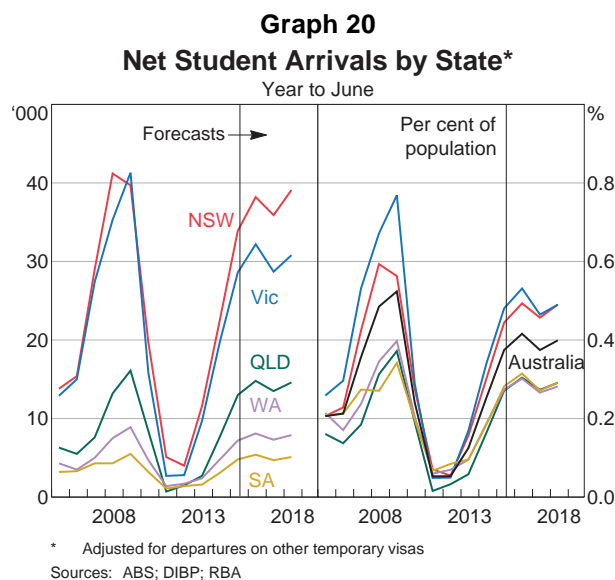
Graph 19
Net Immigration*
By major visa category, forecasts by DIBP



While any net immigration will boost demand for housing, the nature of that demand will depend on the life stage and circumstances of the newly arrived residents. The high fraction of students and former students in the flow of new migrants to Australia implies that the households they form will be younger than average, have lower incomes (at least initially) and be less able to purchase property (without familial assistance) than the average household already resident in Australia. This might result in lower home ownership rates than if migration had been lower or less concentrated in student visa entry. Student migrants will also be more likely to demand housing that is close to

3 These figures could overstate net immigration of students, because migrants who originally arrived on a student visa can leave Australia on another type of visa. Adjusting approximately for this does not change the overall trend or relative size of fluctuations in net immigration by visa type.

universities, city centres and other amenities rather than detached houses on the fringe of cities. It is also noteworthy that New South Wales and Victoria receive a disproportionate share of net student arrivals – more than two-thirds of the total – with projected contributions to total annual population growth of around half a percentage point, compared with 0.3 percentage points or less in other states (Graph 20).



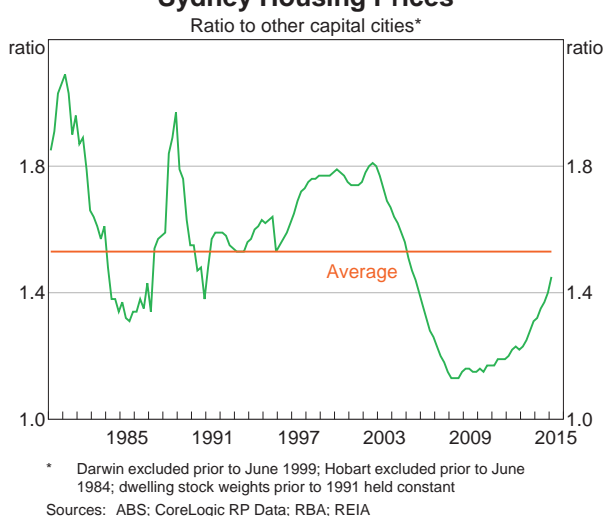
Over the shorter term, fluctuations in interest rates can be expected to affect the demand for housing. By reducing the burden of debt repayments relative to income, lower interest rates may ease cash-flow constraints and increase borrowing capacity at the margin. This effect applies both to owner-occupiers and investors. Lower interest rates also encourage households to save less and borrow more in the present, thereby shifting consumption from the future (Kent 2015). However, prudent buffers on the minimum interest rates that lending institutions use to calculate allowable mortgage loan sizes imply that this effect might be smaller when interest rates are already low. The Australian Prudential Regulation Authority (APRA) has recently provided guidance to lenders that the interest rate used in these serviceability tests should be at least 7 per cent (APRA 2014). The Bank estimates that the lower limits on interest rates used in these calculations are probably binding at present, or close to binding. Thus, households that already planned to borrow as much as lenders would permit would not see an increase in borrowing capacity from a decline in interest rates at present.

