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The great Australian lockout

Inequality in the housing market

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TAI

Policy Brief

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This paper uses unit record data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey. The HILDA Project 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 reported in this paper, however, are those of the author and should not be attributed to either DSS or the Melbourne Institute.

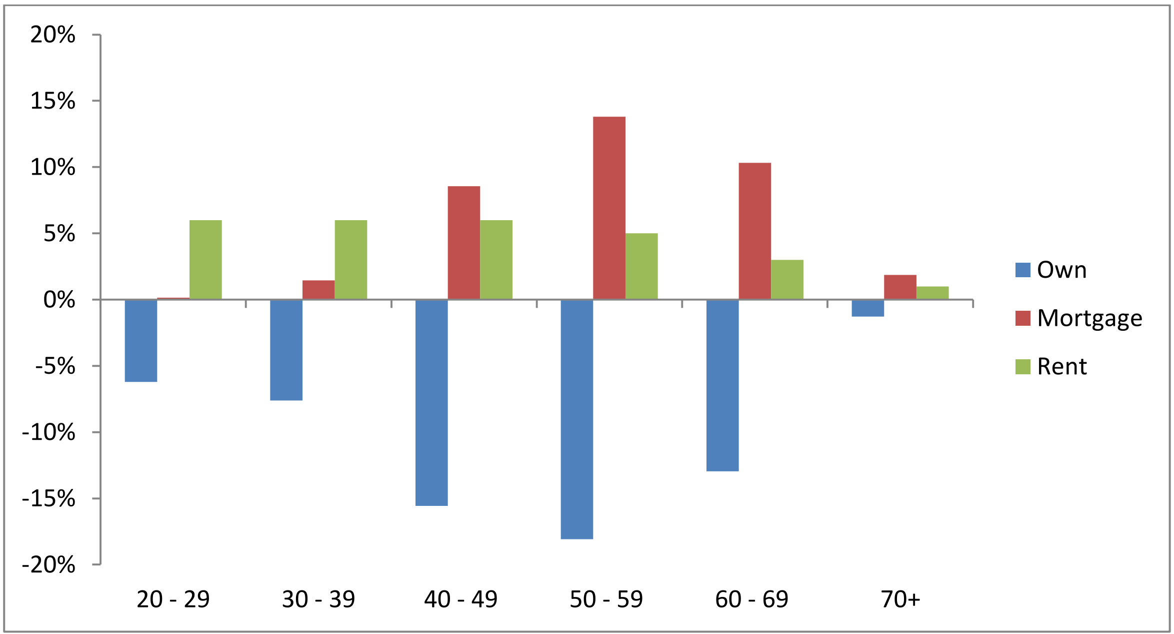
Summary

Home ownership is characterised as the great Australian dream. But is it more dream than reality these days? Home ownership rates are falling, people are holding mortgages for longer and renting is on the rise.

Buying a house has become much harder over the last decade. House prices have increased faster than incomes; incomes are 57 per cent higher than a decade ago, while house prices have risen by 69 per cent over the same period. Australia has the second most expensive property market of advanced economies when measured against incomes and rent. Only Norway is more expensive.

As a result, home ownership rates have declined for all age groups, even for householders in their 60s and 70s. All age groups are renting more and holding mortgages for longer. The biggest proportional decline in house ownership since 2002 is among 50-59 year olds. 18 per cent fewer own houses outright, with large increases in renting and mortgages.

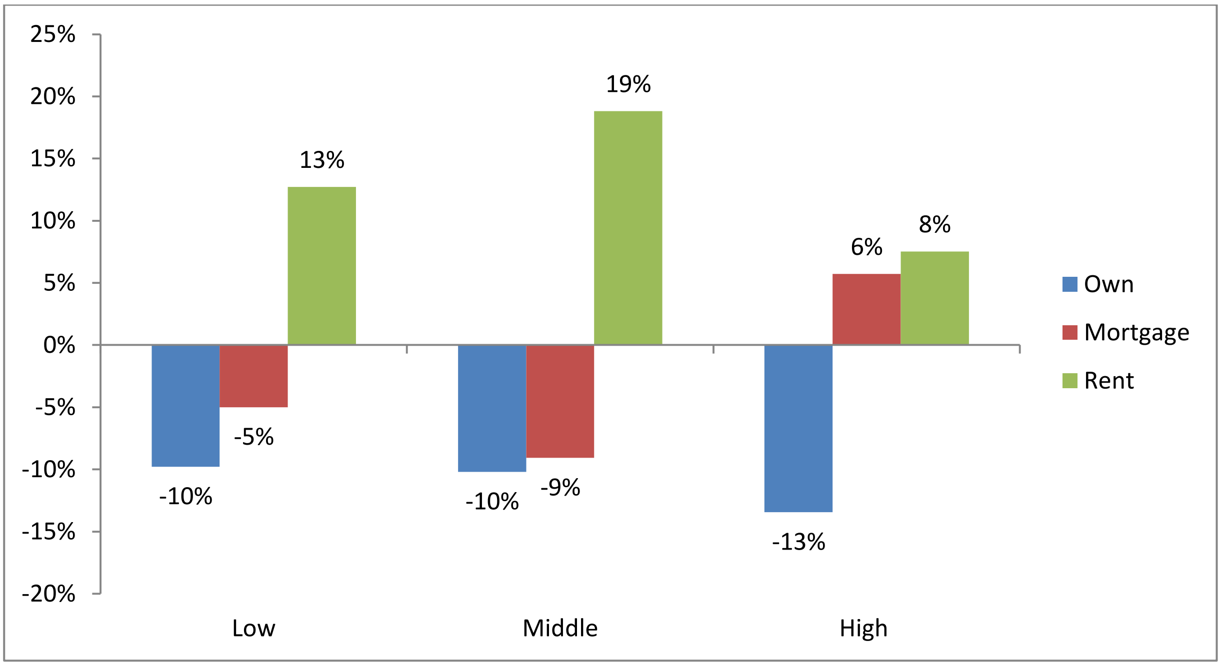
Change in tenure type by age (2002–2012)



Source: HILDA survey 2012.

