On the Determinants of Trends in Urban Housing Prices

By A R Hall

The rapid rise in housing values in Australian cities in recent years has provoked considerable discussion about the reasons for them. The Reserve Bank has participated in the form of speeches by the Governor and Deputy Governor and by articles in the Reserve Bank *Bulletin.* The principal proximate cause for these rises is taken to be the change from a regime of high nominal interest rates to one of relatively low ones. Rises in real incomes, a strongly competitive housing finance market, increases in the affordability of housing, and access to increased equity in house values through housing loans have also been judged important. During the current year disquiet has emerged about accessibility to the market by intending first home owners.

While large increases in house prices have occurred in preferred areas throughout the nation it is the capital cities which are the real 'engines of growth' increasing house prices, in particular, Sydney and Melbourne. Partly because of familiarity with Sydney, partly because it appears to have set the pace in recent years, and partly because of time constraints, this note is limited to the Sydney scene. It is, nevertheless, believed that its experience is of more than purely local significance.

Some characteristics of Sydney's house price structure

There are a number of alternative statistical series on house prices whose timing and rates of change are not always identical. For present purposes that most appropriate is the Real Estate Institute's Market Facts series of median prices and the re-arrangement of them by post codes by the firm Residex. While the most over-heated section of the market appears to be that of high rise units in the inner cities of both Sydney and Melbourne statistical data on this particular sector is not readily available. Of the data which are available the greatest evidence of price over-heating is in the market for houses rather than units. It has been assumed here that it is the experience of prices of preferred inner city house locations that probably triggers rapid increases in city-wide price increases. Whether this is so or not the distinctly higher rates of increase in house prices justify the concentration here on house prices.

In order to test the robustness of the Sydney median house and unit price series their individual post code prices were assembled into frequency distributions both of their prices and of their decennial average price growth rates for the year ending December 2002. All proved to be more or less normal with the great bulk of their observations centred around their median values. The set with the most unbalanced dispersion was house prices which had a disproportionate number of post codes with median values greater than $900,000.

One must still have reservations about a single price supposedly representative of such a heterogeneous group as a large stock of houses. The firm Residex has developed median house price series for sixteen sub-regions of Sydney. One possible way to give a little

more body to the measurement of Sydney's house prices is to use these data to develop a weighted average median price in which the weights are the number of sales in these regions. The results of this calculation for the December 2002 and the June 2003 quarters are $506,000 and $527,000 respectively. The comparable unweighted Residex prices are $445,000 and $470,000. These differences suggest that the simple median understates the relative weight, in the region as a whole, of prices lying somewhat above the middle of the frequency distribution. Both price series can be expected to move more or less together but variations in their rate of movement might be informative.

Any single median price for housing is unsatisfactory. Measurement of house prices in summary form would be considerably improved if the compilers of the statistics would be prepared not merely to locate the median price but, in addition, to select and report the 10^{th}, 25^{th}, 75^{th}, and 90^{th} percentile prices. This information would fill out the city's house price profile and, over time, changes in it would help to interpret trends in the market.