Drivers of Supply

The supply of housing is a stock. The flow of new construction (including renovation of existing stock) is relatively small compared with the existing stock, so housing supply inevitably moves quite slowly in response to the changing needs of and demand for housing by households. There are a number of aspects of the flow supply of new housing that could be made more flexible. However, the effects of such changes on the flexibility of stock supply would be fairly limited. Housing supply in the stock sense will therefore always be somewhat sluggish. In addition, Australia faces a number of particular challenges stemming from the geographical distribution of its population (RBA 2014b). Australia is highly urbanised and its urban population is unusually concentrated in a few large cities. The population densities of these cities are also quite low relative to those of cities with similar population sizes in comparable countries (Ellis 2013).

Two implications of this pattern of urbanisation work against efforts to provide housing at affordable cost. The first is that housing prices in larger cities tend to be more expensive relative to local incomes, even allowing for the fact that incomes are also generally higher on average in larger cities (Andrews 2001), although the wedge between prices in larger and smaller cities can fluctuate noticeably over long periods (Graph 21). A greater fraction of Australia’s population is exposed to these higher big-city housing costs (and enjoy the advantages of larger population centres) relative to the situation in other countries where the population is more dispersed across a larger number of (often smaller) population centres. The second implication is that low-density cities mean that people live further away from central amenities, and it is costly to provide enough transport infrastructure to make the city more accessible.

Graph 21
Sydney Housing Prices



On top of the inherent constraints on supply resulting from the physical characteristics described above, incremental supply (i.e. construction) can also be quite constrained. Some of the constraints on construction are also inherent and relate to the physical characteristics of housing. These include the topological constraints on further geographic expansion of some of Australia’s major cities. Sydney is the most constrained in this respect, being bound by ocean to the east, the Blue Mountains to the west, and national parks in some parts of the north and south. Other factors, including the costs of acquiring and developing land, as well as the cost of building the dwellings, may be more amenable to policy influence.

Complex planning issues and delays that occur during the process of building new dwellings can affect the response of incremental housing supply to increases in demand. Industry participants report that several factors lengthen and complicate the process of receiving approval to build new dwellings, which increase the time and costs spent by developers, as well as creating uncertainty among those involved. Delays in the planning and approvals process that have been identified include:

- difficulties in coordinating between the various agencies involved, including local councils, utility and other infrastructure providers, and state planning and environmental departments
- changing regulatory requirements, and a general lack of uniformity in these across some councils and governing bodies
- insufficient resources at councils to assess zoning and development applications quickly

- community opposition to urban expansion and high-density developments, with existing residents often concerned about the possible change in character of their suburb, environmental issues, the increase in congestion and/or perceived loss of value in their homes.

The provision and funding of infrastructure can also cause significant delays in the supply response, particularly in greenfield areas where the existence of such infrastructure is limited. Industry participants report that the process of negotiating the provision of water, sewerage, transport and energy infrastructure to service new homes can be lengthy, and uncertainty can exist about final charges (even after negotiations); all of these factors can add to the time and costs for developers. Overall, the infrastructure costs incurred by developers can be substantial, and often these must be paid up-front.⁴ The broader point here is that the cost of *serviced* land suitable for housing development can be quite high, and the availability of large amounts of *unimproved* land does little to mitigate this cost, especially if that land is located a long way from population centres.

Industry participants have suggested that these issues can be addressed, and the supply response of housing to increases in demand improved, through a few avenues:

- streamlining the planning and approvals process, including by applying code assessment to a greater range of development applications
- improving the coordination of processes between state government agencies and local councils
- having central authorities assess and approve large projects and coordinate different government agencies, where appropriate
- provide greater certainty on final developer charges to fund necessary infrastructure
- encourage greater up-front discussion between planning authorities and the community to diminish the impact of community opposition on the approval of new developments, and to provide greater certainty to developers.

Within these constraints, the amount of additional housing supply depends on the response of the residential construction industry to various drivers and incentives that shape the profitability of development projects. These include the cost of financing projects, which is primarily driven by the level of interest rates as well as lenders' views about the riskiness of individual projects. Higher construction costs will necessarily tend to reduce construction activity, all else equal, while expectations of rising housing prices, including during the life of the construction phase, will tend to raise expected profitability and therefore boost supply.

