Housing finance in Australia

Presentation to
Bank for International Settlements Markets Committee

Saul Eslake
Chief Economist
ANZ

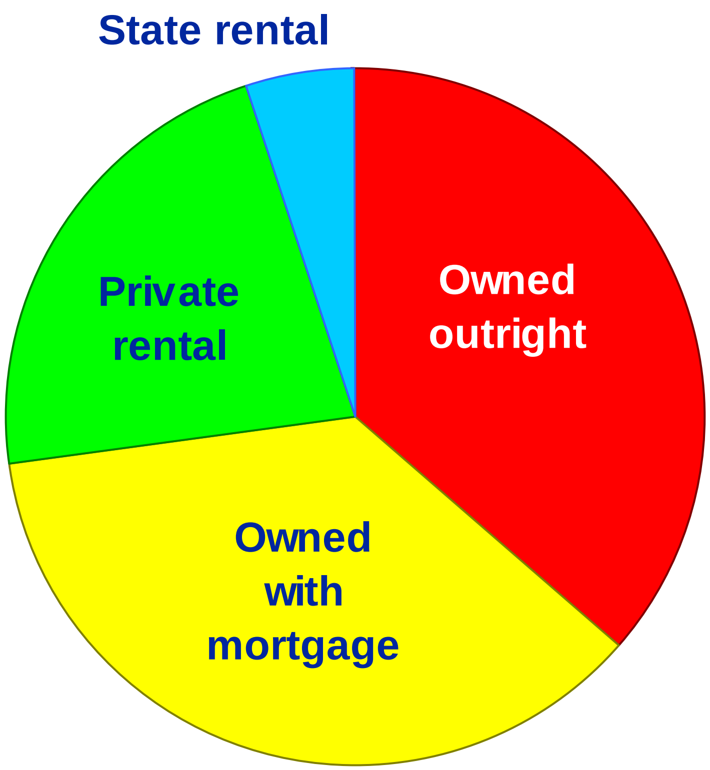
Sydney
19th November 2006

www.anz/com/go/economics

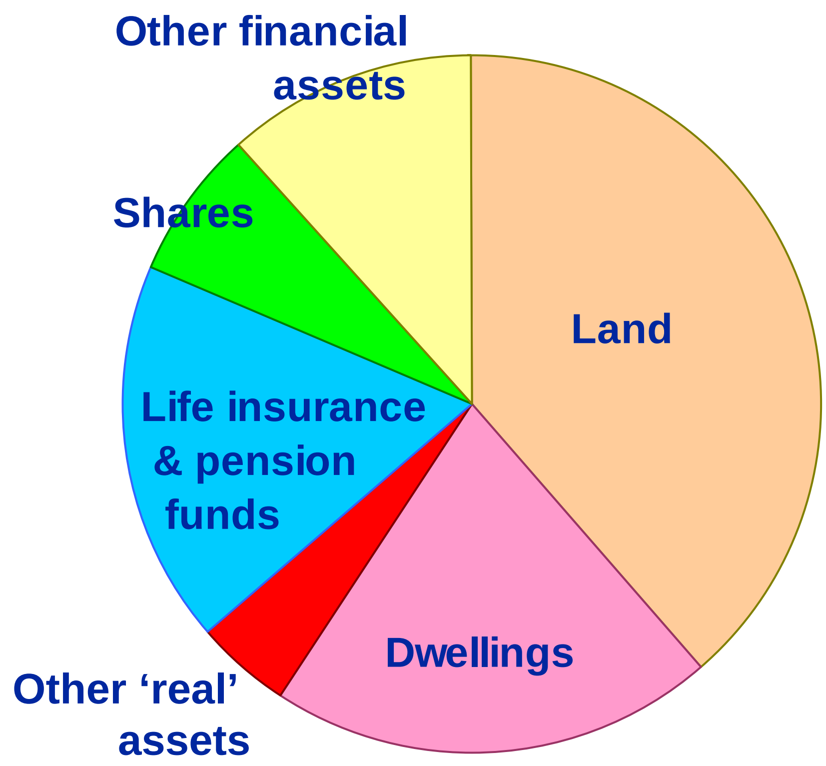
economics@ANZ

Housing is the most important form of wealth for most Australian households

Australian housing tenure, 2005



Composition of household wealth, 2006



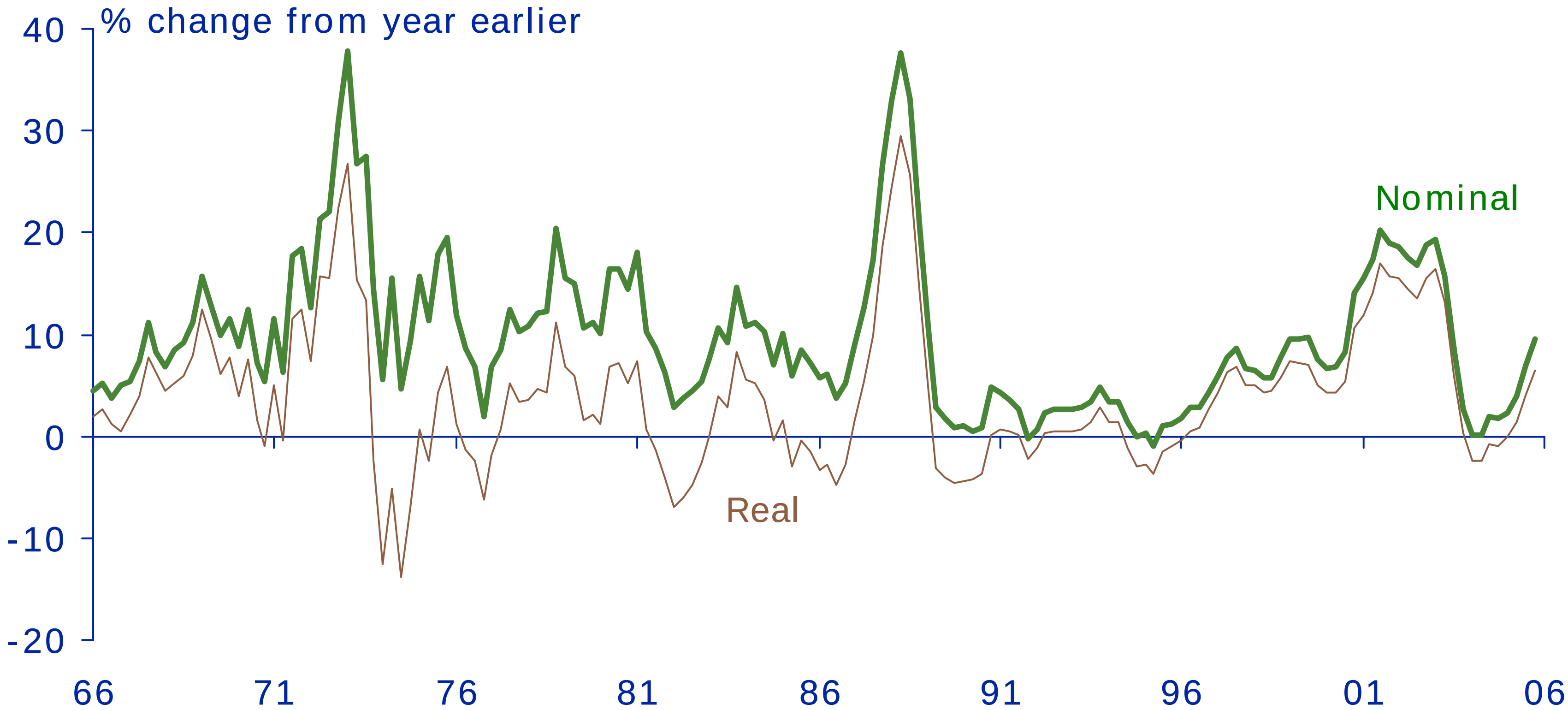
Source: Australian Bureau of Statistics.

Investment in housing has traditionally been favoured by government policies

- Interest payments on borrowings for owner-occupied housing are not tax-deductible, but neither capital gains on owner-occupied housing nor 'imputed rent' are taxed
- Owner-occupied housing is typically exempt from land tax, and excluded from 'assets tests' used to determine eligibility for social security benefits and concessions
- Most first home buyers are eligible for government grants and/or stamp duty concessions or exemptions
- Historically, State housing authorities have constructed housing for sale to eligible individuals, or have been willing to sell rental housing to tenants, upon favourable terms
- Interest on borrowings to acquire investment properties (and other income-producing assets) is tax-deductible (including against other non-investment income – so-called 'negative gearing'), property investors can claim tax deductions for 'depreciation', while (since 1999) capital gains on assets held for more than 12 months have been taxed at half the rate applicable to other types of income

House prices have risen 141% in nominal terms, and 87% in real terms, since the mid-1990s