Examining changes in tenure of working aged people (20-59 years) by income group, we see a disturbing picture of housing inequality emerging. Far fewer middle and low income households are entering the housing market. 19 per cent more middle income households are renting in 2012 than did in 2002, with corresponding decreases in ownership and mortgages. 10 per cent fewer lower income households own houses – a large decrease as only a quarter of low income working aged Australians owned houses to begin with.

Change in tenure type by household income (2002–2012)

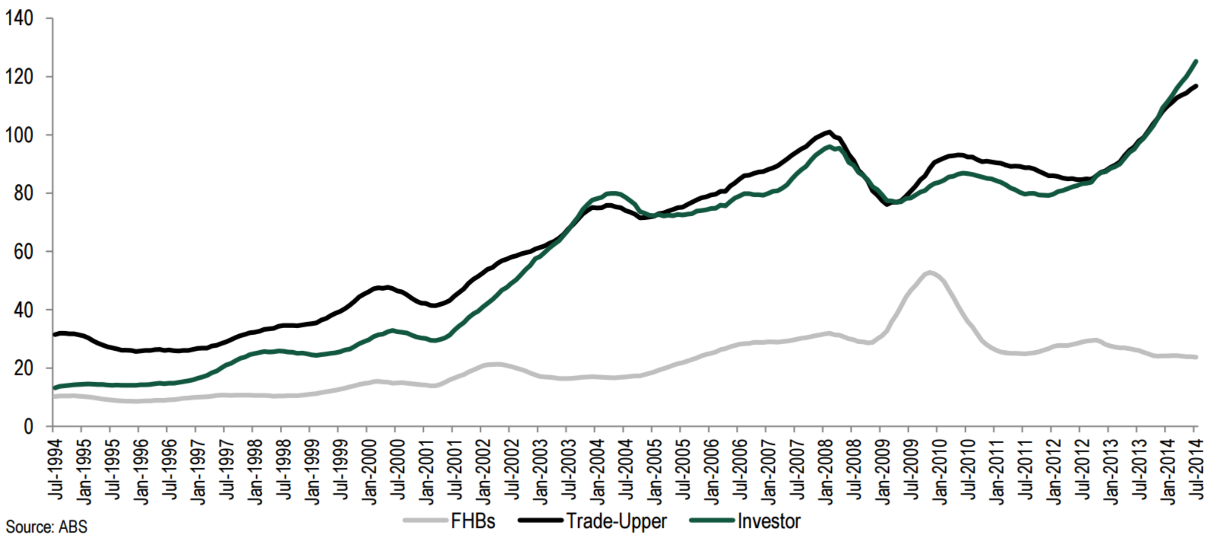


Source: HILDA survey 2012.

This data shows that high income households also have a smaller portion of home owners and increased portions of households who have mortgages or rent. This reflects the concentration of housing ownership among a particular type of high income earners – property investors.

Lending to property investors has skyrocketed, along with lending to existing home owners. Lending to housing investors was roughly equal to lending to first home buyers in 1994, around $15 billion, increasing to around $120 billion in 2014.

Value of lending by buyer category ($b) (1994-2014)



Source: HIA economics group (2014) *A portrait of Australian House Prices* citing ABS, Housing Finance, Australia cat no. 5609.0

Housing policy exacerbates housing inequality. Government policies are heavily skewed towards benefiting investors and existing home owners. Home owners and investors receive 90 per cent of the benefits from housing policies, while renters received virtually no benefits.

For example, negative gearing allows investors to deduct losses incurred on their investment property from their taxable income. This works to both boost house prices and reduce tax revenue by an estimated $6 billion in 2014-15. Capital gains tax treatment of housing is another problem which favours house owners and reduces government revenue. Government expenditure on home owners, primarily through tax concessions, amounts to $36 billion per year.

It doesn't have to be this way. Germany has tenant neutrality, which means that taxes and subsidies relating to housing treat renters and owners equally.