Proportion of Investment Housing Relative to Owner-Occupied Housing

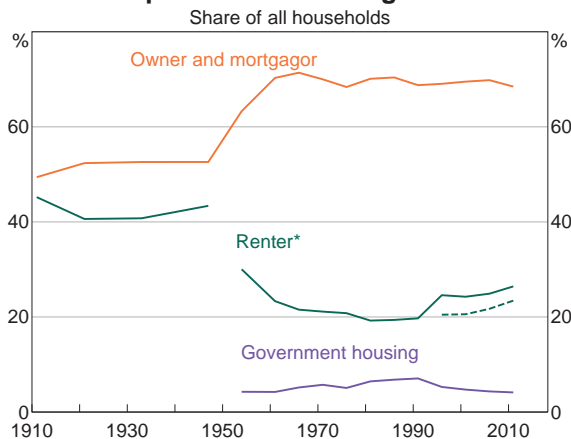
Data on the proportion of the housing stock owned by investors and owner-occupiers are not readily available. However, data on households' tenure type from the Census should be a good proxy.⁵ These data suggest that in 2011 around 68 per cent of the occupied housing stock was owned by owner-

4 Previous work by the RBA suggests that developers can fund at least half of new utility and transport infrastructure, and that developer contributions to infrastructure financing can account for as much as 10 per cent of total development costs: see Hsieh, Norman and Orsmond (2012).

5 Housing tenure of households as recorded in the Census differs somewhat from ownership of the housing stock because it does not provide information about the ownership of dwellings that were vacant on Census night, including (owner-occupied) holiday and second homes as well as vacant properties that are available for rent.

occupiers (as discussed above). Government-owned housing made up a further 5 per cent of the housing stock.⁶ The remaining 26 per cent of occupied housing was rented, from a wide range of sources.⁷ The share of housing rented from real estate agents and other private individuals, which could be assumed to be owned by individual investors, was somewhat less at 23 per cent (Graph 22).⁸ The proportion of the housing stock owned by investors appears similar in metropolitan and regional areas, but by housing type, investors own a much larger proportion of the apartment stock (around two-thirds) than the stock of houses (around one-quarter) (Graph 23).

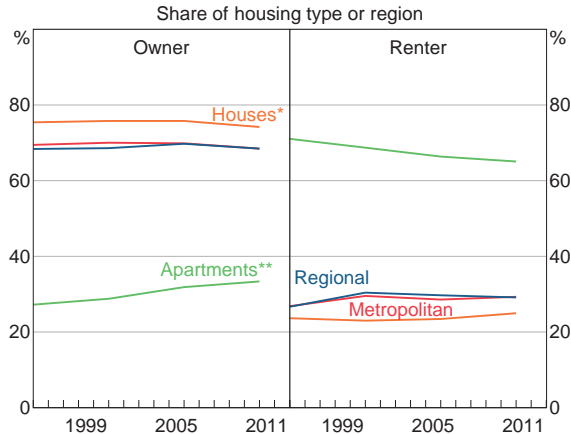
Graph 22
Composition of Housing Tenure
Share of all households



* Renter is inclusive of government housing until 1954, dashed line represents the share of housing rented from real estate agents and other private individuals

Sources: ABS; RBA

Graph 23
Composition of Housing Tenure
Share of housing type or region



* Includes separate houses and semi-detached, row or terrace houses

** Includes flats, units and apartments

Sources: ABS; RBA

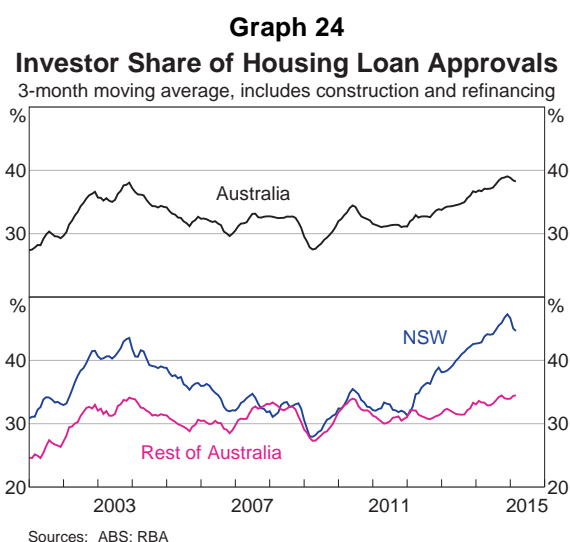
6 This includes a small amount of housing classified in the Census as 'other tenure type'.

7 Including: (i) housing provided by state or territory housing authorities; (ii) housing provided by housing cooperatives and community and church groups; (iii) dwellings rented through a residential park, such as a caravan park; and (iv) housing provided by an employer.

8 However, this includes dwellings rented by members of the owners' family as well as some holiday rentals. As noted above, the tenure data do not capture houses owned by investors that were not rented (such as holiday homes). According to the HILDA Survey, around 9 per cent of investment properties owned by households did not earn rent in the previous year.

