Tuesday, August 26, 2003

Productivity Commission
LB2 Collins Street East
Melbourne, Vic, 3000

Dears Sirs/Madams

Re: Inquiry on First Home Ownership Affordability

The ability of people to buy their first home is affected by, among other things, after-tax incomes, the motivation and ability to save, land values, housing construction costs and financing costs. The Productivity Commission's Inquiry on first home ownership should consider the following areas:

1. Household Incomes
The Commission should examine incomes and employment options for young adults and determine whether any changes have occurred that may have affected their ability to buy their first home. Low growth in full-time employment in Australia and an increase in the casualisation of the workforce may have had adverse effects on the ability of some people to acquire their first home.

2. New Financial Commitments
The extent of financial commitments will affect housing affordability, and the Commission should examine trends to determine if new commitments are adversely affecting home affordability. For example, Higher Education Contribution Scheme debts can reduce the ability to save for a home deposit and to service home loans. The Federal Government is promoting private school education, which may act to increase future commitments for some families.

3. Housing values
The cost of housing relative to income is very high in Australia. A Reserve Bank research paper published in October 2001 found that the ratio of Australia's housing wealth to household income in 1998 was much higher than the ratio recorded in the other advanced countries studied, with the exception of Japan (which had a ratio only marginally higher than Australia's at the time).

Why is housing so expensive in Australia? One reason may be that the population is concentrated in a few large cities - with the attendant high land values. The Commission should examine the impact of urban planning in Australia on housing values and affordability.

Many of our existing cities are enormous, with implications for housing affordability, the environment and social outcomes. Sydney "contains the world's largest area of suburbs - twice the area of Beijing and six times that of Rome" (Encarta Encyclopaedia). Perth "now stretches 170 kilometres north and south of the CBD to make it the largest example of urban sprawl in the country" (Australian Financial Review, page 55, 26 August 2003).

The extent to which governments have focused resources on existing large cities has affected the cost of both land and housing in Australia. Governments could promote and invest in new cities that can attract infrastructure, employers and people. These new cities could be built using environmental and social best practice.

Smaller cities tend to have relatively low housing costs, compared to larger cities. Sydney's housing is the most expensive, followed by Melbourne's and so on. Attractive new cities would encourage people to move from existing cities and could, in the process, help drive down urban land prices nationally. New and well planned cities may also provide economies in land subdivision, housing construction and infrastructure provision.

4. Financiers' Lending Practices

Financiers' credit assessment procedures and lending criteria should be examined to determine the effect on, among other things, housing demand and prices. Lenders' requirements have been relaxed over recent years, including proof of income, debt service ratios, loan to valuation ratios, and property valuations. Home loans have longer terms to maturity and it is now more common for loan expiry dates to span past retirement age and, in some cases, past life expectancy. Financiers also take into account superannuation balances when calculating loan affordability. In many cases, financiers do not now require formal property valuations.

The Commission should consider the effect that the relaxation in lending practices has had on the demand for housing and on prices - and whether these practices are sustainable from the point of view of home affordability in the longer term.

The Commission should also consider whether the information that lenders are required to provide to home borrowers is sufficient. Should prospective borrowers be provided with more information about risks pertaining to their own situation? Examples include the effect on repayments of an interest rate increase of, say, 5 percent; or the effect on the loan to valuation ratio of, say, a 5 percent decline in property values.

5. Financial Institutions Prudential Requirements

The effects of capital adequacy requirements on financial institutions should be examined to determine the effects on the availability and cost of housing loans (which also affects the demand and price of housing). Also, if prudential requirements promote housing investment relative to investment in businesses and other productive assets, this may have an adverse effect on household incomes (and housing affordability) in the years to come.

6. Housing as an Investment
Housing investors can drive up the market price of housing for prospective owner occupiers. The reasons for the high level of investment in investment housing in recent years should be closely examined (including, but not limited to, tax-related reasons). Some reasons may include a perceived lack of alternative profitable investment options, the varying availability and cost of finance for investment alternatives, and inadequate and erroneous information on investment returns and profitability.

Should vendors of properties be required to provide additional information to purchasers who declare that they are investors?

7. The Conduct of Monetary Policy
The Reserve Bank has raised concerns about rising housing prices and growth in housing credit. The Reserve Bank has also raised some concerns about the effect that these developments could have on consumer spending in the years to come and on financial stability.

The Commission should look at the conduct of monetary policy and how this may have contributed to very low household savings and high household debt in Australia - with consequential effects on housing prices and long term housing affordability. Moreover, there are concerns that economic growth has been brought forward by very low real interest rates, which may adversely affect future growth and the ability of borrowers to remain fully employed and earn adequate incomes to repay their loans.

9. Information
The Reserve Bank stated in April 2003 that it had "no detailed information on the distribution of household debt for investment housing". More information needs to be collected to enable a satisfactory analysis of factors driving the housing market as well as on other economic implications. This will also improve policy making.

10. Immigration
The Commission should look into the impact of population growth and immigration on the demand and price of housing.

Yours faithfully

Nigel Fitzpatrick
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