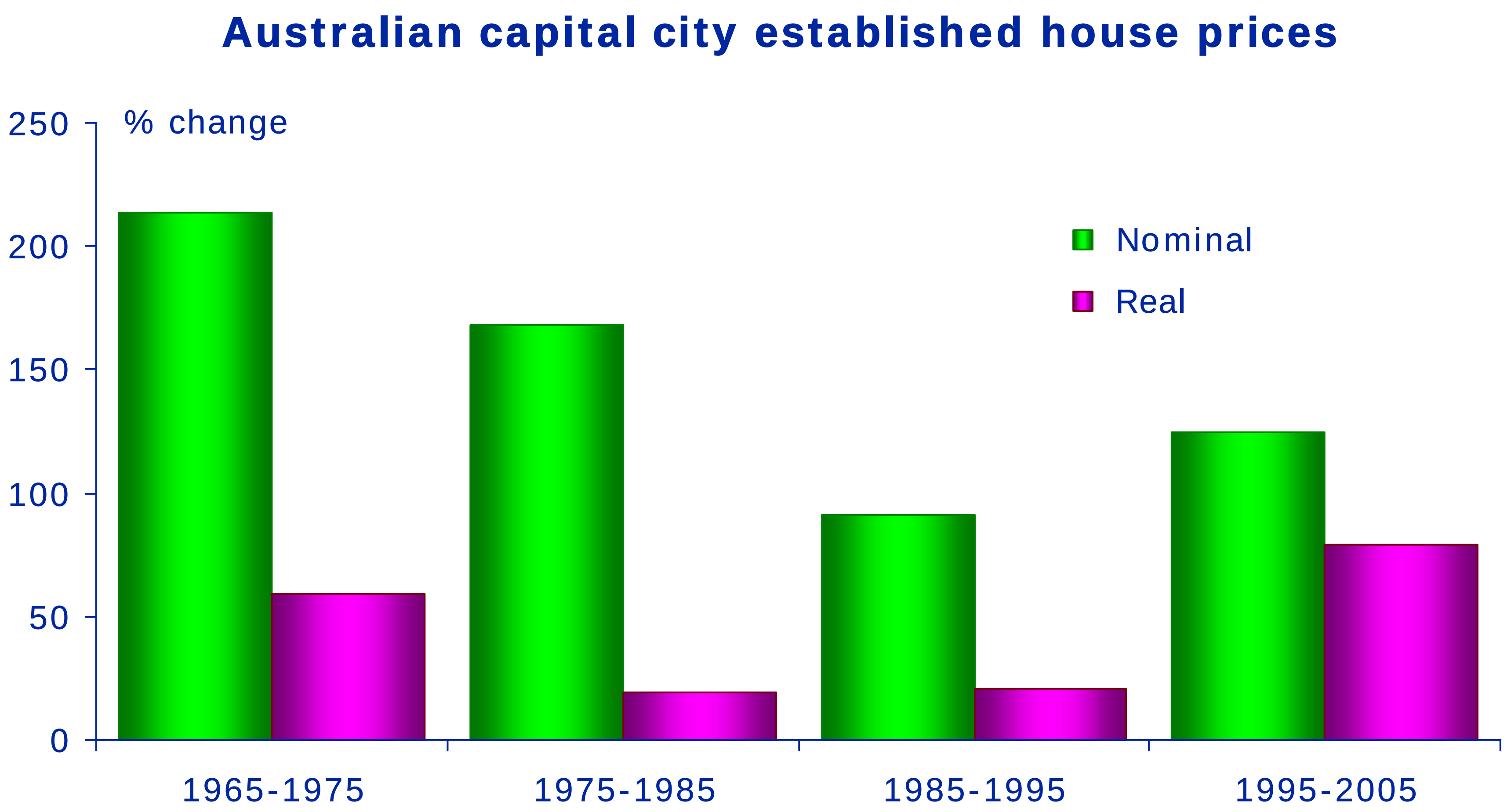
Established house prices – State and Territory capital cities



Note: From 1966 through 1978, figures are for Sydney and Melbourne only; includes Brisbane from 1978 onwards; Perth, Adelaide and Canberra from 1980 onwards; Hobart from 1984 onwards; and Darwin from 1986 onwards. 'Real' house prices are nominal prices deflated by the RBA's 'trimmed mean' CPI series or, prior to 1976, All Groups CPI.

Sources: ABS; Real Estate Institute of Australia; RBA; Economics@ANZ.

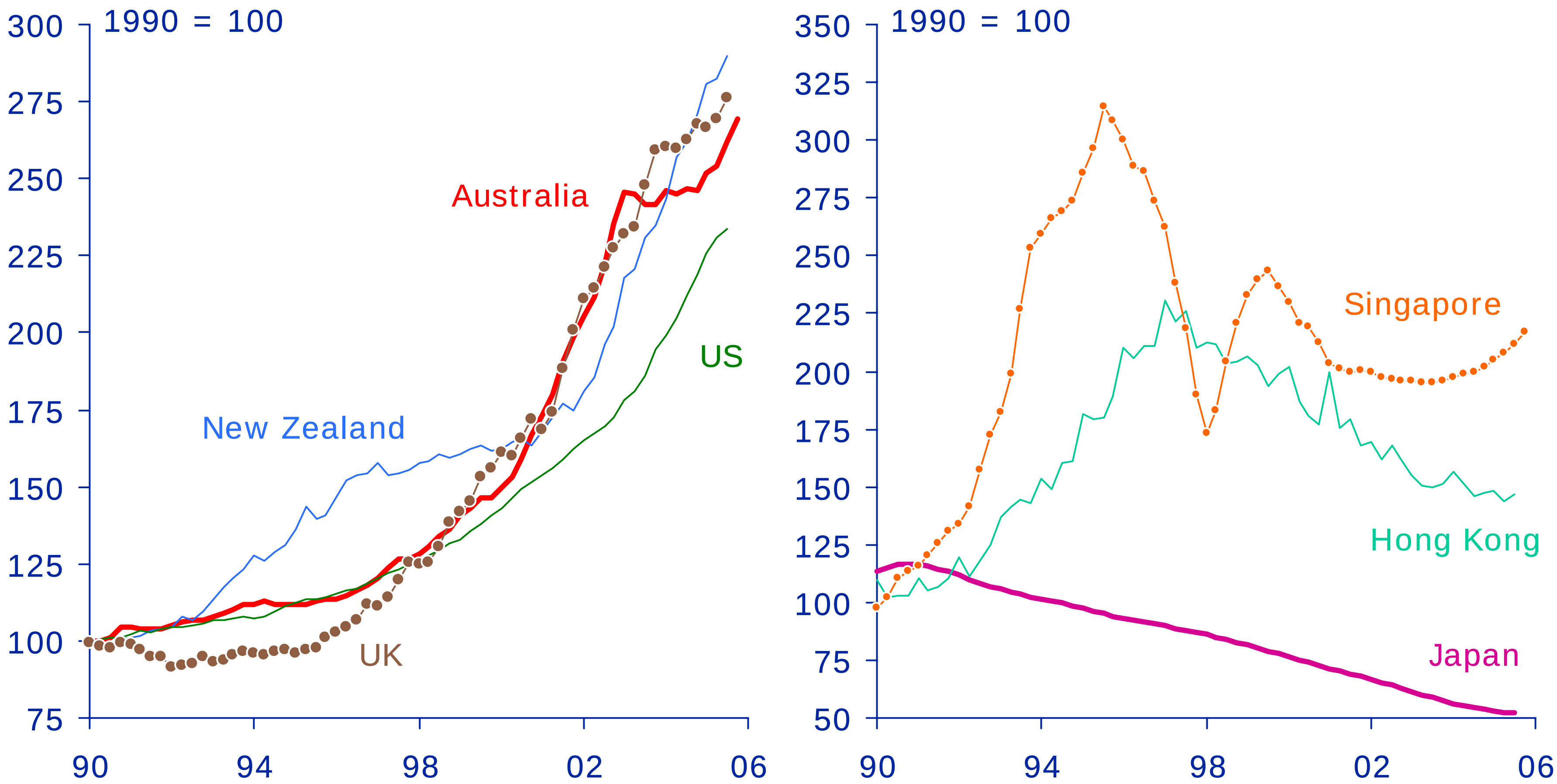
Real house price gains over the past decade have substantially outpaced those of previous decades



Note: See footnotes to slide 3.
Sources: As for slide 3.

Australian house prices have risen more rapidly than in many other comparable countries