Data on the number and value of housing loans outstanding suggest a similar pattern. Around 30 per cent of the number of outstanding housing loans are to investors (with a slightly larger proportion by value).⁹ This is a little larger than the apparent share of the housing stock owned by investors, reflecting investors' greater propensity to have a mortgage compared with owner-occupiers.

The proportion of the housing stock owned by investors looks to have risen over recent decades, offsetting the decline in the prevalence of public housing (leaving the proportion of the housing stock owned by owner-occupiers – the home ownership rate – relatively stable, as discussed earlier). The investor share is also likely to have risen a little further over the past few years, as investors have accounted for an increasing share of property purchases since 2012. Data on the proportion of residential property transactions that involve investors as purchasers or sellers are not readily available, but loan approvals data give some guide as to the prevalence of investors as purchasers. Investors' share of loan approvals has risen from a little over 30 per cent in 2011 to almost 40 per cent recently, with the increase most pronounced in New South Wales (Graph 24).

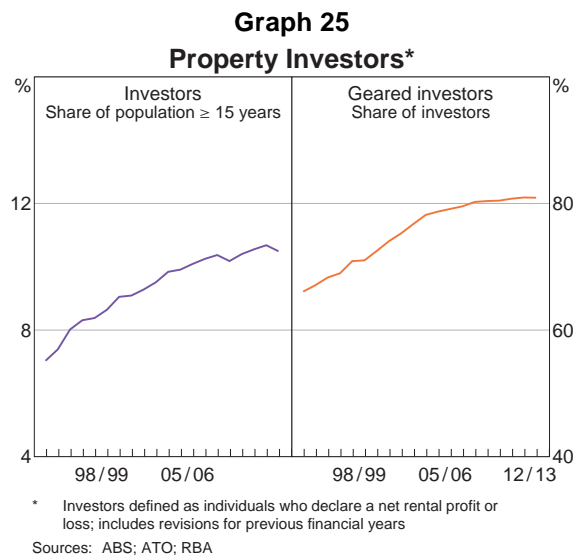


As noted in RBA (2014b), prudent limits on loan sizes are less binding for property investors that have significant equity to deploy than for some other purchasers. As discussed above, typically the interest rate used to calculate allowable loan sizes does not fall as much as actual interest rates, or only up to a point; this practice has been strengthened recently in light of recent guidance issued by APRA (2014). This means the marginal borrower has less scope to increase their loan size as interest rates fall. This practice is in the long-term interest of borrowers, as it helps ensure they can still service the loan once interest rates rise again. However, it does mean that borrowers for whom these constraints are not binding appear to have a relative advantage during periods of low interest rates, since they can increase their loan size and make larger offers for specific properties. In the Australian environment, the most constrained borrower is usually a first home buyer and the less constrained borrowers are investors or trade-up buyers with considerable equity. As such, this might help to explain the low share of first home buyers in recent new lending for housing. Reductions in state government incentives for first home buyers (of established housing) could also have contributed to this outcome. It also implies that the increase in investor demand is likely to have contributed to the recent strong growth in housing prices, particularly in Sydney.

9 Lenders can have difficulty classifying loans by type of purchaser, so these figures will have a margin of error.

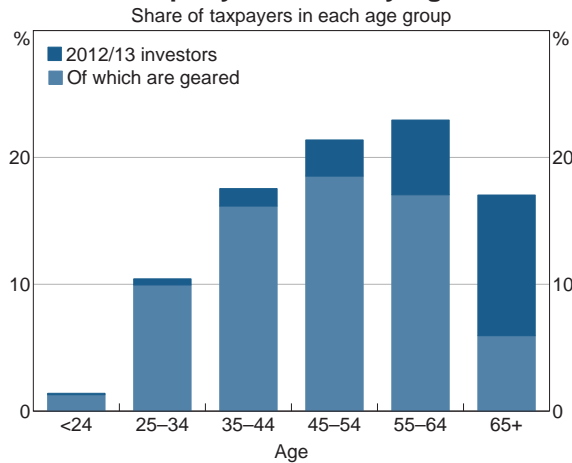
The increase in investor activity and strong growth in housing prices, among other developments, has raised concerns about risks emerging in the housing and mortgage markets. In response to these concerns, APRA announced measures in December 2014 to reinforce sound housing lending practices (APRA 2014). This included a benchmark for lenders' growth in investor housing lending of 10 per cent, above which supervisory action may be intensified. With total lending to investors growing at a little above 10 per cent over the past year, these measures are intended to result in some moderation of investor borrowing and purchasing activity in the period ahead, although it will take some time before the existing pipeline of approvals and pre-approvals are worked through.