Introduction

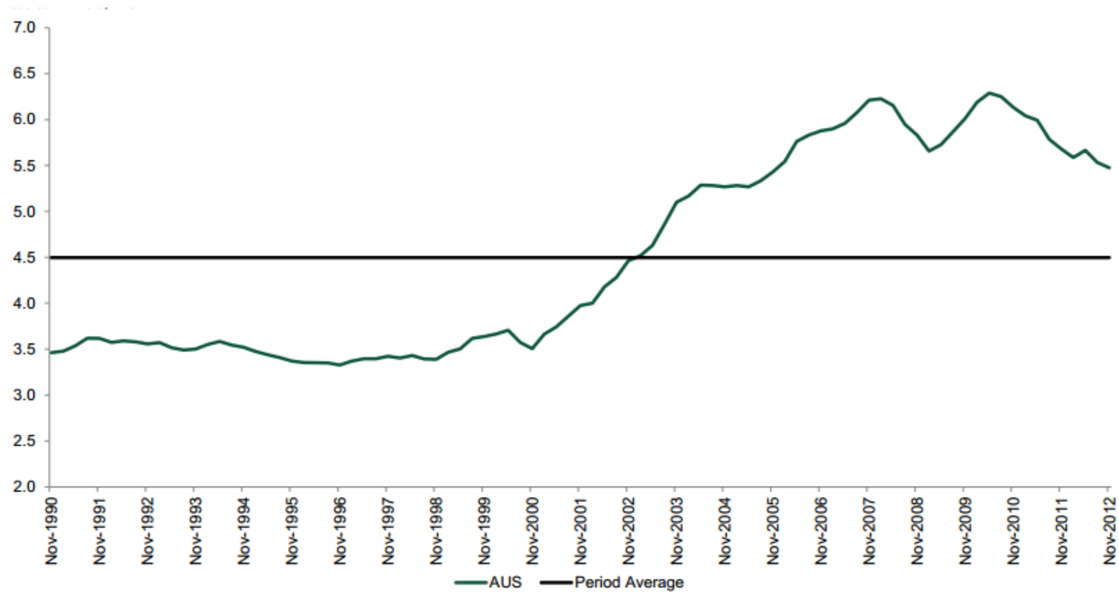
> *"parents should understand they need to mortgage their homes to help their children get into the property market"*[1]

Harry Triguboff, Property Developer

Home ownership is characterised as the great Australian dream. But is it more dream than reality these days? Home ownership rates are falling, people are holding mortgages for longer and renting is on the rise. In 1994-95, 18 per cent of households rented their houses, while at the 2011 census this had increased to 25 per cent.[2]

Contributing to this change is a decline in housing affordability. House prices have increased faster than incomes; incomes are 57 per cent higher than a decade ago, while house prices have risen by 69 per cent over the same period.[3] Figure 1 shows the stability in housing affordability through the 1990s followed by a rise up to the Global Financial Crisis. The house price to income ratio now sits well above the longer-term average of 4.5.

Figure 1: House price-to-income ratio (1990-2012)



Source: HIA economics group (2013) *Perspectives on Australian House Prices*

Australia has the second most expensive property market of advanced economies when measured against incomes and rent. Only Norway was more expensive, according to the Bank of International Settlement.[4] An international survey on housing affordability found that housing in Australia was "severely unaffordable" while Sydney was rated the third least affordable market across 86 major markets in nine countries.[5] Meanwhile, the governor of the Reserve Bank of Australia, Glenn Stevens believes that affordable housing has become a

[1] Hutchinson S and Thistleton A (2014) Foreign buyers drive home prices higher

[2] ABS (2013) *Housing Occupancy and Costs, 2011-12*

[3] National Housing Supply Council (2013) *Housing Supply and Affordability Issues 2012-13*

[4] Scatigna M, Szemere R and Tsatsaronis K (2014) *Residential property price statistics across the globe*

[5] Demographia (2015) *11th Annual Demographia International Housing Affordability Survey:2015*

"major" social issue.[6] Affordability has affected not just home buyers but also renters, with rental prices rising at a faster rate than house prices.[7]

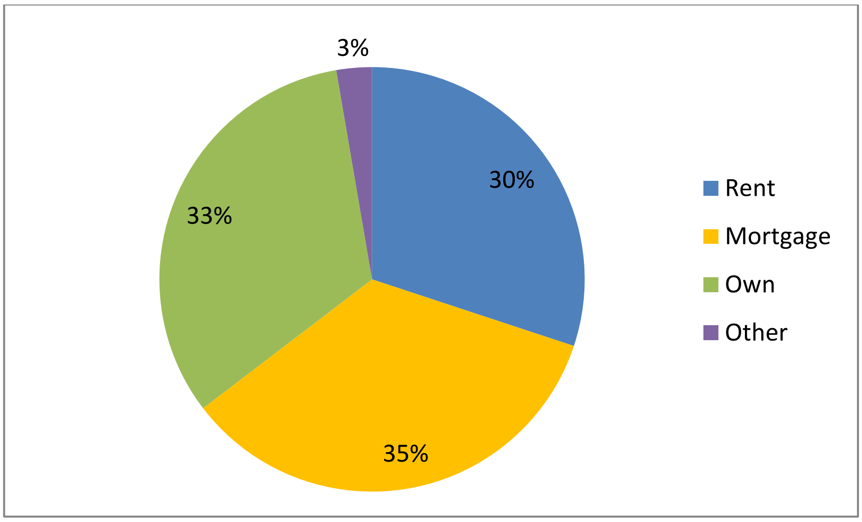
Increasing property prices have made housing affordability an issue for many Australians. A recent survey by The Australia Institute found that 50 per cent of non-home owners were pessimistic they would ever own property, rising to 69 per cent of people for low-income earners.[8] Aspiring home owners saw financial factors, such as property prices and saving for a deposit, as the major restrictions to entering home ownership.

This paper examines the impact of declining housing affordability on equality in Australia. Using data from the Household, Income and Labour Dynamics in Australia (HILDA) survey[9] we examine changes in renting, buying, owning and investing in property over a ten-year period from 2002 to 2012. Changes in home ownership (both outright and with a mortgage) and rental rates are examined for different age and income groups. This research has allowed us to determine how housing affordability is impacting different groups of people across Australian society.

