From: stratinf []
Sent: 29 September 2003 8:29
To: housing@pc.gov.au
Subject: Amendment to Submission 7 - Recommendations

Dear Sirs/Madams

Please find an amended copy of submission 7 - my list of recommendations. I apologise for the inconvenience.

There are some small changes to existing recommendations. Also, I have added to Recommendation 13 the following:

"In Australia, most housing loans are extended at short term variable interest rates, with other home loans on fixed rates for a maximum of 10 years (although many lenders only offer periods of up to 5 years). The short term nature of Australian home loan rates means that such rates are very sensitive to changes in monetary policy. In the United States, a 30-year housing loan market makes that market less sensitive to short term interest rates, and therefore less sensitive to changes in monetary policy (compared to Australia). This may mean that monetary policy in the US can be conducted with less concern about unintended consequences in relation to housing prices".

Regards, Nigel Fitzpatrick

September 25, 2003

Productivity Commission
LB2 Collins Street East
Melbourne, Vic, 3000

Dears Sirs/Madams

Re: Inquiry on First Home Ownership Affordability

The following represents my 16 recommendations in relation to the Inquiry.

Yours faithfully

Nigel Fitzpatrick

Recommendations

1. Governments should define more clearly their role and objectives in relation to housing and regional policy. The Federal Government should also expound its role and objectives in relation to household savings.

Such an approach would allow governments to improve the formulation, consistency and transparency of policies. Objectives could cover:

- Obtaining sufficient information to make good decisions about housing and regional policy, and then collecting this information (or requiring other agencies to collect the information on its behalf – refer Recommendation #2).
- Levels of home ownership.
- Levels of affordability (e.g. housing costs as a percentage of household disposable income and by household disposable income after non-housing expenditures - by area and by household characteristics).
- Levels of homelessness.
- Levels, accessibility and suitability of public and community housing, and private rental housing.

- The availability of affordable housing in preferred areas. Governments may not consider it appropriate to have large residential areas of exclusivity and large areas of social disadvantage.
- The contribution of housing and regional policy to community well being and social capital. Some cities in Australia have become very large in area when compared to cities in other advanced countries. It may not always be in the interests of communities and the nation to release land in existing cities (such as in green belts). Moreover, that strategy may represent only be a short term solution (as eventually these areas will run out). Governments may consider it appropriate to create smaller self-sufficient communities, through decentralization incentives and the creation of new smaller cities. Such a strategy may also have a positive effect on home affordability.
- The extent to which domestic savings should finance housing, infrastructure and investment.

2. A specialist Agency, or a funded research centre, could be established and/or used to research, and disseminate information on, the housing sector.

There is currently a lack of information on housing prices, home affordability, housing debts, housing rents and about the long-term investment returns from housing investment. Additional information would assist in policy making in relation to public and community housing and rental assistance. It could also benefit many other areas of housing policy, as well as other policy areas (such as monetary policy, fiscal policy and tax policy).

A new public agency or a suitable research centre, such as the Australian Housing and Urban Research Institute, could collect more information and provide more detailed research on housing markets. Such an organization could also study the effects of housing on the household sector and the wider economy.

There are already government agencies that provide data and research on specific sectors of the economy – including the Australian Institute of Health & Welfare, and the National Centre for Vocational Education Research.

The Department of Family and Community Services already provides some limited housing market information on its web-site.

A new major housing research body, could also become, and be promoted as, an information warehouse for prospective home owners, housing investors and housing renters. Examples of the information that could be disseminated to investors include average prices, rent prices, rental yields, vacancy rates, property expenses, historical rental returns before and after tax (based on various gearing levels). This information could be provided for various market segments (i.e. geographically and by housing type).

3. Government housing and regional policies should be more transparent.

Each specific government housing policy measure should include specific and detailed cost-benefit analysis, which should be made public. For example, the Federal Government should determine the effects of the first home buyer grant on housing prices and rental prices. If such a government housing subsidy just fuels a compensating housing price increase, the subsidy could have an overall negative effect on affordability for first home and other buyers and renters.

4. The role and objectives of monetary policy should be more clearly defined and more transparent.

There is currently a great deal of confusion about the RBA's role in respect of asset prices, household savings, welfare and long term economic outcomes. The Federal Finance Minster, Senator Nick Minchin, told ABC Radio that "it's not the role of the Reserve Bank to use interest rate policy to clobber a growth in the prices of a particular asset class, in this case, housing. The role of the Reserve Bank is to control overall inflation".

There is one clear consistent factor causing housing prices to rise in most advanced countries: low real interest rates.

The Deputy Governor of the Reserve Bank, Glenn Stevens, said in October 2001 that "monetary policy works, after all, in changing financial prices". Monetary policy uses interest rates to affect asset prices and savings incentives and, through these transmitters, economic activity and consumer prices. Monetary policy does not directly affect the economy.

Yet, the Chief Economist of the ANZ Bank, Saul Eslake, believes that the RBA has "no mandate from the government to target asset prices inflation" (AFR Opinion July 30, 2003). So, while monetary policy is an integral factor in pricing assets, it would have no responsibility for such prices. That is akin to saying a marketing executive has an influence on sales, but no responsibility for sales outcomes. If Eslake is right, he has highlighted a bad policy.

But a major issue facing the RBA at the moment is a debt-ridden household sector. If Australians continue to have little incentive to save, where will that leave our economy in the years to come?

The RBA should also explain more fully monetary policy's time horizon and welfare objectives. "Normal interest rates" should be defined. The RBA should also better explain the interaction between monetary policy and the RBA's financial stability objective.

5. The Reserve Bank needs to collect more information about the distribution of household debts and household incomes and expenditures.