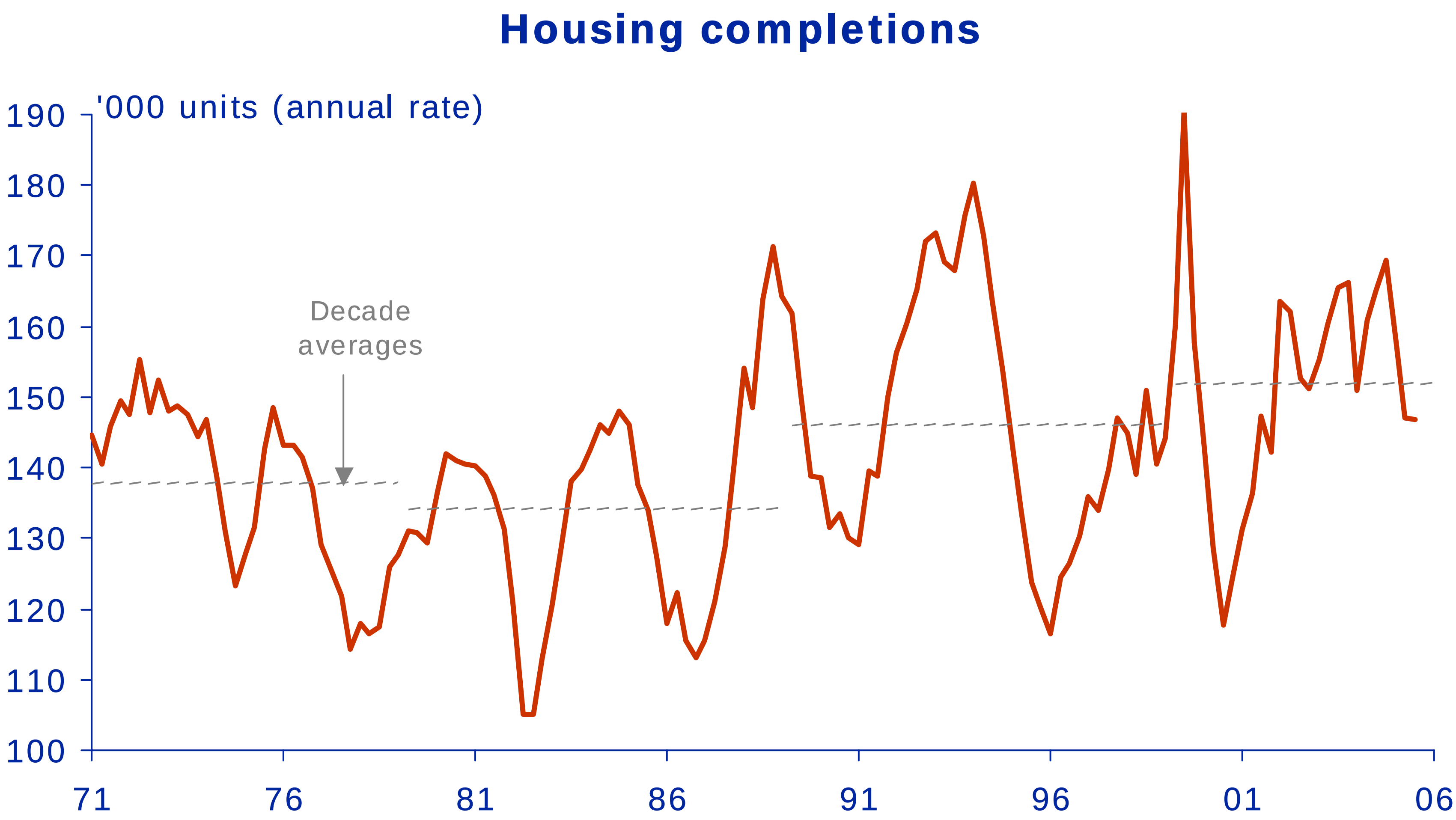
Established house prices



Sources: National statistical or regulatory agencies; Thomson Financial Datastream; Economics@ANZ.

economics@ANZ

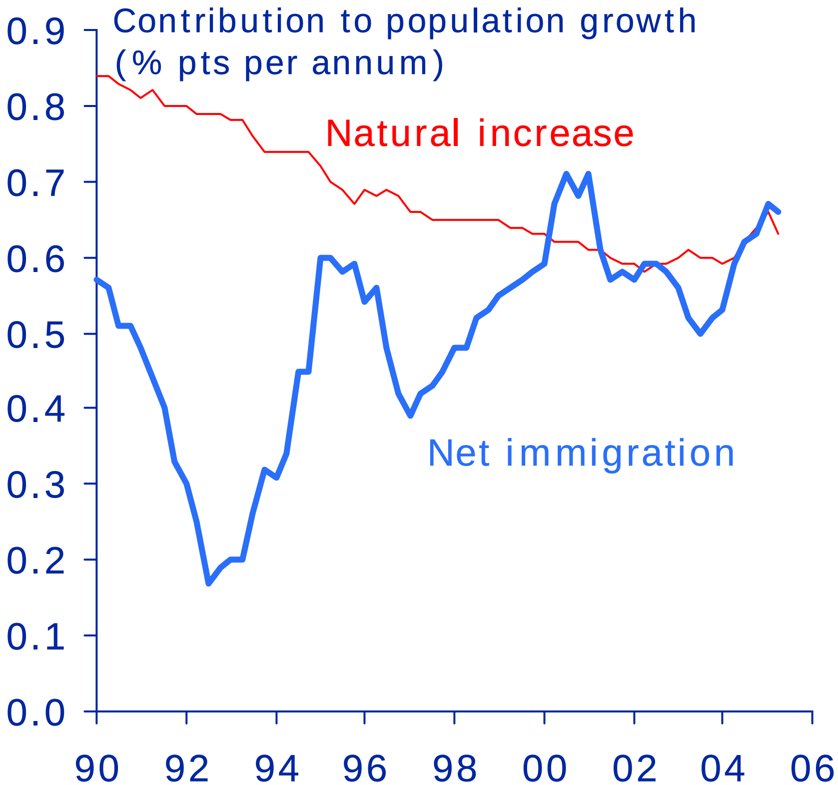
The stock of housing has grown substantially over the past 15 years ….



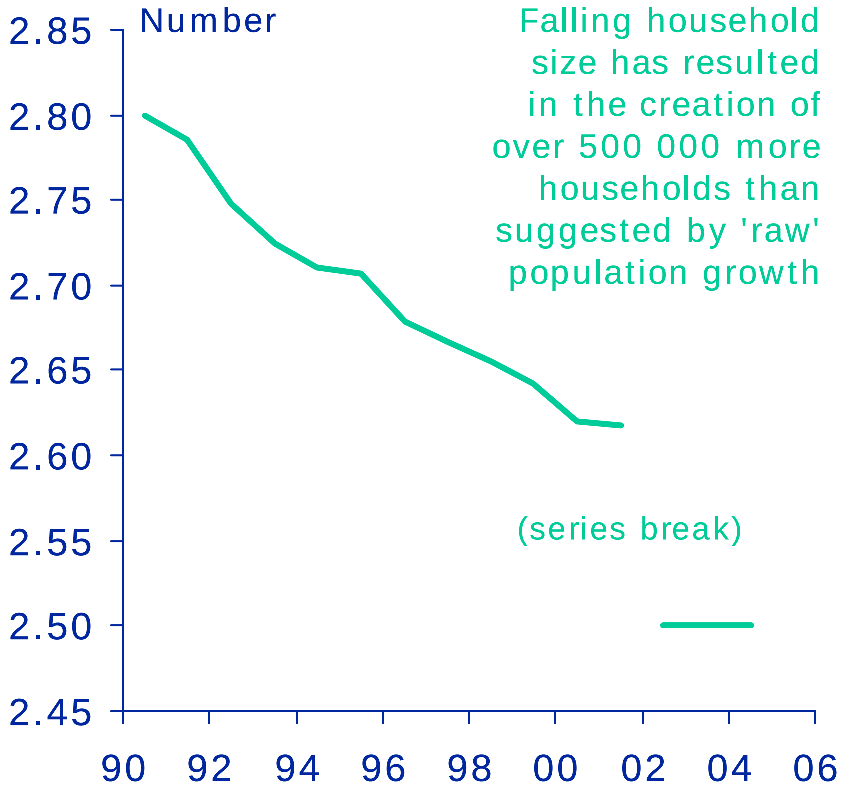
Sources: ABS; Economics@ANZ.

... but so has the number of households requiring accommodation

Sources of population growth



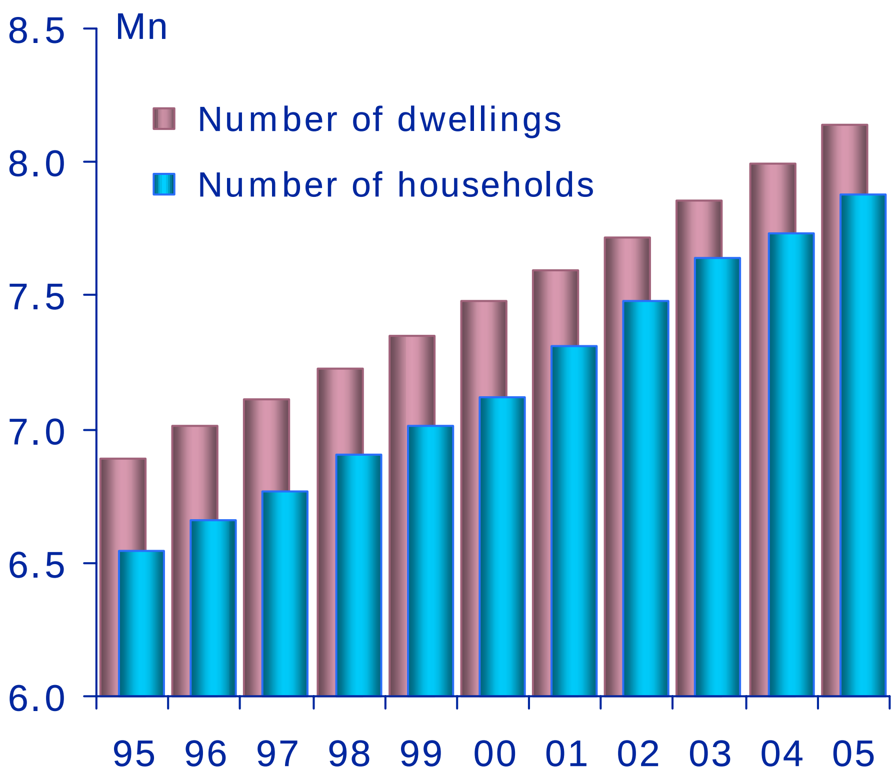
Average number of persons per household



Sources: ABS; Economics@ANZ.