Changing patterns of home ownership

Residential property tenure in Australia divides into three main types – outright owners, those with a mortgage and renters. Figure 2 below illustrates the breakdown of tenure type in the 2012 HILDA survey. When those who own their home outright or have a mortgage are considered together it is clear that the majority of households are home owners.

Figure 2: Breakdown of tenure type (2012 HILDA)



Source: HILDA survey 2012.
Note: 'Other' represents persons living rent free or with life tenure

Home ownership in Australia is largely influenced by age and income. This section begins with an analysis of home ownership by age before examining the divide between income categories.

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[6] Hutchens G and Mason M (2015) *RBA waves red flag over 'very concerning' Sydney property market*

[7] National Housing Supply Council (2013) *Housing Supply and Affordability Issues 2012-13*

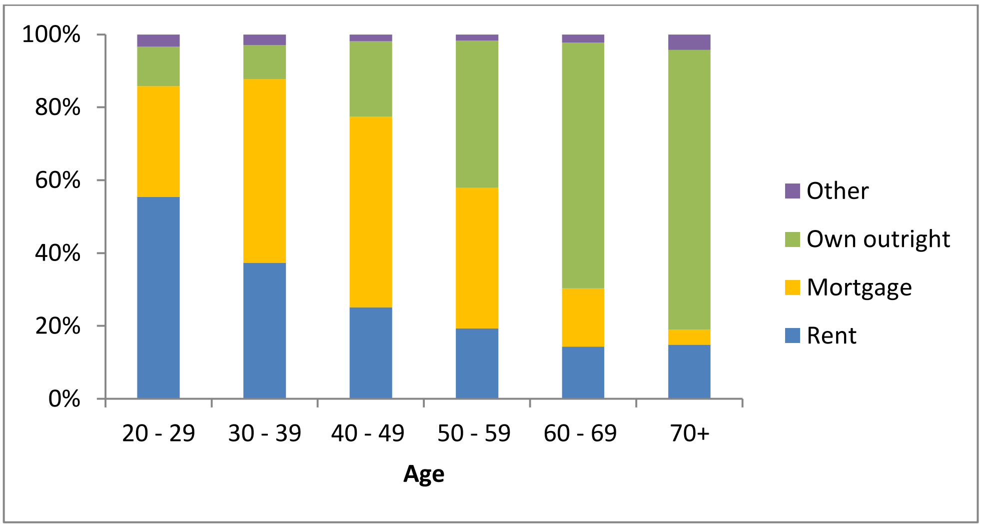
[8] Survey conducted in February 2014 (n=1445)

[9] The HILDA survey is a household based survey run by the University of Melbourne that has been conducted annually since 2001. (Melbourne Institute, The Household, Income and Labour Dynamics in Australia (HILDA) survey)

Home ownership and age

The ‘Australian dream’ is based on the idea of buying a home and paying off the mortgage before retirement. As shown in Figure 3 below, renting is common amongst younger age groups while the vast majority of people in retirement own their home.

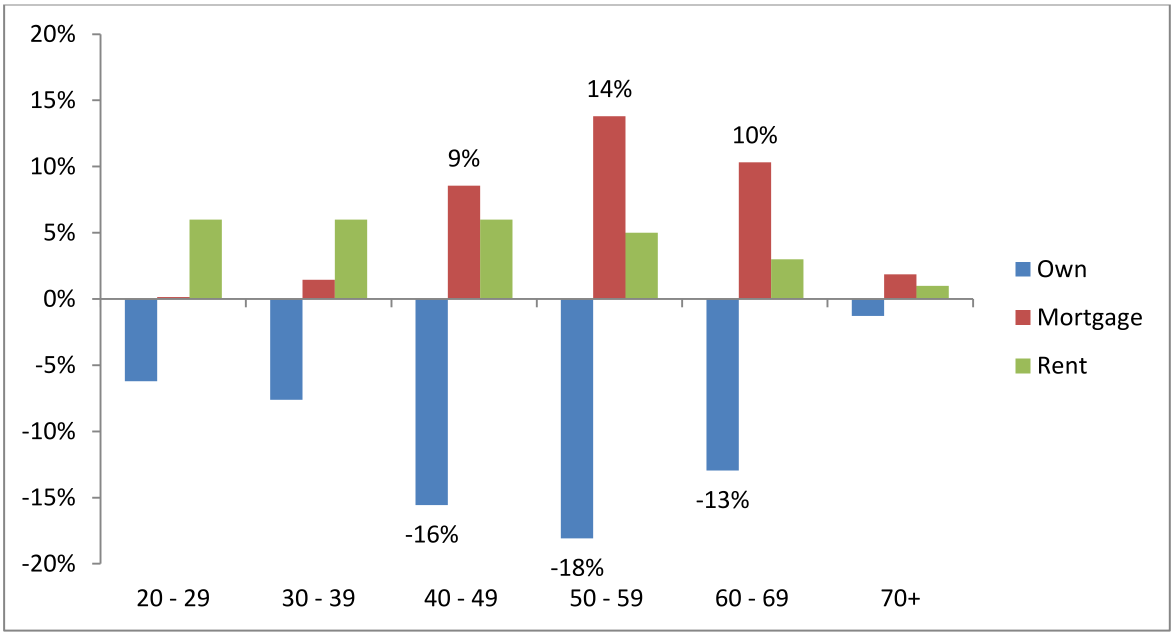
Figure 3: Breakdown of tenure type by age (2012)



Source: HILDA survey 2012.