Tax data show that the share of the population aged 15 years and over with an investment property grew steadily through the 1990s and early 2000s, before broadly stabilising in the late 2000s at around 10 per cent (Graph 25). Over the same period, the share of these investments that were geared – where the investor claimed interest deductions – increased steadily before levelling off at a little over 80 per cent. The share of investors that declared a net rental loss, taking advantage of the tax benefits of negative gearing, was just under two-thirds in 2012/13, having increased from around half in the late 1990s.



Data from household surveys and the tax office suggest that the propensity to own an investment property increases with age, as with owner-occupation, but declines after the age of 65, consistent with households drawing on investments to fund retirement (Graph 26). Since the early 2000s there have been some notable changes in the distribution of investment and gearing across age groups. In particular, the share of property investors that are aged 60 years and over has increased significantly. According to tax data, this shift in the distribution of investors towards older individuals reflects both the ageing of the population as well as an increase in the propensity to own investment property within this age group (RBA 2014a). Tax data suggest that older individuals have also become more likely to have a mortgage against their property investment, with around one-third of investors aged 65 and over claiming interest deductions from their total incomes in 2012/13. Nonetheless, borrowing remained far more prevalent among younger investors, with almost all investors below the age of 45 years being geared.

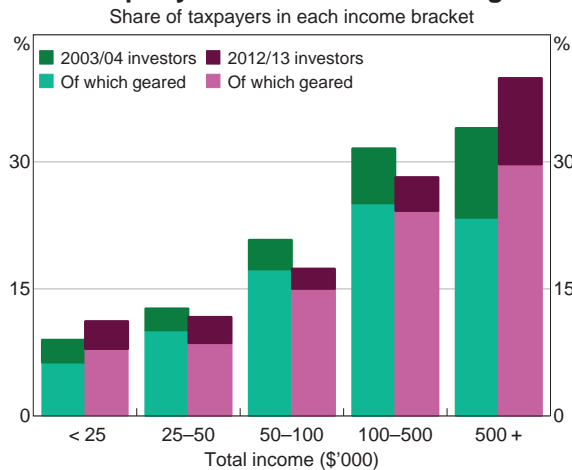
Graph 26
Property Investors by Age



Source: ATO

Tax data also show that the incidence of property investment and the incidence of geared property investment both increase with income (Graph 27).¹⁰ While the incidence of property investment fell between 2003/04 and 2012/13 for most income levels, it increased for those with very low incomes and those with very high incomes. For investors with very low incomes, individuals aged 60 years or older comprised a larger share in 2012/13 than in 2003/04, as an increasing number of baby boomers owning investment properties entered retirement.¹¹ These investors may be more capable of servicing any investment property debt than their younger low-income counterparts. In particular, even though their total income (for tax purposes) is low, they are likely to have non-taxable sources of income, such as drawdowns from superannuation funds.

Graph 27
Property Investment and Gearing



Source: ATO

10 Total gross (before-tax assessable) income includes wages and salaries, net rental income, net capital gains, income derived from financial assets and certain other income items. It excludes non-taxable sources of income such as pension streams and drawdowns from superannuation funds. The average total income per taxpayer was around \$55 000 in 2012/13, excluding these non-taxable sources.

11 The increase in lower-income individuals aged 60 years and over was also partly driven by changes to taxation of superannuation in July 2007. Total income as recorded on the individual's tax return fell for those aged 60 years and over, because some superannuation benefits that had previously been taxed became tax free and are therefore no longer recorded in total income.

While the incidence of property investment increases with the level of income, the Household, Income and Labour Dynamics in Australia (HILDA) Survey also suggests that most investor households are in the top two income quintiles. These households hold nearly 80 per cent of all investor housing debt (Graph 28), and appear well placed to service their debt: they typically use less than 25 per cent of their income to service their total property debt, and around half are ahead of schedule on all their mortgage repayments (Table 1).¹²