Thus the supply of housing has barely kept pace with the increase in underlying demand

Number of households and number of dwellings

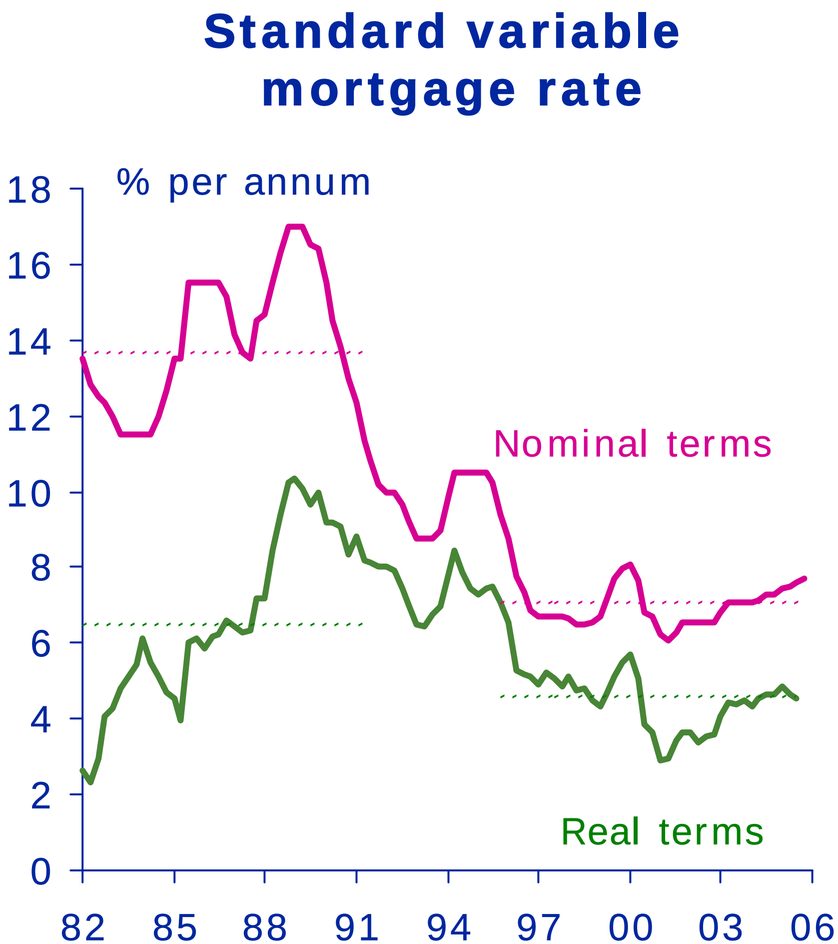


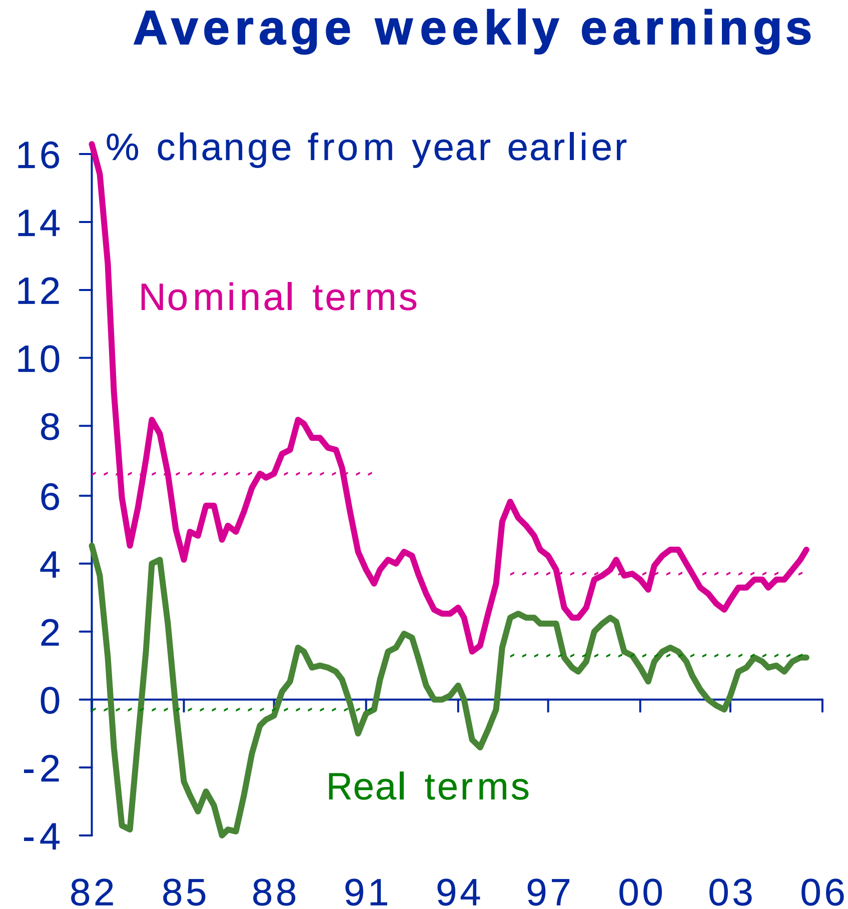
Note: Dwelling stock estimates for 1991, 1996 and 2001 based on census figures; other years interpolated using completions data.
Sources: RBA; ABS; Economics@ANZ.

- **Over the ten years to June 2005, the stock of housing increased by 1.26 million or 18%**
  - **1.44 mn new dwellings were completed during this period, but around 172,000 old dwellings were demolished**
- **Over the same period, the number of households rose by 1.33 million or 20%**
  - **faster than the increase in population (12.5%) because of falling average household size**
- **In effect, the increase in the supply of housing was more than absorbed by increased demand**

economics@ANZ

Since the early 1990s mortgage rates have halved while real incomes have grown by 11½ %

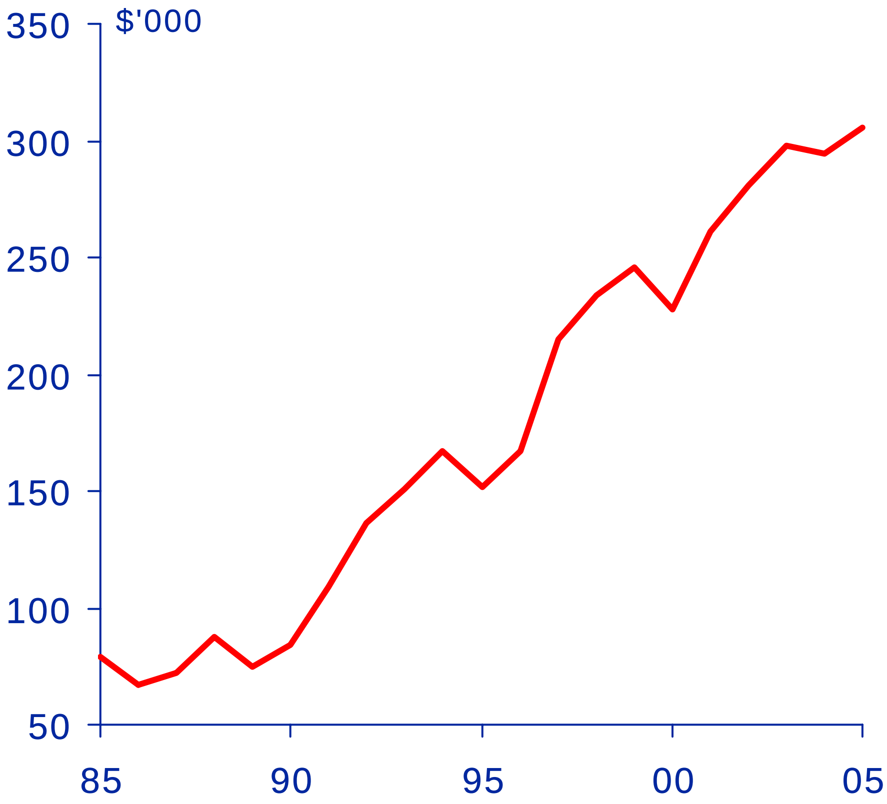




Note: dotted lines show averages 1982-1992 and 1996-2006.
Sources: RBA; Commonwealth Treasury; Economics@ANZ.

'Borrowing capacity' for a 'typical' household has risen by at least 125%

Maximum borrowing by couple earning average male and female earnings, repayments capped at 25% of gross income and 20% deposit



Note: data are for the June quarter each year.
Sources: ABS; Economics@ANZ.

- **Since the early 1990s, average earnings have risen by over 60% while the standard variable mortgage rate has halved**
- **This has increased the maximum amount which a 'typical couple' can afford to borrow under standard lenders' rules from around $135 000 in 1992 to $305 000 in 2006**
- **In practice the rates actually paid by borrowers have fallen by more than the standard variable rate, while the traditional 'rules' are much less rigorously applied**