However, achieving this dream is becoming harder. Home ownership changed in the decade preceding 2012 in three key ways. Comparing 2012 data with data from 2002, we see that people are buying later, renting longer and carrying mortgages much later into life. As illustrated in Figure 4, outright ownership dropped for all age groups while the proportion of people who had mortgages or were renting increased.

Figure 4: Change in tenure type by age (2002–2012)



Source: HILDA survey 2012.

Outright ownership declined by an average of ten per cent over the ten year period. The largest decline was for those aged 40-69 years with an average drop of 16 per cent. Along with the fall in outright ownership, the proportion of people with mortgages later in life increased, in particular for those aged 50-59 (14 per cent).

The decline in outright ownership combined with an increase in the number of people with mortgages shows that some of the decline in outright ownership is partly due to a larger number of mortgage holders. Clearly, people are taking longer to pay off their mortgages. A number of factors are likely contributing to this. Firstly, higher housing costs may have contributed to the extended time that people are taking to pay off their mortgages. Over the ten-year period, adjusted for inflation, mortgage repayments increased by $669 per month (in 2012 dollars). Additionally, people may have taken advantage of low interest rates and redrawn on their mortgage for other purchases, property renovations or the funding of additional investment properties. It is also possible that older age groups are redrawing on their mortgage to assist their children into home ownership.

Though the increase in mortgages has clearly contributed to the fall in outright ownership it does not explain the entire reduction. Changes in rental rates complete the picture. The proportion of people renting increased for all age groups over the ten-year period, in particular for those of working age. For instance, a six per cent increase in renting occurred for those aged between 20 and 49 years and a five per cent increase among 50–59 year olds.

While only a small increase in renting occurred in the older age groups, over 70, it is worth noting that 15 per cent of retirees continue to rent. A survey conducted by The Australia Institute found that 91 per cent of non-home owners who were over 65 were pessimistic they would ever own their own home, indicating that the majority of older renters are likely to stay in the rental market. The HILDA data shows that retired women are more likely to rent than men, with 17 per cent of older women renting compared to 12 per cent of men. While the number of older women who rent increased by three per cent over the ten-year period, the proportion of men dropped by two per cent. This raises potential concerns about a growing gender gap among older Australians.

Owning a home is a great advantage in retirement when income is lower. In comparison to renting, which involves continual costs, housing costs are minimal when a home is owned outright. The 2009 Harmer review found that pensioners who rent have higher financial stress, primarily because of high rental costs.[10] A recent paper from The Australia Institute, *Income and wealth inequality in Australia*, summarised the relativity between pension payments and the Henderson poverty line. It found that a single home owner on the pension is 67 per cent above the poverty line while a single renter is only 14 per cent above. Similarly, a home-owning couple on the pension is 54 per cent above the poverty line while a couple who rent are 16 per cent above.[11]

The number of renters in Australia is growing alongside the increase in house prices, with monthly rental prices increasing by 30 per cent, or $369 (adjusted for inflation, in 2012 dollars) over the ten-year period. Increased rental prices relative to income mean that many aspiring home owners will find it more difficult to save for a deposit, creating an additional barrier to home ownership. An Australia Institute survey indicated that 59 per cent of aspiring home owners were having difficulty saving for a deposit, while a further 69 per cent were struggling to find an affordable property. The increase in the portion of people renting in all age groups indicates that housing affordability is affecting people throughout their lives. To understand how income influences housing affordability we will now consider how changes in housing have been experienced by households with different incomes.

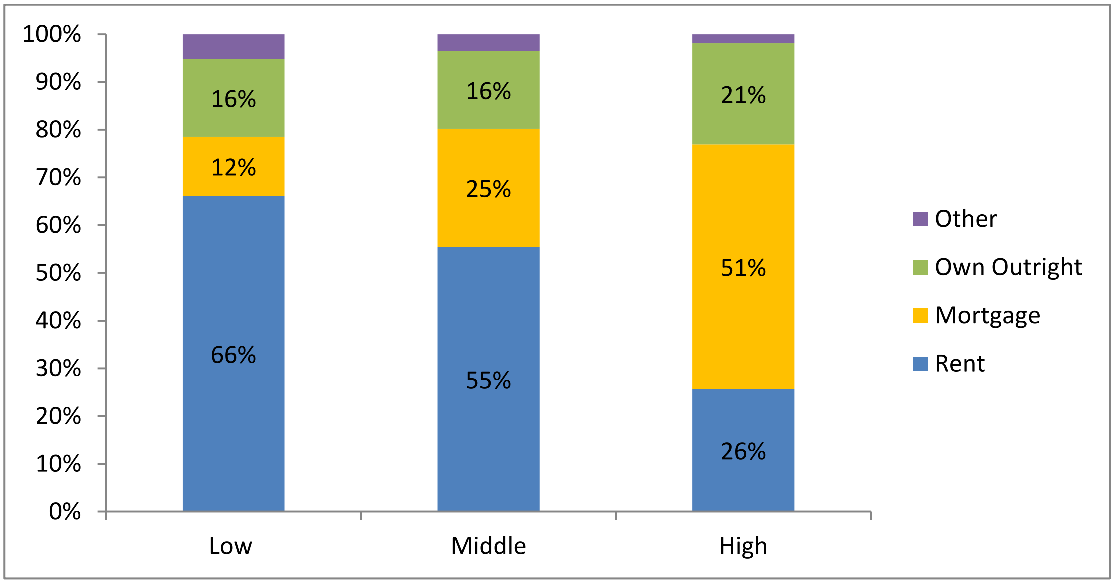
[10] Harmer J (2009) Pension Review Report

[11] Richardson D and Denniss R (2014) *Income and wealth inequality in Australia*

Home ownership and household income

Income has a large influence on people's housing arrangements.[12] Renting is more common for low income households and property ownership more likely for those with a higher income (see Figure 5).