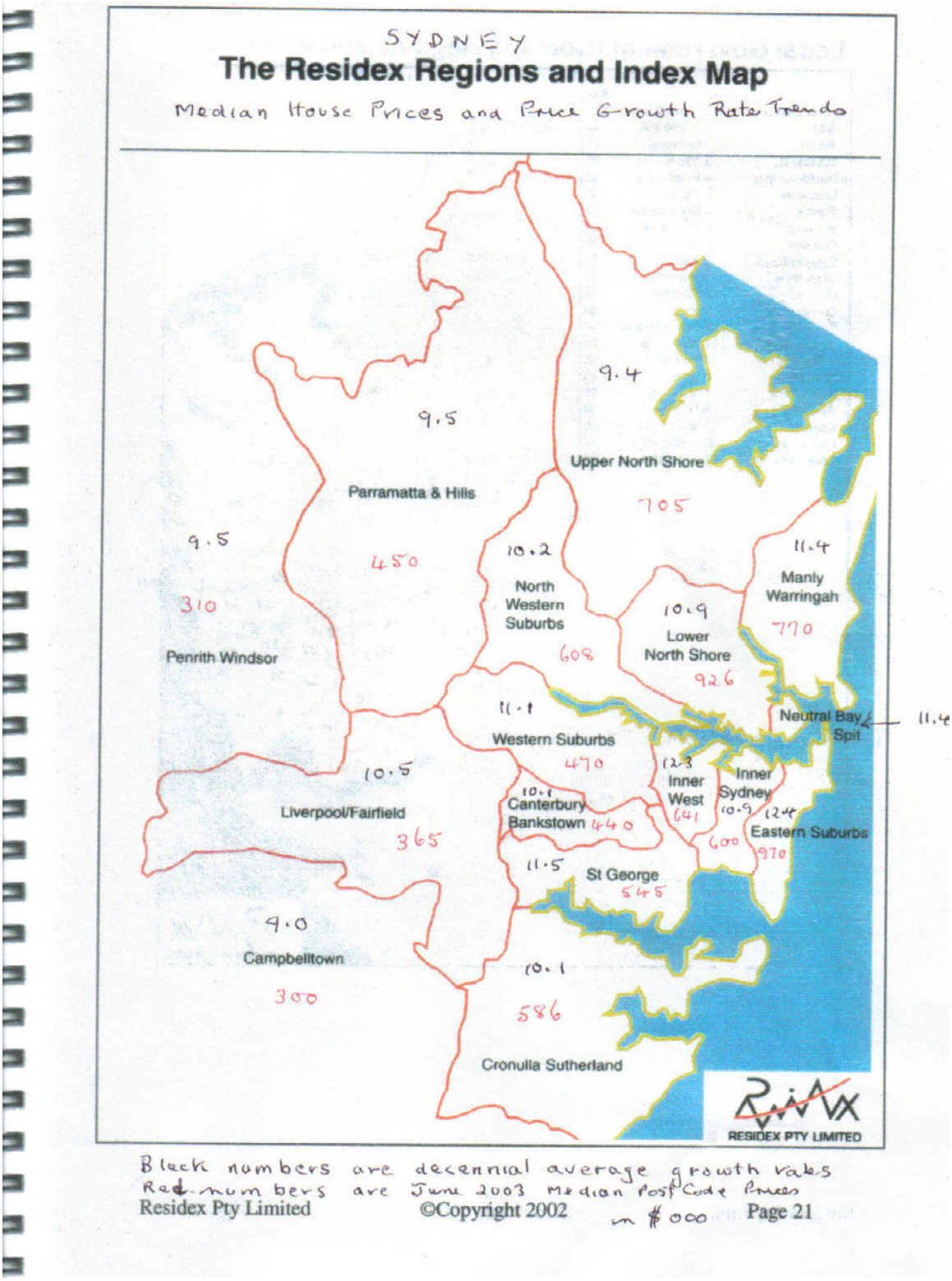
A rough approximation for this information can be obtained from the available sets of median post code prices and decennial rates of price increase when ordered as frequency distributions (Table 1). From what has been noted above, the levels of all these

Table 1
Houses and Units 2002
Selected points on the price level and price increase post code frequency distributions

Selected Points	Houses		Units	
	Price	Decennial Price Increase	Price	Decennial Price Increase
	$000	% p.a.	$000	% p.a.
10%	290	8.4	227	5.4
25%	387	9.0	275	6.1
Median	519	9.8	357	6.9
75%	711	11.4	406	8.0
90%	942	12.1	469	9.0

observations are higher than the similar points that would be obtained from the much larger sets of actual individual house and unit prices and rates of price increase. The actual dispersion of Sydney house prices is obviously considerably greater than that of the post code medians.

An important characteristic of urban house price structures can best be illustrated by reference to a map. The most useful for present purposes is that of Residex which defines Sydney's house price sub-regions (Figure 1). On it have been recorded their respective decennial rates of price increase ending in June 2003 and their median prices at that time.



Both have a rising trend towards the coast. This reflects topography, past history, transport cost differentials and locational preferences. The pattern of the pace of change is best captured by the rates of price increase. The steepness of the price gradient that has emerged over time is recorded in the median prices. The important point is not so much

the slopes of these data but the fact that the whole price surface has been shifting upwards significantly faster than the rate of inflation, and has been doing so for a long time. While the selection of a map with a small number of sub-regions makes 'the big picture' clear it does so at the cost of concealing the great complexity of the short term movement of this price surface which makes it particularly difficult to determine the currently emerging rate of change for the city as a whole.