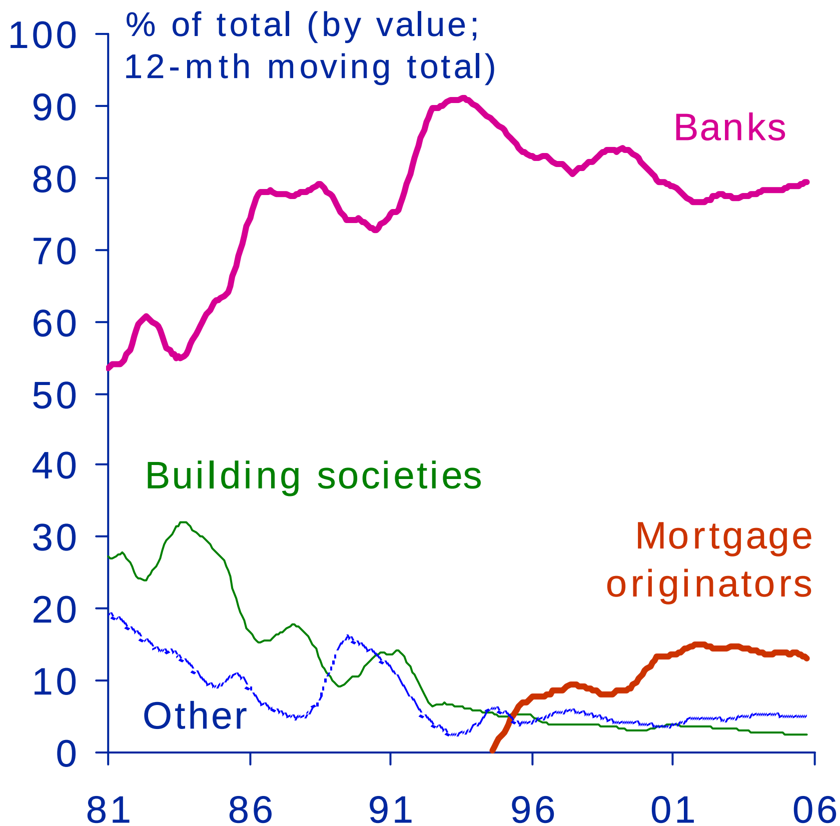
economics@ANZ

Innovations in Australian housing finance since the early 1990s

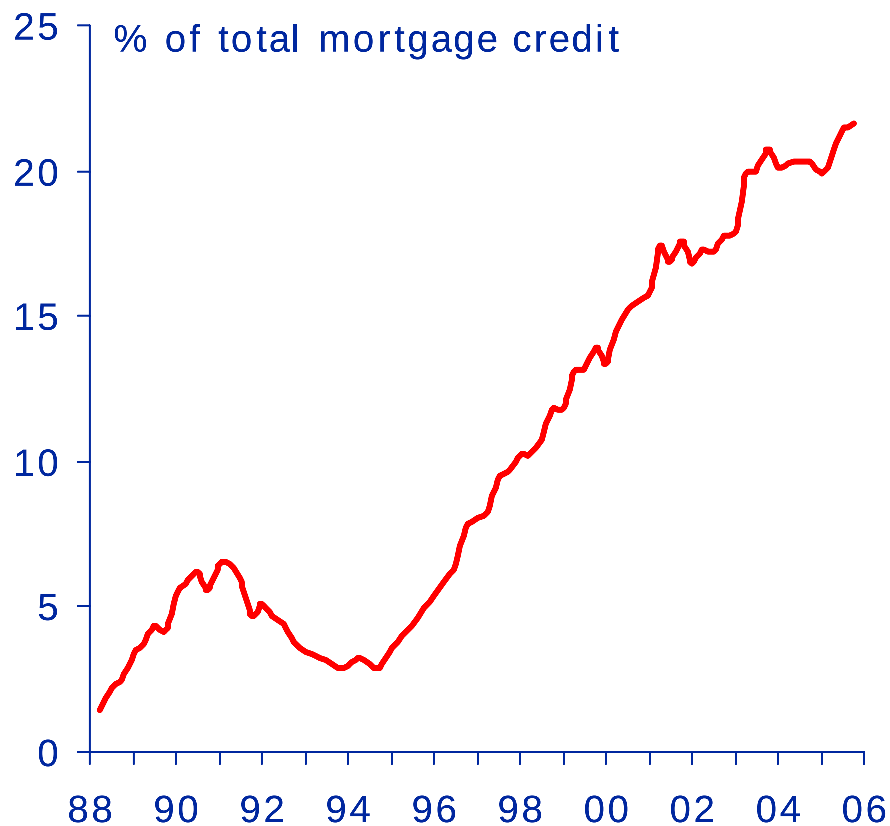
- Entry of new types of lenders
  - in particular, mortgage brokers and originators, whose loans are funded by wholesale lenders via securitization
- Heightened competition among lenders
  - enhanced by reductions in transaction costs (eg abolition of stamp duty on mortgages) and improved technology
- Greater flexibility in the management of loans
  - new features such as flexible repayment schedules, interest-only loans, 're-draw' facilities, home equity loans, 'offset accounts' (allowing interest on deposits to be offset against mortgage interest), split (part fixed, part floating) loans
- Wider availability of mortgage finance
  - higher loan-to-valuation ratio (LVR) loans, 'low-doc' loans (requiring less disclosure of servicing capacity), 'sub-prime' lending, 'shared equity' loans
- Easier terms for lending to property investors
  - elimination of interest rate premium on investment loans, introduction of split-purpose loans

Entry of mortgage originators and brokers has heightened competition in the mortgage market

Share of new housing finance commitments



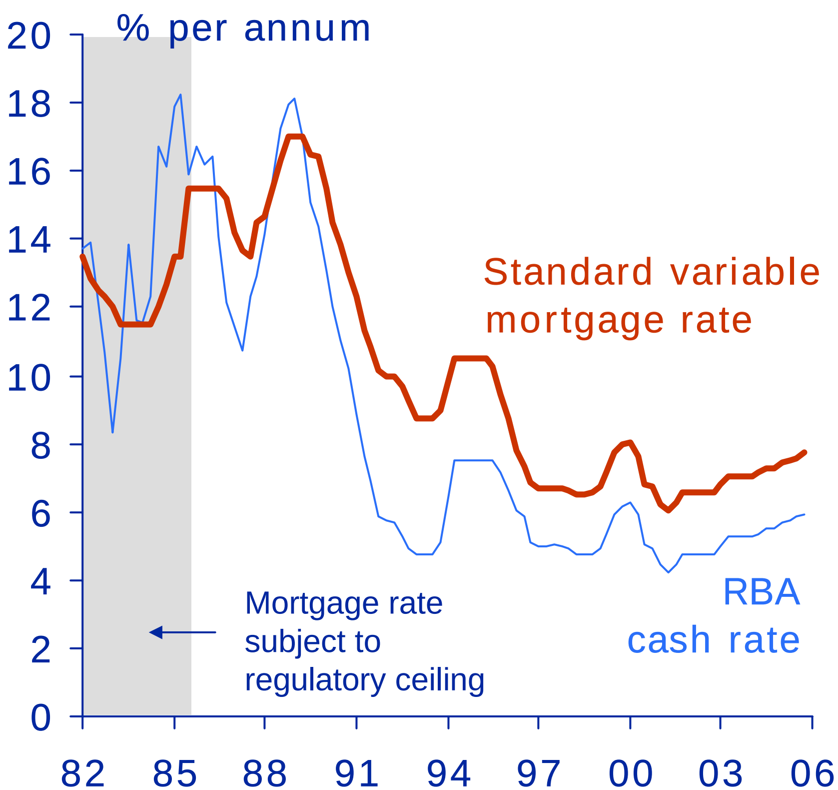
Securitizations as a pc of total mortgage credit



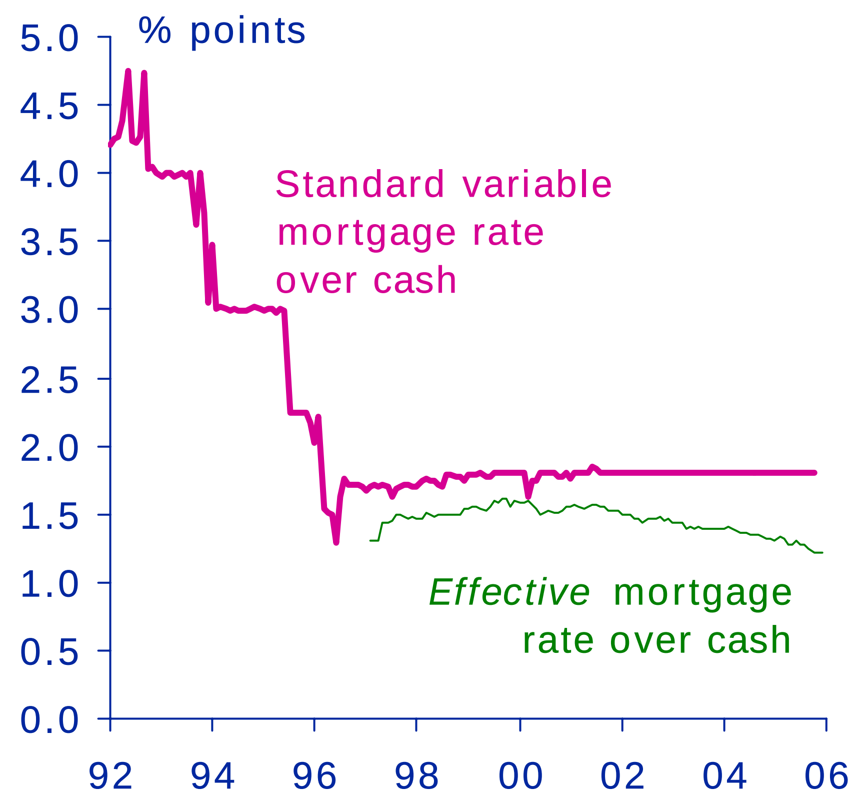
Note: 'other lenders' include credit unions, life and general insurance companies and government agencies.
Sources: ABS; Economics@ANZ.

Competition among lenders has resulted in a further lowering of effective mortgage rates