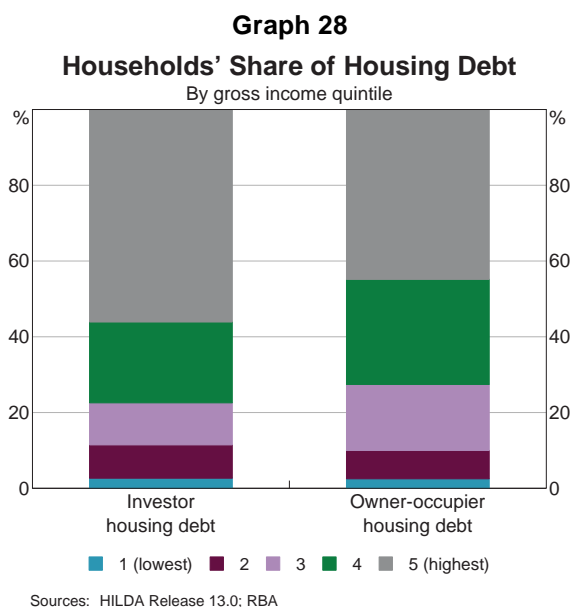


Table 1: Housing Debt Serviceability

Owner-occupier and investor households, by gross income quintile, 2010

Gross income quintile	Ahead of schedule on total mortgage repayments		Median total housing debt repayments to gross income ratio	
	Per cent of households in each income quintile		Per cent	
	Owner-occupiers ^(a)	Investors ^(a)	Owner-occupiers ^(a)	Investors ^(a)
1 (lowest)	36	26	50	128
2	48	26	30	46
3	48	38	25	35
4	55	44	19	24
5 (highest)	62	49	16	21

(a) Most investors are also owner-occupiers, but some are not: according to HILDA, just over 3 per cent of households were investors but not owner-occupiers in 2010, with a median age of 37 years (compared with 50 years for all investor households)

Sources: HILDA Release 13.0; RBA

12 Debt servicing in the HILDA Survey is measured as 'usual repayments'. For an amortising loan, it is likely to capture scheduled principal and interest repayments as well as any regular excess repayments made by the borrowers.

Impact of Taxation

The Bank has previously discussed the tax treatment of housing in Australia at length (RBA 2003b). Australia's treatment of property investors is at the more generous end of the range of practice in other industrialised economies, but not overwhelmingly so. In particular, a wider range of expenses, including some non-cash expenses, may be deducted against non-property income than is possible in some other jurisdictions. Capital gains tax (CGT) is also calculated at a concessional rate, although unlike in countries such as New Zealand, it applies to all sales of investment properties, not just those sold relatively soon after purchase.¹³

The tax system also advantages owner-occupiers, particularly those with little or no debt: although they cannot deduct mortgage interest repayments from tax as in some other countries such as the United States, neither are they subject to taxation on imputed rent. Countries that tax imputed rent (e.g. Switzerland) tend to have lower home ownership rates than in Australia. In addition, unlike investment properties, capital gains from the sale of the principal place of residence are not subject to CGT.

A major tax change since 2003 is that the threshold for the top marginal rate has increased significantly relative to the overall income distribution. This has reduced the proportion of taxpayers with the strongest incentive to minimise tax through negative gearing. With mortgage interest rates also having fallen over this period, some properties might no longer be negatively geared.

The Bank believes that there is a case for reviewing negative gearing, but not in isolation. Its interaction with other aspects of the tax system should be taken into account. The ability to deduct legitimate expenses incurred in the course of earning income is an important principle in Australia's taxation system, and interest payments are no exception to this. To the extent that negative gearing induces landlords to accept a lower rental yield than otherwise (at least while continued capital gains are expected), it may be helpful for housing affordability for tenants. It is worth noting, however, that the interaction of negative gearing with other parts of the taxation system may have the effect of encouraging leveraged investment in property. In particular, the switch in 1999 from calculating CGT at the full marginal rate on the real gain to calculating it as half the taxpayer's marginal rate on the nominal gain resulted in capital gain-producing assets being more attractive than income-producing assets for some combinations of tax rates, gross returns and inflation. This effect is amplified if the asset can be purchased with leverage, because the interest deductions are calculated at the full marginal rate while the subsequent capital gains are taxed at half the marginal rate. Since property can usually be purchased using higher leverage than other assets that produce capital gains, property is especially affected by this feature of the tax system.

Another change in the landscape since 2003 is that superannuation funds are now able to borrow. Some self-managed superannuation funds have taken advantage of this by adding geared property into the fund portfolio, both residential and, in particular, commercial property. At the margin, this has increased the population of potential investors. Although the share of the housing stock owned by these funds is small, it has grown quickly (RBA 2013). The Bank has previously observed that leverage in superannuation funds may increase vulnerabilities in the financial system and therefore supports limiting the scope for leverage in these funds (RBA 2014c).