Apart from the recent high rate of growth of house prices, Table1 and Figure1 jointly illustrate another feature of Sydney's house price structure. It has a widespread dispersion of growth rates both absolutely and geographically. Inherent in these facts is a still greater dispersion of individual house prices. Inflation, building costs, and interest rates are broadly comparable throughout the city region. Therefore the primary reasons for the house price dispersion are the quantity/quality of the buildings and the land values upon which they are located. There is normally a limit to the amount one wishes to spend on a building. With continuing city population growth, inflation, and rising real incomes there is virtually no limit to the value of the land on which it is built. The greatest contributor to Sydney's rising house prices is the unearned increment to the value of the land upon which its houses are built.

Urban land prices – some specific examples

While this section is designed to point up the role played by rising land values it also attempts to illustrate the importance of decomposing the recent rises in urban property values into their main components: inflation, interest rates, quantity/quality improvements and land values. The exercise is of a descriptive rather than analytical character and starts with a couple of specific instances whose facts are known.

The first specific example is that of a house on the edge of a cliff at south Coogee one of whose boundaries is 'the high water mark the Pacific Ocean' – a perfect example of the real estate agents' chant "location, location, location". At the time of its purchase in mid-1983 the house was a small two-bedroom , cavity-wall brick house which had been unoccupied for seven years and, in consequence, was in need of long overdue maintenance. The sale price was $171,000. The then reported official land value was $110,000 – a valuation made in 1981 as at mid-1980. A subsequent official land valuation, made in 1985, but as at mid 1983, was $130,000. In relation to the actual sale price of the joint house and land in 1983 the latter is a reasonably accurate determination of the then market value of the land. Over the next few years the size and quality of the house was considerably improved by a variety of expenditures. By mid 1987 these had amounted to about $70,000 so that the historic cost of the then house had become some $240,000. If the expenditures from 1983 to 1987 are adjusted by the CPI price levels at which they occurred the final cost of the house and land in 1987, at 1987 prices, becomes $305,000. The house was sold at auction in mid 2001 for $1,620,000. There were no further alterations to the house from 1987 to 2001. It remained well maintained.

Into what components can the price change between 1987 and 2001 be broken down? In the Table 2 the unadjusted Consumer Price Index (CPI) has been used to estimate the

rate of inflation and hence the change at constant prices. The interest rate change is measured on the assumption that the interest rate in 2001 was that prevailing in 1987 and by using that assumed rate to revalue land and building as at 1987 to 2001 interest rates. The percentage changes in all these items were then converted into annual average rates of change. The residual after these calculations (Row 5) is the rate of change in constant prices of the value of land and building together with any errors and omissions in the prior calculations. Obviously too much weight cannot be given to the components estimated in this fashion but the results are plausible and can reasonably be taken as indicators of their relative orders of magnitude. This comment applies equally to the subsequent calculations made along similar lines.

Table 2
Annual average rates of change in components of one house price 1987-2001

	% p. a.
1. Increase in price at current prices	12.5
2. Inflation (CPI) rate	3.5
3. Increase at constant (2001) prices [1]	8.8
4. Increase arising from the decline in interest rates	4.3
5. Increase in building/site value at constant prices (3-4)	4.5

An alternative way of analyzing the changes in the land value of this property is possible because, in due course, the purchaser proceeded to knock it down. In effect he judged the land value to be $1,620,000, land which he considered deserved a building in conformity with this value. There thus exist accurate land valuations for 1983 and 2001.

Table 3
Annual average rates of change in land value 1983-2001

	% p. a.
1. Increase in land price at current prices	15.1
2. Inflation (CPI) rate	4.3
3. Increase at constant (2001) prices [2]	10.3
4. Increase arising from decline in interest rates	3.8
5. Increase in pure site value (3-4) at constant prices	6.5

If the house had continued to remain in use (as was intended by the under-bidder at $1,610,000) the sale would have included a quantity/quality of building component in the real price change. If, as would seem reasonable, the relative contribution of the renovations were taken to be in proportion to the expenditure on them to the total value on completion (all items valued at 1987 prices) then the 6.5% per annum increase at constant prices of item 5 in Table 3 would have consisted of a 1.7 % per annum increase arising from the change in building quantity/quality and 4.8% per annum increase in pure site value.

[1] Items 2 and 3 do not add to 1 because of rounding in growth rate estimates.
[2] Items 2 and 3 do not add to 1 because of rounding in growth rate estimates.

A few kilometres south of the first specific example, on the edge of a ridge overlooking Maroubra valley, with the north end within walking distance of Maroubra Beach and the south end a similar distance from Malabar Beach, is a string of 19 blocks of units containing some 330 units. The units range in size from one to three bedrooms, the majority being two bed rooms. The blocks are of much the same vintage and, partly judged from externals, are well maintained. In any one year the median sale price is likely to be a two bedroom unit and the median sales from year to year should be of roughly comparable quality. Records are available for purchases back to 1974 but until the mid 1980s there are not enough instances to accept the median price as representative. Table 4 makes a set of similar calculations to those in the previous tables for the years from 1987 to 2001 and 2002.