Standard variable mortgage rate vs cash rate



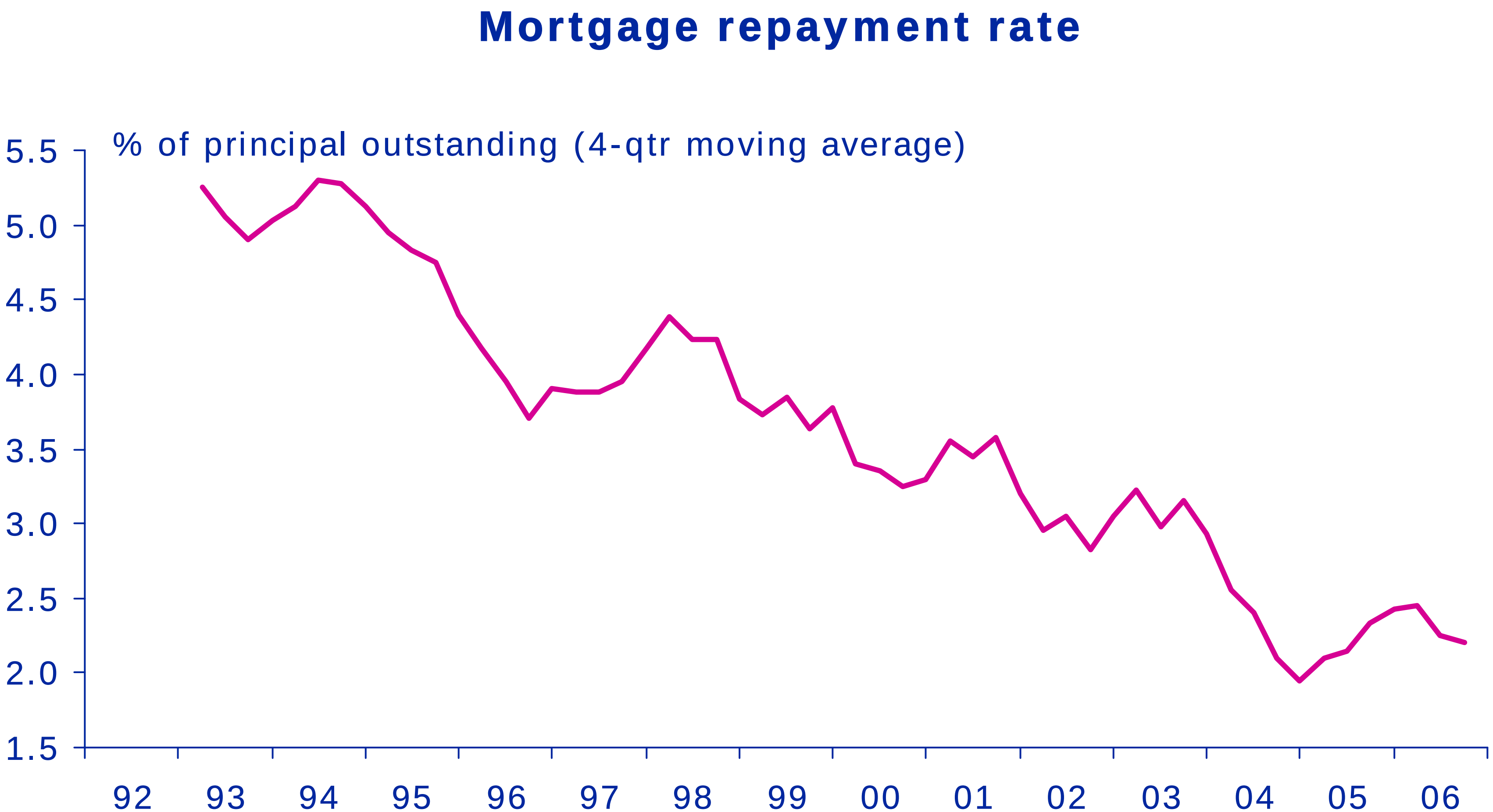
Mortgage lenders' margins



Sources: RBA; Economics@ANZ.

economics@ANZ

Australian households are repaying mortgage principal more slowly

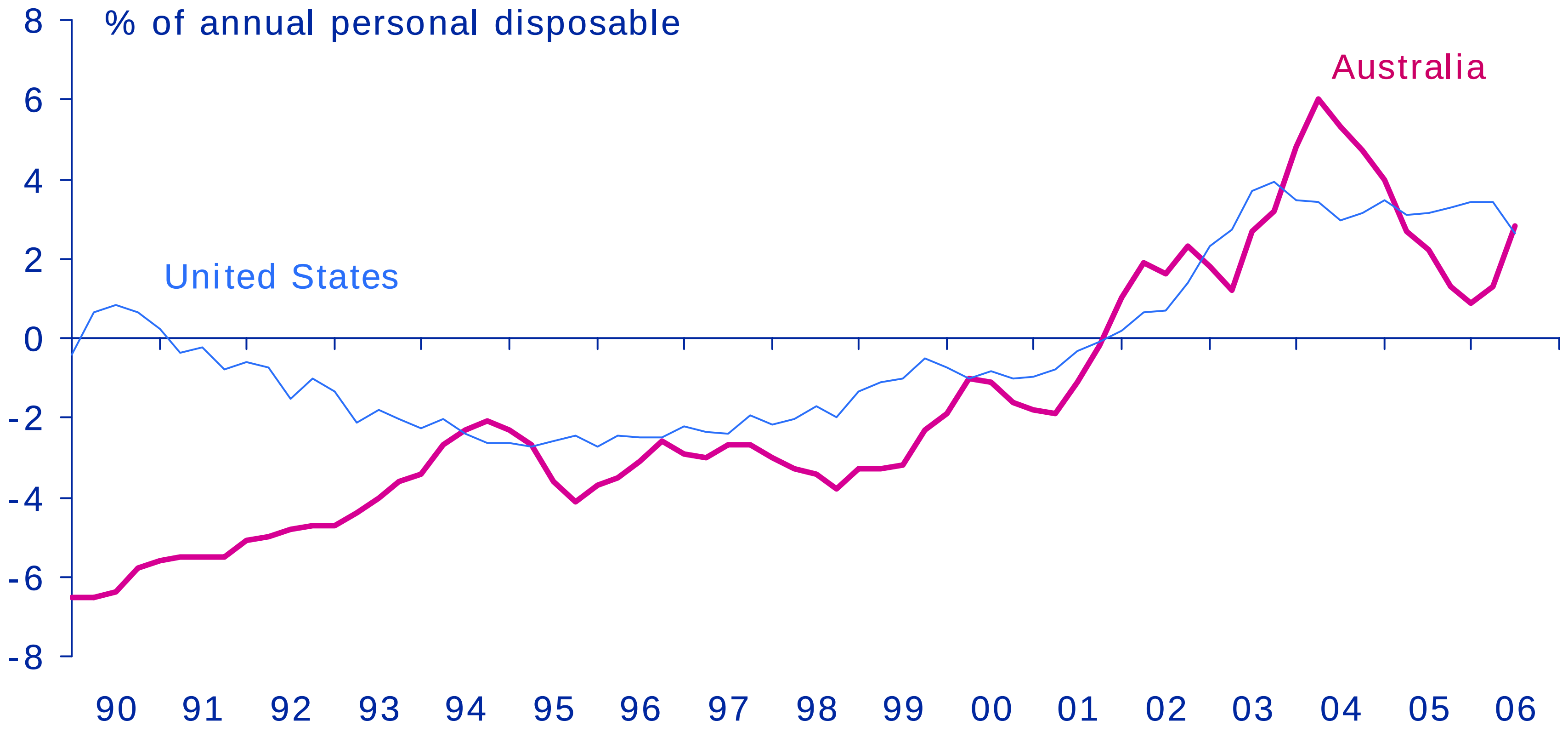


Sources: ABS; Economics@ANZ.

economics@ANZ

As in the US, mortgage market innovations have allowed Australians to ‘tap’ their real estate wealth

Mortgage equity withdrawal – US and Australia

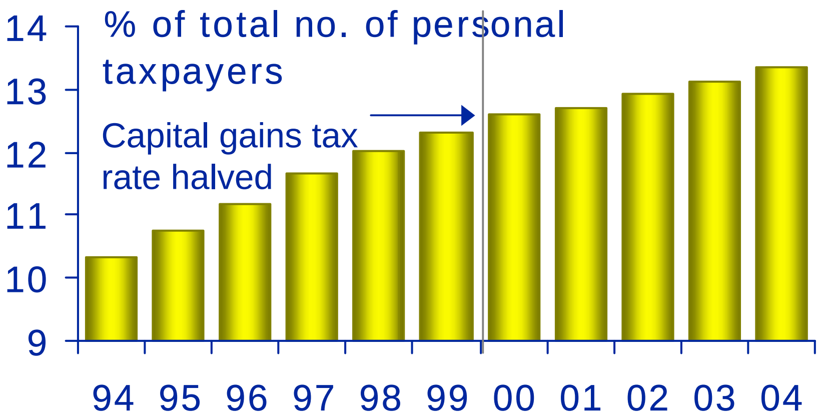


Sources: RBA; ABS; US Federal Reserve; Bureau of Economic Analysis; Economics@ANZ.

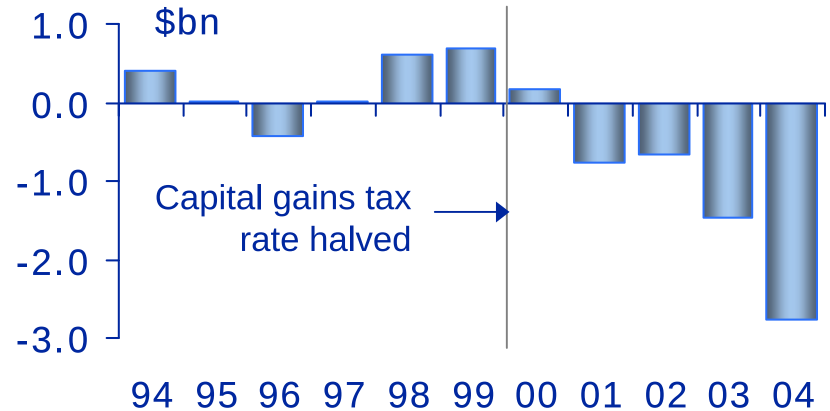
economics@ANZ

The tax system has encouraged investment in rental property especially after 1999

