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SUBMISSION TO: Inquiry into First Home Ownership
Productivity Commission
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Home ownership is preferred to renting simply because it gives some sense of security but chiefly because it results in equity for the buyer and equity is becoming more important as a means of providing for aged housing and/or retirement income.

For many people first home ownership is difficult just because of the need for a relatively large first payment just when family pressures are greatest only to become less burdensome as family income increases. In the past governments have attempted to ease the entry into ownership by cash grants. land grant or subsidy and interest rate subsidy. all of which involve some problems.

What I propose is an altered way of managing the mortgage so that in calculating the periodic payment account is taken of the changing level of income over time. This is preferred as it involves no direct intervention in the market place. In the past mortgage payments have been calculated using what I will refer to as the standard method which takes account of interest rate (cost of money which recognises the changing cost of money from time to time). number of payments and amount borrowed but not the changed income of the borrower. I propose an "indexed" method of calculation which involves the above as well as the change (usually an increase) in family income from time to time. This results in a smaller initial payment which changes over time in exact sympathy with the family income.

In what follows unless otherwise stated it will be assumed that the calculation is based on a yearly rate instead of monthly as is usual. that there are 25 yearly payments, that 20% is provided as deposit* that property increases in value at 4% per year and that interest and change in income are as stated; also that the borrower is able to make payments by committing no more than 30% of gross annual income.

It will be seen that with the above assumptions positive equity will result from the first payment.

Assume that borrower A wishes to purchase a home for 53009000 and must barrow $240.000. If interest is 6.5% per annum this will require an annual payment of $199676. If now we allow an annual increase of half of 6.5%. that is 3.25% per annum, the initial payment becomes 514.466 per annum the former requiring an annual income of $6596009 the latter of $489205, The former will stay unchanged as long as interest remains unchanged whilst the latter will increase at 3.25% each year and will become $32181 after 25 years. If instead we allow an annual increase in income of only 2% per annum the initial yearly payment becomes $16687 and becomes 526840 in 25 years,

In all cases equity is acquired from the very first payment with annual rate of increase in equity being greatest in the first case (standard form). less in the third case and less still in the second case always positive so that after 15 years the standard form gives 71% with 70% at 2% per annum indexed to income. All cases will repay the full capital and all interest after about 25 years.

The indexed method makes the loan accessable to a family which would not have sufficient income under the standard form but results in yearly increases about consistent with those resulting from renting the same house. That is the ranter can actually buy the property if the indexed method is used. Of course there are other differences but except for one of these they have have similar effect in standard and indexed forms. The real difference is that income to the lender will be less with indexation for the first years (to about 9 years with 2% indexation) so that either the lender will accept less at first only to receive more in the later years or I would suggest a government agency supplement the early payments and receive the money back in later years. being in the long run income neutral.

It is suggested that indexation be set as low as possible. say at the real rate of increase (as with interest rates) or at one third of the interest rate. The result is buyers being able to buy a property whilst having an initial income which is too little with the standard form but always having positive equity. This would seem to me to benefit the buyer, the building and other allied industries and provide flexability to

the buyer from the first payment to the last and so 100% equity after 25 years when retirement is near.

If as is probable the buyer wishes to sell before the final payment the balance owing would be less the real amount owing; that is less than with the standard form but after about 5 years not much less.