Table 4

Annual average rates of change of unit prices 1987-2002

	% p. a.	
	1987-2001	**1987-2002**
1. Increase in unit price at current prices	11.6	12.3
2. Inflation (CPI) rate	3.5	3.5
3. Increase at constant (2001) prices [3]	7.9	8.6
4. Increase arising from decline in interest rates	4.3	4.3
5. Increase in building/site value (3-4) at constant prices	3.6	4.3

As there was no appreciable change in the buildings over this period the increases in item 5 of Table 3 may reasonably be taken as increases in land value alone. In which case it is apparent that much of the high rate of increase in pure land value illustrated in Table 2, and the comment on it, reflects the presence of a high demand for urban land well beyond that particular land's prestige position.

The Maroubra post code prices provide a convenient way of putting the South Maroubra sample of units into a wider context. Its December quarter 2002 price increase for units was 11.5%. Its decennial annual average increase was 10.1%. These numbers are not directly comparable with those in Table 4 because of the differences in time periods but their rough similarity suggests that comparable analysis would be appropriate for the Maroubra post code median rate of change. Table 5 performs that task.

[3] Items 2 and 3 do not add to 1 because of rounding in growth rate estimates.

Table 5
Maroubra post code median unit prices
Components of their annual average rates of change
1992 to 2002

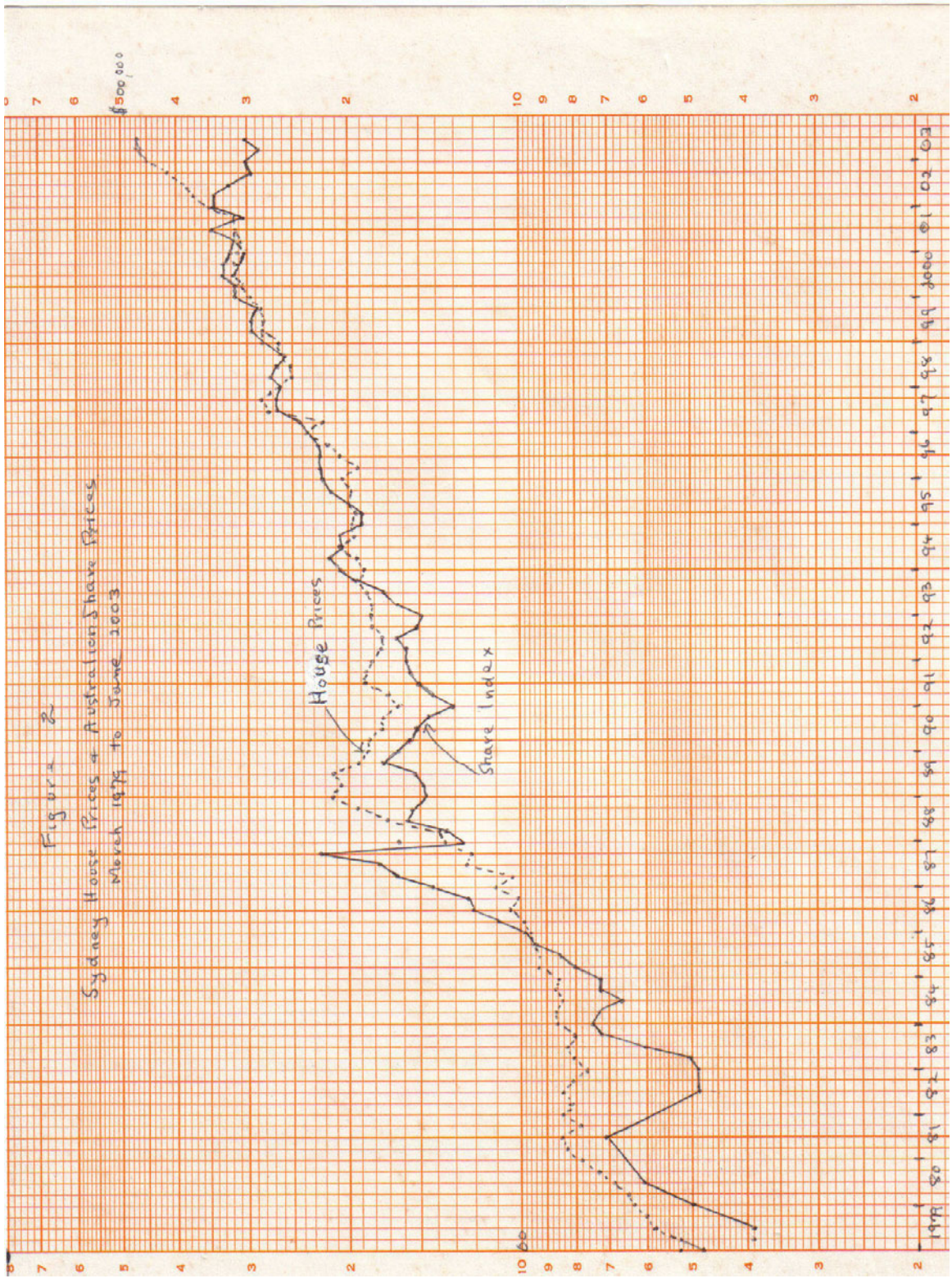
	% p. a.
1. Increase in unit price at current prices	10.1
2. Inflation (CPI) rate	2.5
3. Increase at constant (2002) prices	7.6
4. Increase arising from decline in interest rates	4.8
5. Increase in building/site value (3-4) at constant prices	2.8