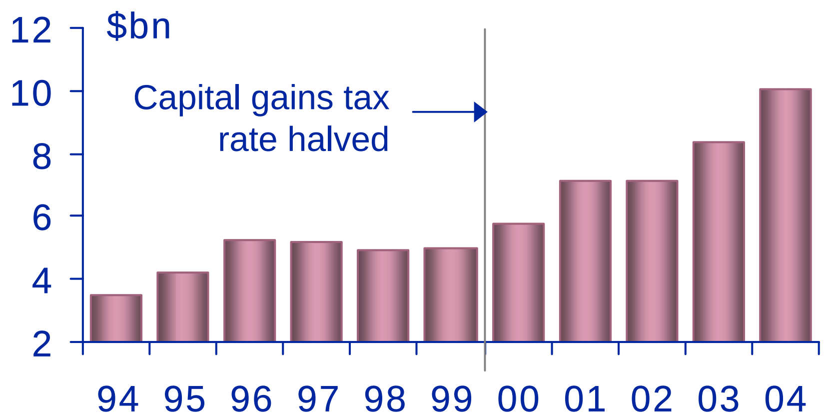
Taxpayers with rental income



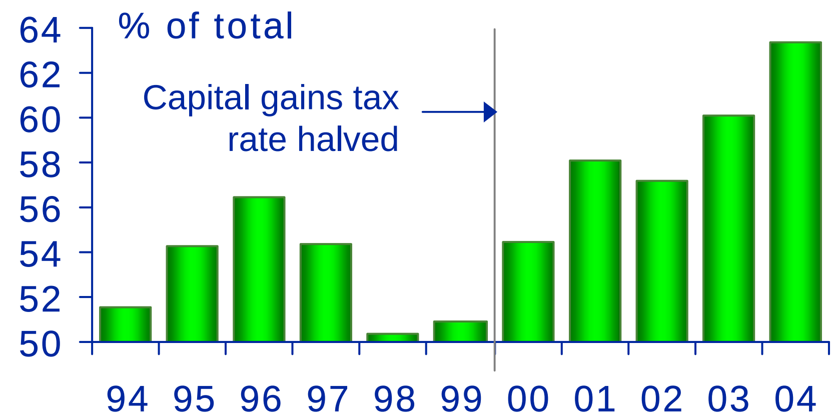
Net rental income



Interest paid by property investors



Loss-making property investors

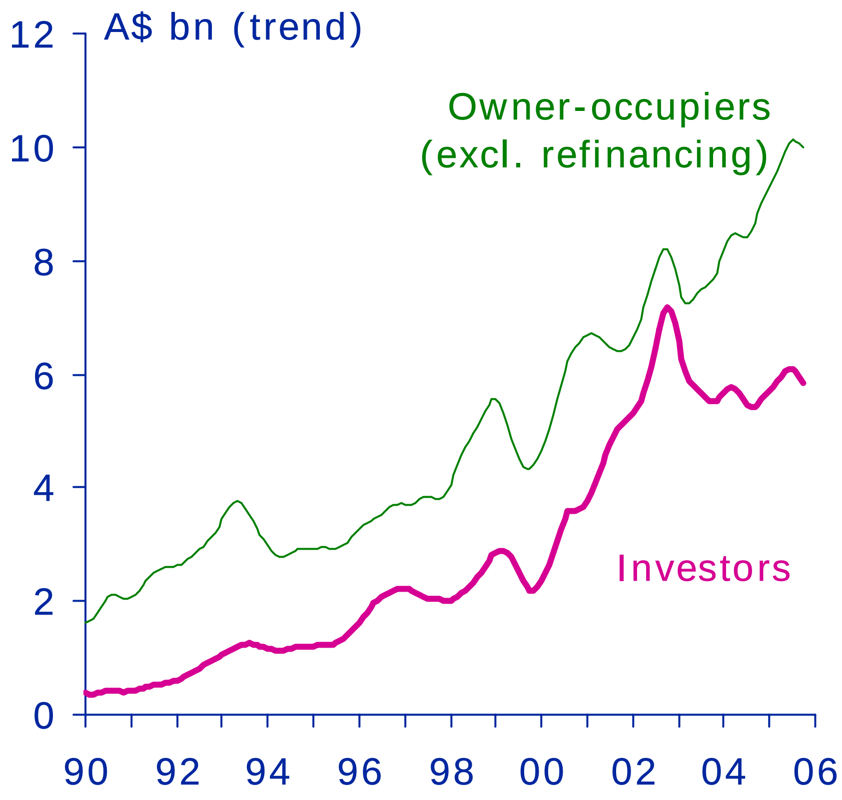


Note: Data are for fiscal years ended 30 June.
Sources: Australian Taxation Office; Economics@ANZ .

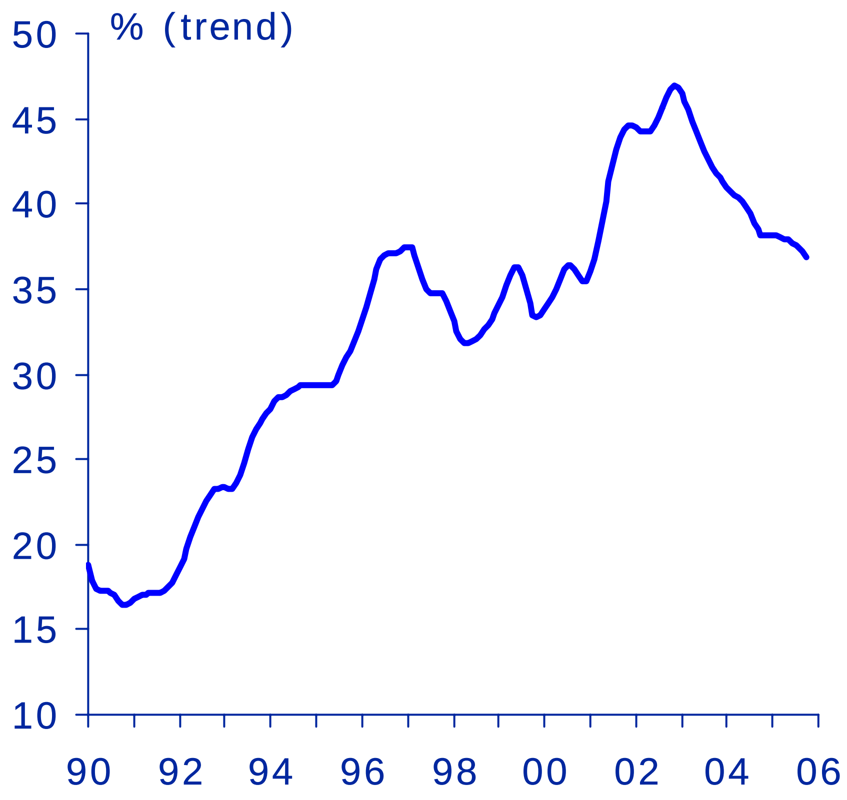
economics@ANZ

Investment property lending grew rapidly especially after the 1999 tax changes

Finance commitments to owner-occupiers & investors



Loans to investors as a pc of total commitments

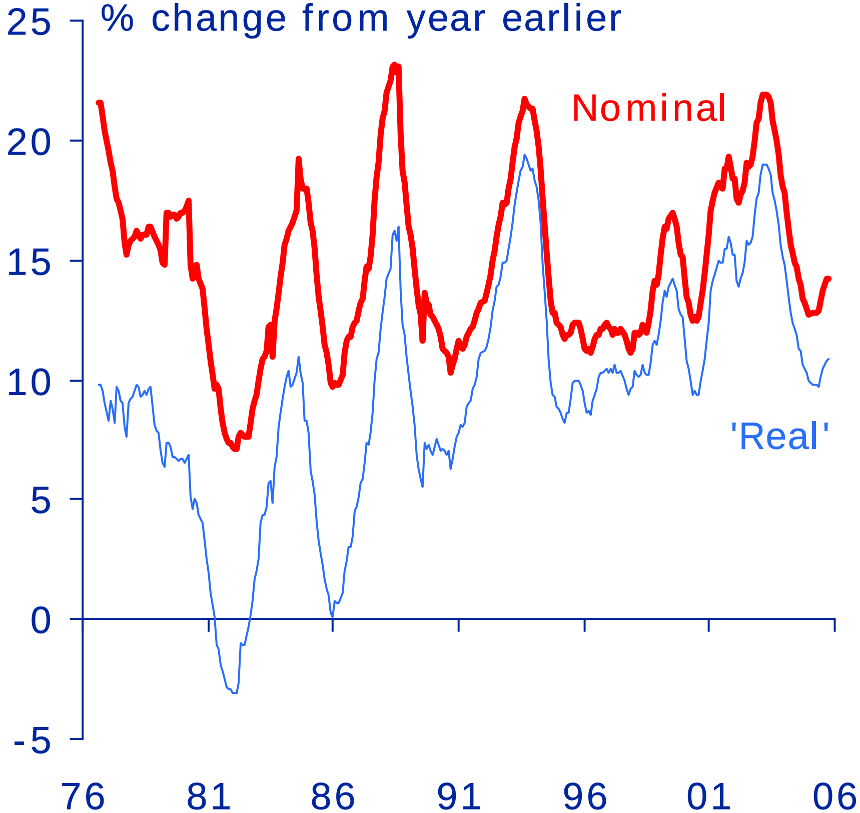


Source: ABS.