Figure 5: Breakdown of tenure type by household income, 20–59 years (2012)



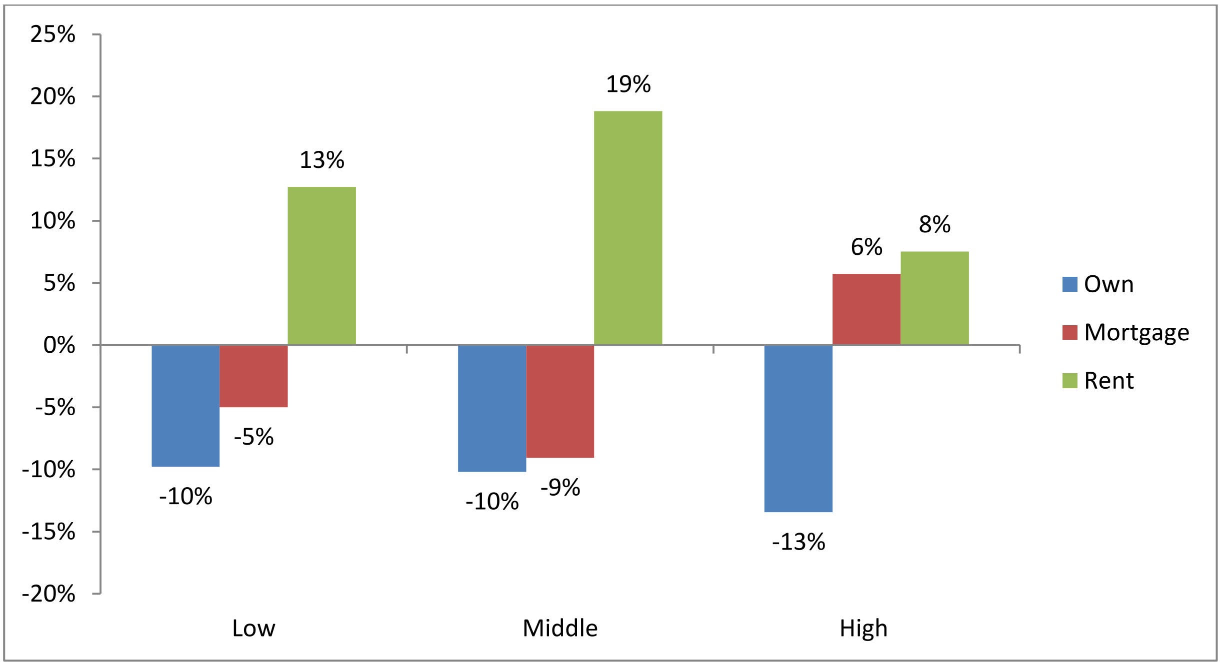
Source: HILDA survey 2012.

While it is not surprising that lower income households rent more and higher income earners more often buy houses, we see that between 2002 and 2012, this pattern has become more pronounced. There have been significant changes in outright ownership, mortgages and renting by income for those aged 20–59 years.[13] As shown in Figure 6, all income groups saw a drop in outright ownership and an increase in renting. However, changes in the number of people with mortgages were not consistent across income groups. Low and middle income households experienced a decline in mortgages while the number of high income households with mortgages increased.

[12] Income categories based on ABS (2013) Household income and income distribution.

[13] The income section examines people between the ages of 20-59 years. People of retirement age have been excluded from this analysis since the majority of people of retirement age have paid their home off fully. Including older households who reported proportionally smaller changes in tenure type would have a disproportionate influence on an analysis of change by income.

Figure 6: Change in tenure type by household income, 20-59 years (2002–2012)



Source: HILDA survey 2012.

Low and middle income households saw an overall drop in home ownership over the ten year period, as evidenced by the decline in both outright ownership and mortgages. The proportion of low income households who were outright owners declined by ten per cent and there was a five per cent decline in the number of people with mortgages. These declines are quite significant considering that low income households had relatively small rates of home ownership at the beginning of the ten year period. The number of low income people who owned their home outright or had a mortgage dropped by more than one third from the 2002 percentage levels.

Middle income households saw a similar trend. The proportion of people who owned their home outright dropped by 10 per cent while those with mortgages dropped by nine per cent. This reflects a drop of around one quarter of the 2002 percentage levels for mortgages and a drop of more than one third for outright ownership.