Trends in Sydney house prices

It is now time to revert to the larger picture It will be convenient to place the current situation in its historical context. Figure 2 (page 8) plots Sydney median house prices and Australian share prices from 1979 to 2003. The series have been plotted on a semi-log scale so that the slopes of the data reflect their rates of growth. The distinct change in trends at the end of the 1980s is primarily the result of the shift from the high rates of inflation over the two decades ending then to the low rates of inflation that were re-established during the 1990s.

The two series have been presented together to illustrate their interdependence. That they exhibit basically the same long term trends confirms that both these types of property market are segments of a single capital market. Returns in the two markets do not diverge from each other for very long. But they do diverge for a year or two. In the early 1980s the divergence took the form of rough house price stability while shares experienced a sharp decline. Phase inversity is more interesting during the next two occasions, in the late 1980s and during 2002. In these instances falling share prices and strongly rising house prices encouraged investors and speculators to switch markets. In doing so reasonable house price growth was converted into unsustainable ‘bubbles’. During 2003 there have been increasing signs of a reversal of this process. A slackening in the growth of house prices has more or less coincided with a recovery of share prices. Some segments of the latter market have already yielded speculative gains well in excess of those now available in housing.

If one sets aside the last year or so of the period the trend rate of increase in house prices was 7.5% per annum. The trend rate of inflation over the same period was 4.1 % so that the trend increase at constant prices was 3.4 %. As the trend increase over most of this period in real earnings was only of the order of 2% per annum it is clear that the trend constant price increase includes the effects of an increased ability to bid up house prices arising from the effects of falling interest rates on reducing the costs of servicing housing loans.



If it is accepted, as a working hypothesis, that this trend has continued and will continue to do so until December 2003 then at that date the Sydney post code median house price would be $440,000. The actual realized price will probably be between $480,000 and

$490,000. The Sydney house price level is currently excessive but probably only by about 10%. The implications of this judgment will be considered further below.

When the pattern of change in house prices reported in Figure 2 is compared with the associated changes in interest rates the following story emerges. During the late 1980s house prices rose vigorously despite interest rates rising to very high levels in both nominal and real terms. Inflationary expectations and 'animal spirits' dominated the scene. House prices remained at a high level during the first half of 1989 and then began to fall under the combined influence of very high interest rates and declining house price-increase expectations. The decline in house prices continued until late 1990 at which point prices began to rise gently until mid 1994. Depressed economic conditions over most of this period prevailed over the large fall in interest rates from 17% in March 1990 to the 8.75% that lasted for almost a year from October 1993. Rates rose from September 1994 to 10.5% in the following December at which point they remained until June 1996. House prices stagnated while interest rates remained at this level but responded quickly to the then downward trend in interest rates which bottomed at 6.5% in the first half of 1999. The rise in interest rates which began in July 1999 and which peaked between August 2000 and early 2001 was again accompanied by price stability during 2000 and early 2001. The interest rate fall to a low of 6.05% in December 2001 was the prelude to the final burst of very rapid price increase to the end of 2002. During this phase there was a slight rise in interest rates to 6.55% in June 2002 at which level they have since remained.