13 Properties acquired before 20 September 1985 are also not subject to CGT. Gains on properties sold within one year are subject to income tax rather than CGT.

Opportunities for Reform

In considering opportunities for reform, the Bank believes that it is worth bearing in mind that there are both benefits and costs of owner-occupation. The broad policy objective of ensuring that all Australians can access suitable housing at reasonable cost need not translate into an objective that all households should purchase their home early in life, let alone that they should all be able to purchase their first home in their ideal location.

There is nonetheless a clear policy argument for ensuring that there are no artificial barriers constraining households from becoming home owners at some point in their adult lives. The Australian welfare system is designed in such a way that outright (debt-free) home ownership in retirement years is a key part of avoiding poverty in old age. But that does not say anything about when an owner-occupied home first needs to be purchased. Ensuring appropriate housing in retirement could be consistent with a range of home ownership rates for the whole population.

In addition, there are clearly benefits to home ownership that households value. These include having control over their home and its modification, security of tenure and a greater sense of attachment to their home. Academic literature also points to a range of benefits that are correlated with home ownership, including around community engagement and outcomes for children. However, Andrews and Caldera Sánchez (2011) survey this literature and conclude that these correlations do not necessarily imply that home ownership causes these benefits; rather, both outcomes may reflect a separate, common cause.

At the same time, it must be recognised that there are also costs of owner-occupation, meaning that for some households, home ownership is not in their best interests, at least at some points in their lives. For example, households that are likely to move within a few years would face greater costs of moving than if they rented. Some of these costs, such as stamp duty, are within the control of government policy, but legal and real estate agent fees can represent several percentage points of the total purchase price of the property, adding up to thousands of dollars. Because home owners are therefore less likely to move, they are less likely to be able to take up employment opportunities in other locations and might therefore be more likely to be unemployed, all else equal (Caldera Sánchez and Andrews 2011; Oswald 2009). It should be noted, however, that this effect has been difficult to establish with Australian data (Flatau *et al* 2002; Flatau, Forbes and Hendershott 2003).

More importantly, the purchase of a home represents a large financial commitment to buy a lifetime of housing services up-front. Therefore, this usually involves taking on a substantial debt commitment. For lower-income households or households with variable incomes or insecure employment, taking on a large debt commitment might not be in their best interests, given their current circumstances. The experience of the United States in the lead-up to and during the recent financial crisis demonstrates that households are not well served by being extended credit that they cannot reasonably service; the increase in US home ownership rates that occurred in the years preceding the crisis has proved to be ephemeral. In other words, it would be counterproductive to try to encourage more home ownership by making it easier for marginal buyers to borrow more. Both for this reason and in the interests of financial system stability, the Bank would not support measures that expanded credit supply to households at the expense of prudent mortgage lending standards.

While it is undeniable that more younger households would be able to purchase a home if housing prices were significantly lower relative to their incomes, there are no examples internationally of large falls in nominal housing prices that have occurred other than through significant reduction in capacity

to pay (e.g. recession and high unemployment). There is no mechanism to get a large and sustained level shift down in prices while a substantial fraction of the population can – safely and sustainably – service the obligations involved in paying the higher price. Additional housing supply ought to dampen housing prices, and more probably will reduce the growth rate of housing prices that occurs in response to increases in demand for housing. There is, therefore, an argument for government policy to avoid creating unnecessary barriers to supply. However, there is no example in Australia or internationally where supply expansion *on its own* generated housing price declines of a similar order of magnitude to the increases in prices seen in some Australian cities in recent years; some academic work on this issue suggests that removing supply constraints in a single population centre might not reduce prices significantly (Aura and Davidoff 2008).

Given the value Australian (and other) households place on home ownership, policy should not unduly advantage property investors at the expense of prospective owner-occupier home buyers. Financial stability considerations would suggest that tax and regulatory frameworks should avoid encouraging over-leveraging into property, whether by owner-occupiers or investors.