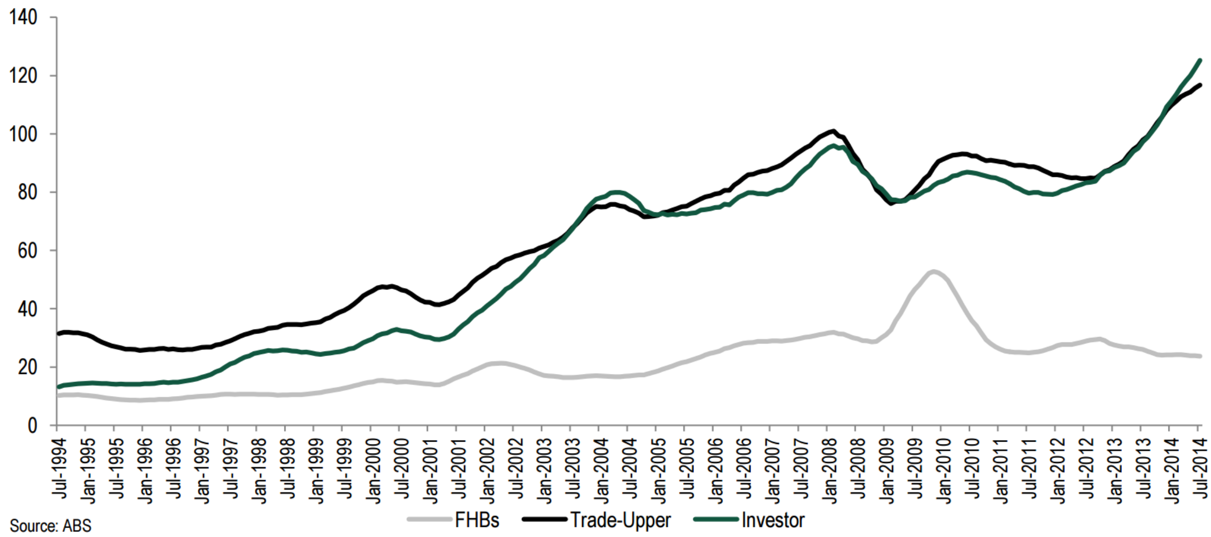
In contrast to low- and middle-income households, the number of high income households with mortgages increased (six per cent). It appears high-income households are extending the duration of their mortgages, possibly due to adding value through extended debt for renovations, moving into more expensive houses or taking advantage of lower interest rates and buying investment properties. The increase in mortgages does not offset the entire reduction in outright ownership, which means there was a reduction in the proportion of higher income earners who owned houses, albeit smaller than low- and middle-income households. The reduction in ownership corresponds to increases in renting.

Low- and middle-income households appear to have been most affected by increasing house prices with many being locked out of the property market as a result. The decline in the number of middle income households who own homes is particularly significant as it shows that housing affordability is affecting the 'average' Australian. This represents a growing gap between high income earners and low and middle income earners. This income disparity is even larger when property investment is considered.

Property investors and housing affordability

Many commentators have attributed the rise in house prices to the increased availability of mortgaged finance and lower interest rates.[14] Access to cheap credit has allowed some households to maintain higher levels of debt and there has been a huge jump in the number of property investors (see Figure 7).

Figure 7: Value of lending by buyer category ($b) (1994-2014)



Source: HIA economics group (2014) *A portrait of Australian House Prices* citing ABS, Housing Finance, Australia cat no. 5609.0

Figure 7 shows that first home buyers make up only a small proportion of the market. Lending to first home buyers has hardly changed between 1994 and 2014, aside from a jump after the financial crisis, when investors temporarily left the market.

In contrast, lending has skyrocketed to property investors and existing home owners “trading up” to newer houses. Lending to housing investors was roughly equal to lending to first home buyers in 1994, around $15 billion, but has increased to around $120 billion in 2014. Rising house prices mean deposit requirements for potential buyers have grown and first home buyers are being squeezed out of the market as a result.[15]

The HILDA data shows that the vast majority of investors (81 per cent) are high income earners and the majority already own their family home. Not only does this mean it is wealthier Australians who are contributing to pricing others out of the housing market it also means it is the rich that benefit from government policies that encourage investment in housing.

Government policy

Government policies are heavily skewed towards benefiting investors and existing home owners. Home owners and investors receive 90 per cent of the benefits from housing policies, while renters received virtually no benefits.[16]

[14] See for example Council of Australian Governments (COAG) (2012) *Housing supply and affordability reform;* Productivity Commission (2004) *First Home Ownership*

[15] For example see Kwek G, Nicholls S and Johnstone T (2014) *Baby boomers continue to squeeze out first-timers* and Janda M (2014) *Australian homes worth $5 trillion as investors hit 10-year high*

[16] Kelly J-F (2013) Renovating Housing Policy

One major policy that benefits existing home owners is arrangements around negative gearing. Negative gearing allows investors to deduct losses incurred on their investment property from their taxable income. This loss of income tax revenue is estimated to cost the government around $6 billion in 2014-15.[17] High income households are particularly favoured by these tax concessions as they have a greater capacity to purchase property and face a higher marginal tax rate on their income tax.

Negative gearing has the effect of increasing the prices of houses because the vast majority of investors buy established properties. This places upward pressure on house prices, hence pricing out many would-be first home buyers.[18] The result is a redistribution of wealth towards those who own real estate and away from those who do not. This of course favours the wealthy at the expense of the poor.[19] The RBA is currently voicing concern about investors over-inflating the housing market and is considering imposing restrictions to curb risky lending.[20]

Another policy problem is the relatively light taxation applied to capital gains on investment properties. Investors who have held a property for at least 12 months are entitled to a 50 per cent discount on taxes levied on any capital gains when they sell.[21] This light tax treatment of capital gains ensures that investors are encouraged into strategies that make losses in the short term but generate long run capital gains.