It is useful to contrast this account of the short term responses of house prices to changes in interest rates with an analysis of medium term trends in house prices relative to the theoretically expected changes in house prices arising simply as a result of interest rate changes. . This is attempted in Table 6. In this context the term interest rates is to be

Table 6
Trends in Sydney House Prices

Annual Average Percentage Changes

	1990-1996	1996-2001	2001-2003
House prices	2.8	8.7	21.6
Less Inflation	2.6	2.2	2.8
At constant prices	0.2	6.5	18.8
Less Interest rates	9.2	7.6	1.9
Residual	-9.0	-1.1	16.9

interpreted as the potential rates of change in house prices that would have occurred over the selected periods if the end period prices had fully adjusted to the periods' changes in interest rates. It is thus an hypothetical measure. The table fully confirms one fact evident in the previous paragraph namely that there are long lags in the full response of house prices to interest rate changes. Over the period 1990 to 1996 adverse economic

conditions dominated over the potential effect of lower interest rates to raise house prices. Between 1996 and 2001 the continued trend decline in interest rates was more or less fully reflected in the rise in house prices. The numbers nevertheless suggest, for what they are worth, that there was still some unexploited leverage over house prices in 2001 from prior falls in interest rates. A variety of easy financial conditions and the trigger of the effective halving of the rate of capital gains tax meant that more than full advantage was taken of this situation during 2002.

The general impression which can be deduced from most recent public comment on the state of the housing market is that it remains considerably over-heated. This is probably largely a confusion between high levels and high growth rates of prices. As was observed above, and as has been noted elsewhere, growth rates slackened markedly in the first half of 2003 and now (October) are probably growing more slowly. How soft the landing will be from price levels which are too high in relation to trend will depend on the declining rate of growth continuing, and then stabilizing for a year or two. Whether future events will allow the luxury of this time path is unlikely as the return to sustainable price levels is likely to be accelerated by rising interest rates. The Australian Prudential Regulation Authority has estimated (*Sydney Morning Herald* 10.10.03) that the bank sector could easily withstand a 30% fall in home prices. The last time that occurred was in the severe recession we had to have in which even banks did not fare well.

Much of the previous discussion has focused on the role played by changes in interest rates in shaping changes in house prices. As is well known the 'bubble' phase of the recent past depended greatly on the ease with which finance for housing was then being provided. Comment on this seeming policy failure will be made below. Here it needs to be noted that at least as late as June 2003 bank finance for housing was growing at over 20% per annum at a time when the growth rate of housing prices was falling. This may reflect a difference between Sydney and Australian conditions but this is unlikely. As much of bank new lending for housing is now re-financing much of the apparent lending for housing may in fact being used for consumption or for investment in other than housing. An interest rate increase now appears to be needed to calm down spending on more than housing.

Some major general policy issues

Banks and house prices

The occasion for the Productivity Commission inquiry into first home ownership was a decline in house affordability as a result of rapid price increases well in excess of growth in nominal incomes. This had the inevitable effect of producing a decline in the number of first home owners (henceforth FHOs) seeking housing finance. It follows that one way of assisting FHOs is to prevent the recurrence of similar phases of excessive rises in house prices. Any such phases depend upon the ready availability of finance. Excessive supplies of finance are amongst the areas of authority of the Reserve Bank. This is particularly so when it is trading banks which are amongst those lending too freely.

The Reserve Bank began publicly to draw attention to rising house prices in its May 2002 'Statement on Monetary Policy' and has done so on a number of occasions since then. It has devoted particular attention to the rise of investor finance for housing and to a perceived growing imbalance between the supply and demand for rental accommodation, especially in the construction of units in inner city areas. Its mere watching brief has apparently recently been condoned by a group of experts whose consensus view appears to have been that it is inappropriate for central bankers to take specific action against 'asset price bubbles'.

If the Reserve bank were contemplating an increase in interest rates to curb our recent house price bubble, and it probably was, then there are good reasons why it took no such action. General price inflation was not out of hand and there has been considerable uncertainty about current and future trends in aggregate economic activity. The economic control problems arising from an excessive rise in house prices were potential rather than actual.