The RBA has stated that it has no detailed information on the distribution of housing investor debt. The RBA needs more information on the distribution of household debt in order to understand the state of the housing asset/debt markets and to understand the effects of policy.

It is possible that after the RBA lost its role as prudential regulator of the deposit taking institutions, it may have also lost some ability to act quickly to obtain relevant information from lenders. If so, recommendation #6 may assist the RBA.

6. The Council of Australian Regulators (CAR) should have its own staff and conduct its own research, independently of the RBA, APRA and ASIC.

CAR does not currently have its own staff; with support provided by RBA offices. The Council only aims to meet quarterly. While there are cooperation agreements between the members of CAR, the writer believes it is important that one agency is responsible for adequate coordination of policy and for promoting information flows. CAR could also look more closely for any inconsistencies that may exist in the approach of its members.

7. The Australian Tax Department (ATO) should increase auditing activity of housing investors.

To the extent that housing investors are able to avoid or evade income tax through housing investment, this would tend to have an upward effect on prices that some investors will be prepared to pay for housing property. Tax audits should seek to, among other things, identify investors who are not declaring rental income, who are receiving less than market rents (e.g. by renting to family members), or who are falsely claiming a deduction of private expenses (such as attributing home renovation or repair expenses against rental property).

8. The ATO's tax return may also be able to collect more information and earlier information in relation to housing investment.

Purchase prices and debt levels could be sought in a tax return in the tax year in which an acquisition is made. The ATO could then provide better consolidated and segmented data on investment activity, which may provide data pertinent to its own revenue raising efforts. Such information could also be of use to other agencies.

9. Foreign investment rules in relation to housing should be reconsidered.

Consideration needs to be given to the costs and benefits of allowing foreigners to acquire Australian residential property.

10. Prudential capital adequacy rules for deposit taking institutions need to be closely evaluated for the affect on housing prices, housing affordability (in the long term) and financial stability.

There is a 50% weighting for most loans secured by residential housing, so that a lender only needs half the capital to lend against this security compared to a loan secured by most other types of security (e.g. commercial property or plant and equipment).

Moreover, it is proposed that the capital weighting for loans secured by residential real estate will fall further under BASLE II. The RBA has stated that loans for housing investment are riskier than loans for housing occupation, yet this does not appear to be reflected in capital weightings.

11. Parliament should consider the appropriateness of the level of resources available to Australian Prudential Regulation Authority (APRA).

Concerns have been expressed about inappropriate lending for housing. There have also been some concerns expressed about the effects on the stability of the financial system in the event of a significant fall in housing prices. APRA has required financial institutions to conduct stress tests to determine the effect that a housing correction would have on their balance sheets.

But greater scrutiny of APRA is urgently required.

An Inquiry into Banking Supervision was called in 2001 by the House of Representatives Standing Committee on Economics, Finance and Public Administration with some fan fair (e.g. advertising in national newspapers). The Inquiry received submissions, some of which expressed concerns about the practices of, and resources available to, APRA. However, the Inquiry was abandoned.

If it was considered to be appropriate to conduct an inquiry into banking supervision in 2001, it is more appropriate now.

12. Housing investment advice should come under the similar regime as other investment advice and come under ASIC's umbrella.

It is apparent that there are questionable practices occurring among some property investment advisers and that this is potentially a factor driving investment demand and pushing up housing prices. It is also reportedly having an adverse effect on the financial wellbeing of some investors. Some concerns have also been expressed about effects on the wider economy.

13. Consideration should be given to the development of long-term bond and housing interest rate markets.

The availability of fixed interest rates for a period that more closely matches loan maturities may promote a less volatile housing market and may provide prospective home owners with greater certainty about loan commitments. Such a market would also help in determining home affordability in the longer term.

In Australia, most housing loans are extended at short term variable interest rates, with other home loans on fixed rates for a maximum of 10 years (although many lenders only offer periods of up to 5 years). The short term nature of Australian home loan rates means that such rates are very sensitive to changes in monetary policy. In the United States, a 30-year housing loan market makes that market less sensitive to short term interest rates, and therefore less sensitive to changes in monetary policy (compared to Australia). This may mean that monetary policy in the US can be conducted with less concern about unintended consequences in relation to housing prices

14. Credit laws need to be examined and strengthened where appropriate.

More information needs to be provided to borrowers, including on:

- The effect of changes in interest rates on repayments, more particularly following the expiration of "honeymoon" interest rate periods. Borrowers should be made fully aware that variable interest rates can potentially fluctuate significantly.
- Where loan terms span retirement age, borrowers should be made fully aware that they may find it difficult to meet scheduled repayments after retirement age and after being made redundant by an employer.
- The risks to borrowers from unemployment, underemployment, incapacity or a fall in property prices. Investors should also be made aware of risks associated with tenant vacancies and a fall in rental prices.
- The effect on borrowers if they default in making scheduled repayments should be made abundantly clear.
- Lenders should make it very clear to borrowers that set-off deposit accounts can be applied against loan balances at the discretion of the lender (this is usually in the fine print of contracts).

15. Vendors of investment property should be required to provide additional information to prospective purchasers. This could include historical information on rental receipts and outgoings and any actions against a tenant.

Similar information is already required to be provided in small business conveyances.

16. Policy makers should look more closely into the wider implications of growth in securitization of mortgages.

Implications include promoting foreign borrowings to fund local housing, and loss of control by prudential regulators over lending. APRA should ensure that, where financial institutions securitize and sell loans to get them off balance sheet, there is no recourse back to the financial institution. APRA should also ensure that these transactions do not involve “cherry picking” where the better credits are sold (with lower quality credits remaining on balance sheet).

Nigel Fitzpatrick