The Murray Financial System Inquiry explicitly argues that we need to rein in the favourable tax treatment of housing investors. The report states that the tax treatment towards investors “tends to encourage leveraged and speculative investment in housing”.[22]

Home owners also benefit from government policy through the tax system. The family home is exempt from capital gains tax, making owner-occupied housing one of the most tax-advantaged form of assets.[23] Government expenditure on home owners, primarily through tax concessions, amounts to $36 billion per year.[24]

In contrast to investors and home owners, renters receive very little government support. Rent assistance is available to those on welfare benefits, such as Newstart, though the recent review into the welfare system found it has not kept pace with the growth in rent prices. For instance, while rent assistance increased by 40 per cent between 2001 and 2013, median rents for those who receive the payment increased by between 65 per cent and 100 per cent.[25]

Housing stability for renters is low with residential tenancy rules heavily favouring landlords. While some countries, such as Germany (see Case Study), have laws that provide security of tenure for renters, many renters in Australia have to move much more frequently than they would like.[26] Rules such as short standard leases (usually six or twelve months) and short notice periods for landlords can create uncertainty for many renters.

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[17] The Australia Institute estimates based on Australian Taxation Office data

[18] Eslake S (2013) *50 years if housing failure*

[19] Nanegbi R (2002) *Negative gearing: Future directions*

[20] Canberra Times (2014) *RBA slammed by real estate lobby group REINSW for property investor u-turn*

[21] Australian Taxation Office, *Tax-smart investing: What Australian property investors need to know*

[22] p.17, Financial Systems Inquiry Panel (2014) Financial System Inquiry Final Report, panel chaired by Mr David Murray, Commonwealth of Australia.

[23] Yates J (2007) Affordability and access to home ownership: past, present and future?

[24] Kelly J-F (2013) *Renovating Housing Policy*

[25] Department of Social Services (2014) *A new system for better employment and social outcomes.*

[26] Kelly J-F (2013) *Renovating Housing Policy*

Case Study: Renting in Germany

Though home ownership may be characterised as the ‘great Australian dream’, this is not the case worldwide. For example, in Germany 60 per cent of properties, or 24 million dwellings, are rented.[27]

Unlike in Australia there is no great advantage to owning a home in Germany. Germany has tenant neutrality, which means that housing subsidisation treats renting and owning as equal. Furthermore, the rental sector in Germany serves the same function as owner-occupied housing in Australia, it provides security of tenure.[28]

Tenants enjoy far greater rights in Germany. For example, the standard lease in Germany is indefinite and a landlord can only break contracts in special circumstances with a notice period that is dependent on how long a tenant has lived there.[29] Additionally, rent cannot be increased by more than 20 per cent over three years.[30]

In addition to more equal renting conditions, the economic incentive to buy a home is not as strong in Germany as in Australia. House prices in Germany are undervalued when considering the price-income ratio and price-rent ratio. Additionally, a large deposit (20 per cent) is required for housing finance, providing an obstacle to home ownership.[31] It is clear that renters in Germany currently enjoy much better conditions than those in Australia.

Although buying a house is the “dream” in Australian culture, the example of Germany shows that housing ownership is not the most important policy goal. Instead, we need policies that ensure housing is secure and affordable whether rented or owned by the occupiers. The issue of housing affordability is complex and there is no silver bullet solution available. However, it is important that government policies are examined to ensure they are helping people access affordable housing rather than preventing them.

Conclusion

Housing affordability issues have changed the makeup of the housing market over the last decade. Not only are fewer households able to break into the housing market but those who do hold onto mortgages for longer. Low and middle income households have been most affected by higher house prices with a reduction in both outright ownership and the number of people who hold mortgages. In contrast, households with higher incomes are holding mortgages for longer but are not experiencing as much difficulty entering the market.

A broad increase in the proportion of people renting during this time has also occurred, with the data indicating that most of this change was among low- and middle-income households. Of particular concern is the increase in renting among older Australians who may face financial difficulty if they continue to rent in retirement. The interaction between lower incomes and renting rates suggests that housing affordability issues are contributing to the rise in the proportion of renters.

The reduction in home ownership and increase in rental rates has the potential to increase inequality between those who own their home and those who do not. Those who own property benefit from price increases while those who do not are priced out of the market and pay higher rent. Increases in rent place a further restriction on aspiring home owners as saving for a deposit becomes more difficult. The income breakdown illustrates that housing affordability is likely increasing the gap between high-income earners and those on low and

[27] Haffner M. E. A (2011) *Secure occupancy in rental housing: A comparative analysis*

[28] Haffner M. E. A (2011)

[29] Kollewe J and Elliot L (2011) *Home sweet home is a rented property for many Germans*

[30] Palmer J (2011) *Brits buy homes, the Germans rent – which of us has got it right?*

[31] Palmer J (2011)

middle incomes. A further concern is that this income disparity will be transferred across generations as those people who cannot afford a home themselves will be unable to assist their children in entering home ownership.

There is a strong income disparity between those who own investment properties and those who do not. Property investment is strongly concentrated in high-income households. This means policies such as negative gearing and capital gains discounts, strongly favour the well off. Since negative gearing increases property prices it reinforces the redistribution of wealth further towards investors and away from those who have not achieved home ownership. Housing inequality is likely to be extended in the coming decade unless the government steps in to address housing policies and the disparity they create.

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