But there were, and still are, potential management problems inherent in excessive asset prices. As just noted they may inhibit the appropriate timing of future uses of the interest rate weapon when it is really required. Another concern is the lack of equity in a situation in which less well off members of the community are prevented from exercising their housing preferences because of speculative behaviour of the well-to-do. Moreover the interest rate tool, and preaching to the unwilling, are not the only weapons in the Reserve Bank armoury. There was a time, well within living memory, when Australia's central bank would have told the banks in no uncertain terms to place quantitative limits on their lending for specific purposes. This may not be ideal practice and needs to be used sparingly but it is better than allowing bankers freely to succumb to the moral hazard of simply lending for the sake of profits when they have no responsibility for tidying up the subsequent mess. Truly competitive Australian bankers, in times without benefit of central bank protection, did better than this. The current economic philosophy that financial markets know best, when it is clear that what they are doing is only best, if at all, for well paid market participants is not one that the Reserve Bank should abjectly follow.

Given that housing price bubbles emerge as accelerations of the rate of change in 'normal' house prices the higher this rate is the greater is the probability that it will get out of hand. There are thus grounds for suggesting that the Reserve Bank should review the rate parameters of its existing inflation policy. At present the range is from 2% to 3%. Even though this objective has now been realized for a considerable time consumers' inflation expectations are usually significantly above this at 4% plus. This combination of inflation rates, growth rates of real incomes, and of unjustified expectations, together with rising land values, is likely to create beliefs that the normal rate of house price appreciation is of the order of 7%. If this expectation is not realized for a few years then an expectation of a recovery-to-trend only needs a mild stimulus from animal spirits to feed upon itself. Outbreaks of house price bubbles are likely to be endemic in an economic system based around the current inflation objective. The time between such events, which are apparently believed to be difficult for central banks to control, could be

significantly increased if the whole price increase structure were built around an inflation range objective of nil to 2% which, if achieved, would mean a realized average of 1%. Fears of deflation in this situation are probably exaggerated and show little confidence in the broadly efficient operations of market economies in real terms.

One other feature of the banks' present behaviour is the extent to which their excessive funding of the house property boom has relied on borrowing from abroad. The Reserve Bank notes their reliance on overseas funds in its *Annual Report 2003* but sees no serious dangers in the present situation. That judgment may well be correct but economic historians, who remember the seriously adverse consequences of the Australian banks' borrowings abroad in the speculative phase of Australia's late 19th century economic development, will not be quite so sanguine. There are always risks in funding non-traded goods investment with other than domestic savings.

Population growth and housing prices

The recent rapid growth of Sydney house prices has stimulated debate on the role of net immigration in contributing to these increases. Much of the debate has been special pleading and significantly misdirected. There can be no doubt that immigration increase of the order of less than half a per cent per annum cannot cause a house price boom of more than 20%.[4] Equally, neither can total population increase of a little over 1% do so. The inability of the Australian Bureau of Statistic to count the population of Australia accurately hasn't helped the discussion.[5]

At the same time there can be no doubt that positive population growth at relatively small growth rates, whatever their natural increase/net immigration composition, will exert an upward influence on house prices whenever there are constraints on the supply of land for housing. This has been the case in Sydney for a long time and has recently become the case in Melbourne.[6] Even without this constraint if the population increase is accommodated by an ever wider population dispersion the combined effects of differential transport costs and inner city location preferences will result in the population increase contributing to an increase in the city house price surface (see Figure 1) not to mention the city's infrastructure costs. Similarly the housing of additional population in the form of increasing housing densities in the inner city or around transport nodes raises neighbouring land prices. It is the role of population increase in causing small bubbles across its house price surface' and their tendency to ripple outwards, that has most effect in helping to generate significant changes in the city's price level.

In the Sydney setting the facts that population growth continues at more than 1% per annum and that nearly half of this increase derives from immigration is sufficient to support Bob Carr's repeated claim that Sydney is the chief sufferer from current levels of

[4] B Birrell and E Healy 'Migration and the housing affordability crisis' *People and Place* Vol. 11 No. 3, 2003 pp.43-56

[5] P McDonald et al 'Alternative net migration estimates for Australia: exploding the myth of a rapid increase in numbers' *People and Place,* vol. 11 No. 3 2003, pp. 23-36

[6] B Birrell and E Healy, op. cit. pp.53-4

the Commonwealth Government's immigration program. When the population effect is magnified in the manner just described then that immigration policy is a not unimportant reason why the Commonwealth should make a positive response to the problem of housing affordability. Easing back on immigration is clearly one such option.

Some specific first home owner policy issues

As the Commission's Issues Paper makes clear there is a wide range of ways in which alterations to existing policies could be of assistance to FHOs. This section is confined to only one set of them. It may only be preaching to the converted but this sermon is rarely presented with the fervour that it deserves.