Reserve Bank of Australia
25 June 2015

References

- Andrews D (2001)**, 'City Sizes, House Prices and Wealth', *RBA Bulletin*, December, pp 1–6.
- Andrews D and A Caldera Sánchez (2011)**, 'The Evolution of Homeownership Rates in Selected OECD Countries: Demographic and Public Policy Influences', *OECD Journal: Economic Studies*, 2011(1), pp 207–243.
- APRA (Australian Prudential Regulation Authority) (2014)**, 'APRA Outlines Further Steps to Reinforce Sound Residential Mortgage Lending Practices', Media Release No 14.30, 9 December. Available at <http://www.apra.gov.au/MediaReleases/Pages/14_30.aspx>.
- Aura S and T Davidoff (2008)**, 'Supply Constraints and Housing Prices', *Economics Letters*, 99(2), pp 275–277.
- Bourassa SC (1995)**, 'The Impacts of Borrowing Constraints on Home-ownership in Australia', *Urban Studies*, 32(7), pp 1163–1173.
- Caldera Sánchez A and D Andrews (2011)**, 'To Move or Not to Move: What Drives Residential Mobility in the OECD?', *OECD Economics Department Working Papers*, No 846, OECD Publishing.
- Clapham D, J Hegedüs, K Kintrea, I Tosics and H Kay (eds) (1996)**, *Housing Privatisation in Eastern Europe*, Greenwood Press, Westport, CT.
- Elliott DB, K Krivickas, MW Brault and RM Kreider (2012)**, 'Historical Marriage Trends from 1890–2010: A Focus on Race Differences', SEHSD Working Paper No 2012-12.
- Ellis L (2013)**, 'Housing and Mortgage Markets: The Long Run, the Short Run and the Uncertainty in Between', Address to the Citibank Property Conference, Sydney, 23 April.
- Flatau P, M Forbes and PH Hendershott (2003)**, 'Homeownership and Unemployment: The Roles of Leverage and Public Housing', NBER Working Paper No 10021.
- Flatau P, M Forbes, G Wood, PH Hendershott and L O'Dwyer (2002)**, 'Home Ownership and Unemployment: Does the Oswald Thesis Hold for Australian Regions?', Murdoch University School of Management and Government Working Paper No 189.
- Hsieh W, D Norman and D Orsmond (2012)**, 'Supply-side Issues in the Housing Sector', *RBA Bulletin*, September, pp 11–19.
- Jääskelä J and C Windsor (2011)**, 'Insights from the Household Expenditure Survey', *RBA Bulletin*, December, pp 1–12.
- Kent C (2015)**, 'Monetary Policy Transmission – What's Known and What's Changed', Public Lecture at the Australian National University, Canberra, 15 June.
- Kohler M and A Rossiter (2005)**, 'Property Owners in Australia: A Snapshot', RBA Research Discussion Paper No 2005-03.
- Kulish M, A Richards and C Gillitzer (2011)**, 'Urban Structure and Housing Prices: Some Evidence from Australian Cities', RBA Research Discussion Paper No 2011-03.
- Laker J (2007)**, 'Credit Standards in Housing Lending – Some Further Insights', Address to The Institute of Chartered Accountants in Australia, Melbourne, 20 June. Available at <<http://www.apra.gov.au/Speeches/NewDocLib2/04-Chart-Acctnts-MN-20-Jun-07.pdf>>.

Oswald A (2009), 'The Housing Market and Europe's Unemployment: A Non-technical Paper', in C van Ewijk and M van Leuvensteijn (eds), *Homeownership and the Labour Market in Europe*, Oxford University Press, Oxford.

RBA (Reserve Bank of Australia) (2003a), 'Household Debt: What the Data Show', *RBA Bulletin*, March, pp 1–11.

RBA (2003b), 'Submission to the Productivity Commission Inquiry on First Home Ownership', RBA Occasional Paper No 16.

RBA (2013), 'Box D: Self-managed Superannuation Funds', *Financial Stability Review*, September, pp 54–57.

RBA (2014a), 'Box C: Households' Investment Property Exposures: Evidence from Tax and Survey Data', *Financial Stability Review*, September, pp 49–51.

RBA (2014b), 'Submission to the Inquiry into Affordable Housing', Senate Economics References Committee, February.

RBA (2014c), 'Supplementary Submission to the Financial System Inquiry', August.

The Senate (2015), 'Out of Reach? The Australian Housing Affordability Challenge', Report of the Senate Economics References Committee, May.

Yates J (2011), 'Explaining Australia's Trends in Home Ownership', *Housing Finance International*, 26(4), pp 6–13.

Copyright and Disclaimer Notices

HILDA

The following Disclaimer applies to data obtained from the HILDA Survey and reported in this submission.

Disclaimer

The Household, Income and Labour Dynamics in Australia (HILDA) Survey was initiated and is funded by the Australian Government Department of Social Services (DSS) and is managed by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute). The findings and views based on these data should not be attributed to either DSS or the Melbourne Institute.