The community's apparent preference for home ownership has been greatly influenced by a whole range of policies which have made renting a distinctly uneconomic proposition. Politicians pandering to a perceived majority preference and bureaucrats' home ownership self interest have created a playing field for owners and renters that is anything but level.

Since the introduction of income taxation more than a century ago the tax system has been biased in favour of home ownership by the exclusion from income subject to taxation that income which takes the form of the housing services provided by an owner - occupied dwelling. For considerable time eligibility for receipt of an age pension has been based on completely inappropriate assumptions about the values of owned homes. At the moment the assets criterion for eligibility for an age pension values an owned home is set at $108,000. This means that the owner of a home worth more than $1,000,000, who is asset rich, but only slightly income poor, can be eligible for some amount of age pension and its other benefits. On the introduction of capital gains tax in the mid 1980s owner occupied homes were excluded from liability for it. Is it any wonder that people prefer home ownership?

If houses were purchased on a market place with a level playing field for both owners and renters, and if the income necessary for the operations of government were obtained through means other than income tax, then renters and owners would be economically indifferent to home ownership. They could either save and invest in order to help pay rent or save and invest in a home. The investment risks between houses and other forms of investment would differ but this would be reflected in their relative yields. In other respects the returns on investment in either category would be equal.

If income taxation exists then for the housing market to remain level the income derived from home ownership, equivalent to its rental capacity, needs to be included in the measurement of income for the determination of taxable income. Otherwise, as at present in Australia, income earned to pay rent is taxed while equivalent income from home ownership is not. Renters ability to save for any purpose is reduced relative to that of home owners. For any given level of total income renters are disadvantaged. Given that the average renter is likely to be poorer than the average home owner the inequity in the treatment of the former is further increased. In addition there is an undue bias in favour of

investment in housing. Restoration of equity and efficiency, under the condition of no net increase in total income tax, would mean a lower level of *rates* of income tax for all and a consequential increase in the ability of renters to save.

The same inequity, and perhaps even greater investment market inefficiencies, arise from the immunity of home owners to capital gains tax on the sale of their homes. Investment in assets other than home ownership is liable to capital gains tax. Capital gains on homes, most of which are in cities, are currently virtually universal, mainly unearned, frequently large, and used as stepping stones for the purchase of ever more expensive dwellings, are not. The facts that they are not reaped by non-home owners, are not taxed in this form, and are accessible more than proportionately in relation to existing wealth, make their exclusion from taxation particularly inequitable and wasteful of real resources. This bias in the tax structure is a significant element in the increasing inequality of wealth which is having increasingly corrosive effects on the community's perceptions of the fairness of the economic system. All aspects of the subsidies in favour of home ownership are overdue for re-examination of their equity and economic inefficiencies.

Conclusion

The occasion for the setting up of an inquiry into first home ownership was an excessive increase in house prices relative to the growth of nominal incomes. This rate of growth of house prices has slackened and will continue to do so. It will probably be transformed into a period of stable then falling prices especially when interest rates rise in the relatively near future. To this extent the problems of FHOs are already in the course of partial solution.

On the other hand the dynamics of urban house price formation are such that large capital gains are generated for existing home owners. They are largely unearned, arise in a manner which is highly inequitable, and are fostered by the tax system. Unless this situation is recognized, and is at least partially remedied, the difficulties of FHOs will certainly persist and probably intensify. In general FHOs are amongst the less well off members of the community.

The 'problem' facing FHOs is a permanent one. There will always be a proportion of the population who are potential FHOs. If they are to be given assistance it needs to be of an enduring character. The First Home Owners Grant scheme is an ad hoc hand out which does not directly encourage increased saving and may even reduce it. What FHOs really need is assistance to develop savings habits, both to build up a suitable deposit and to establish the consumption/saving behaviour necessary to manage debt repayment without undue difficulty. Some form of subsidy for savings in a form over which individuals have direct control, and which gives them continuing encouragement to establish savings habits, must be the preferred form of long term assistance for FHOs. As a means of countering the community's current love affair with debt the need to strengthening savings habits has much wider significance than mere assistance to FHOs.

The ability to save of FHOs, and of that proportion of the community which needs or prefers rental accommodation, would, and should, be assisted by removing the income tax inequities they currently suffer relative to home owners. So too should home owners be deprived of immunity from capital gains tax on their homes. This is inequitable, inefficient, wasteful of resources, and contributes to the unnecessarily high prices for housing that FHOs now have to pay.