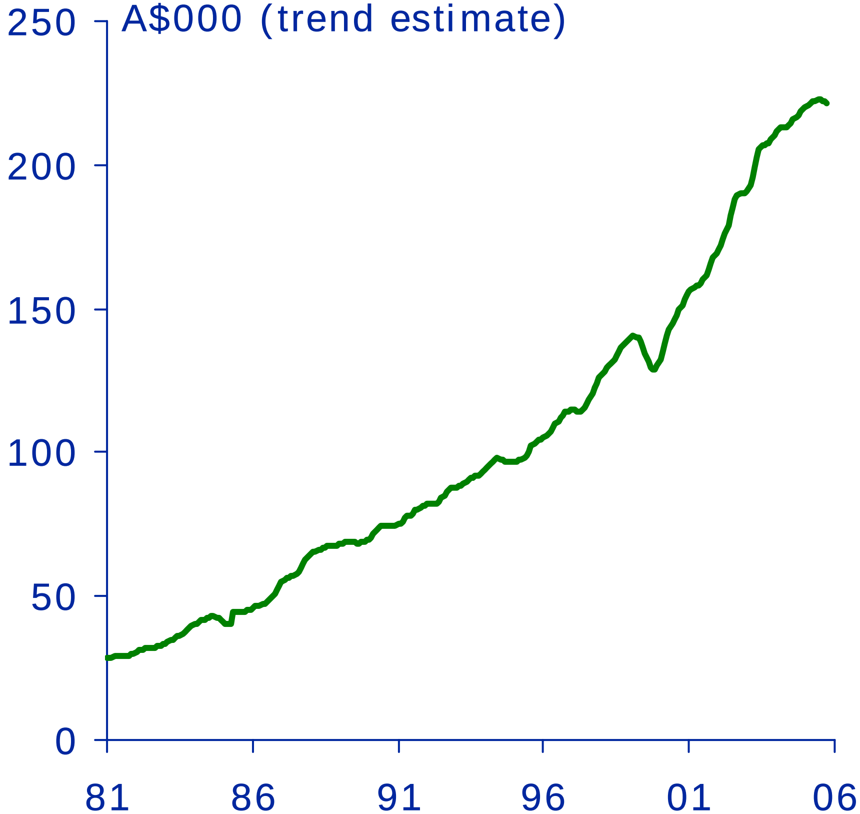
economics@ANZ

Borrowing for housing has grown rapidly over the past fifteen years

Mortgage credit to households



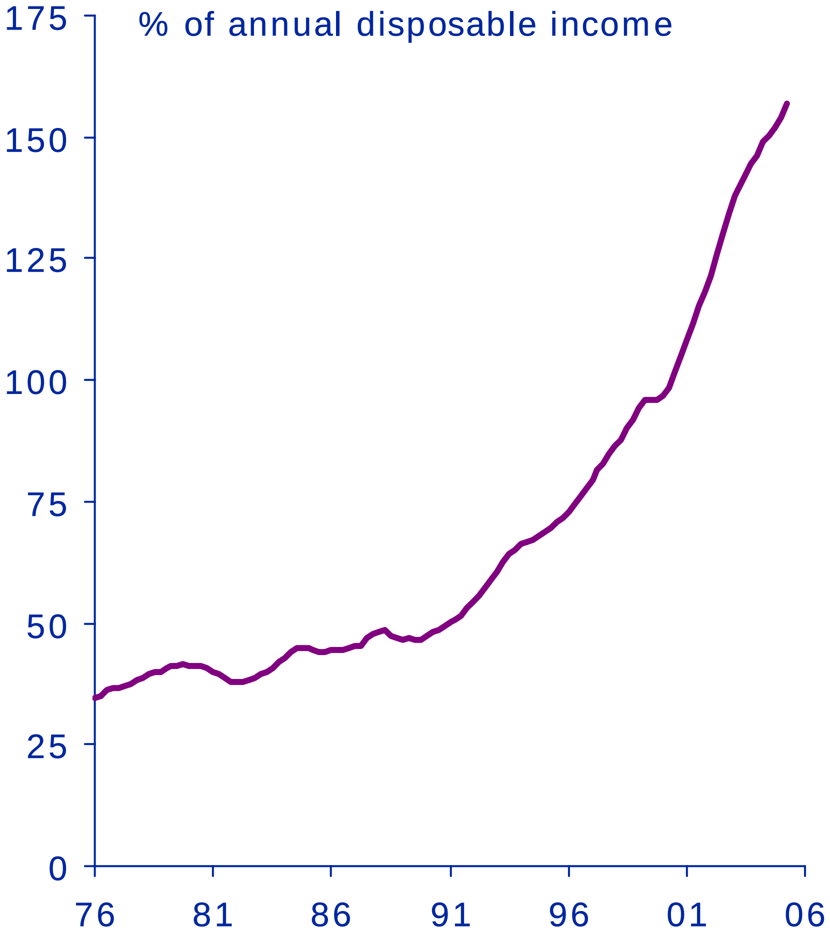
Average new mortgage



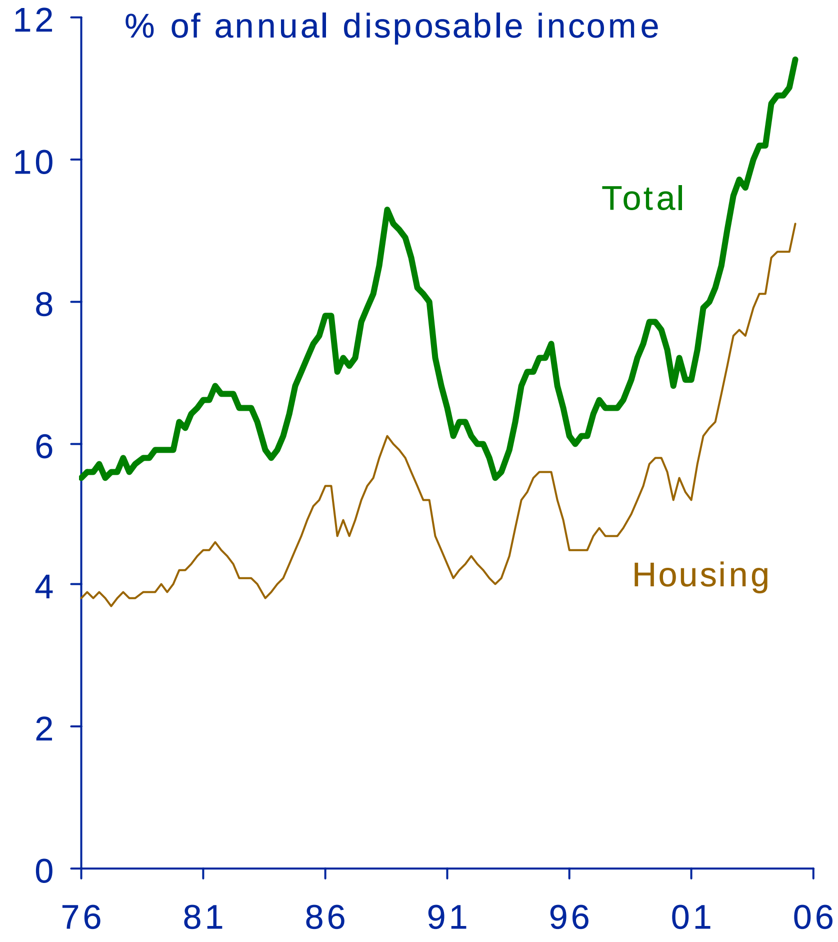
Note: 'Real' mortgage credit is nominal credit deflated by the 'trimmed mean' CPI.
Sources: RBA; Economics@ANZ.

As a result, both debt and interest payments have risen substantially relative to household income

Household debt to income

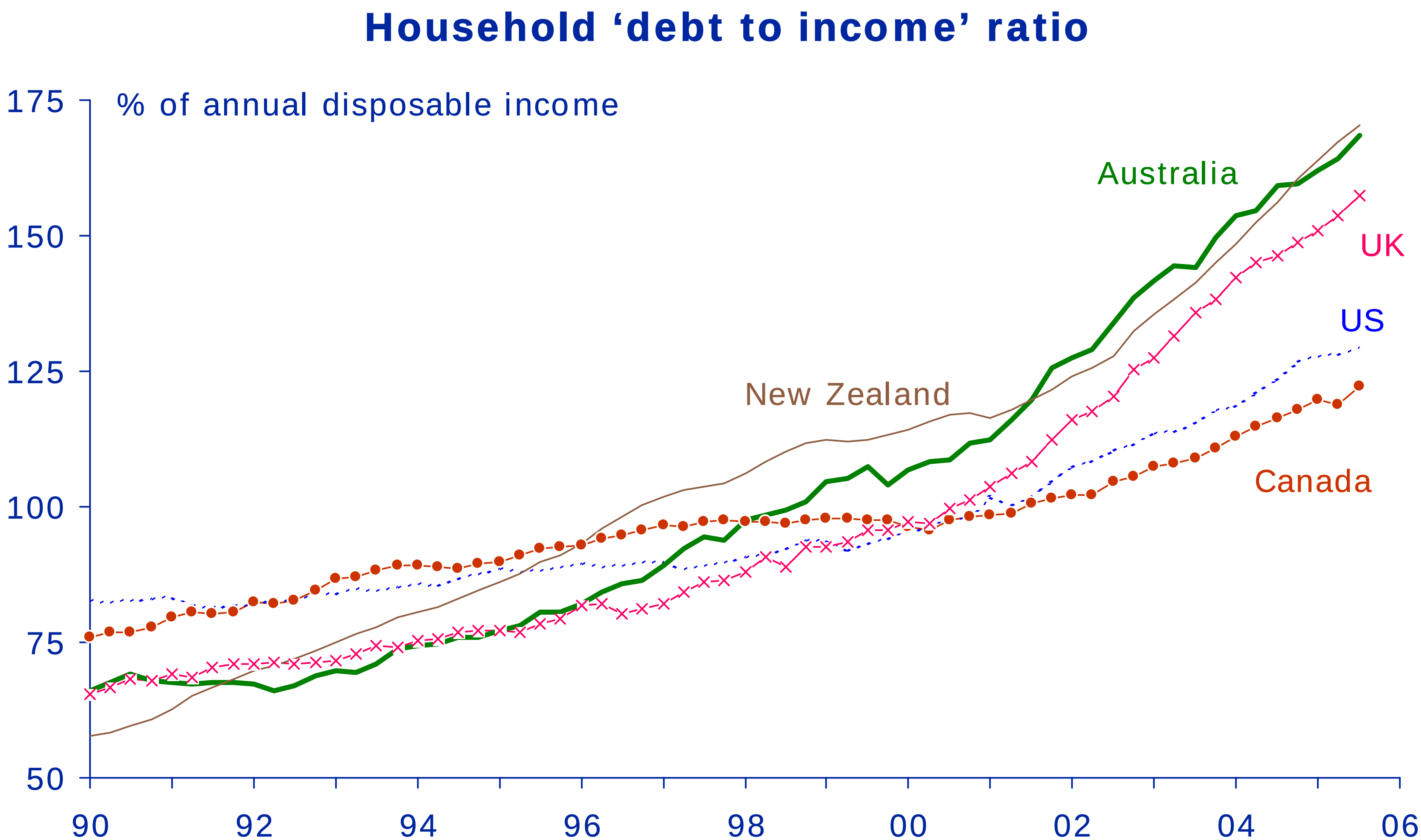


Interest payments to income



Sources: Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.

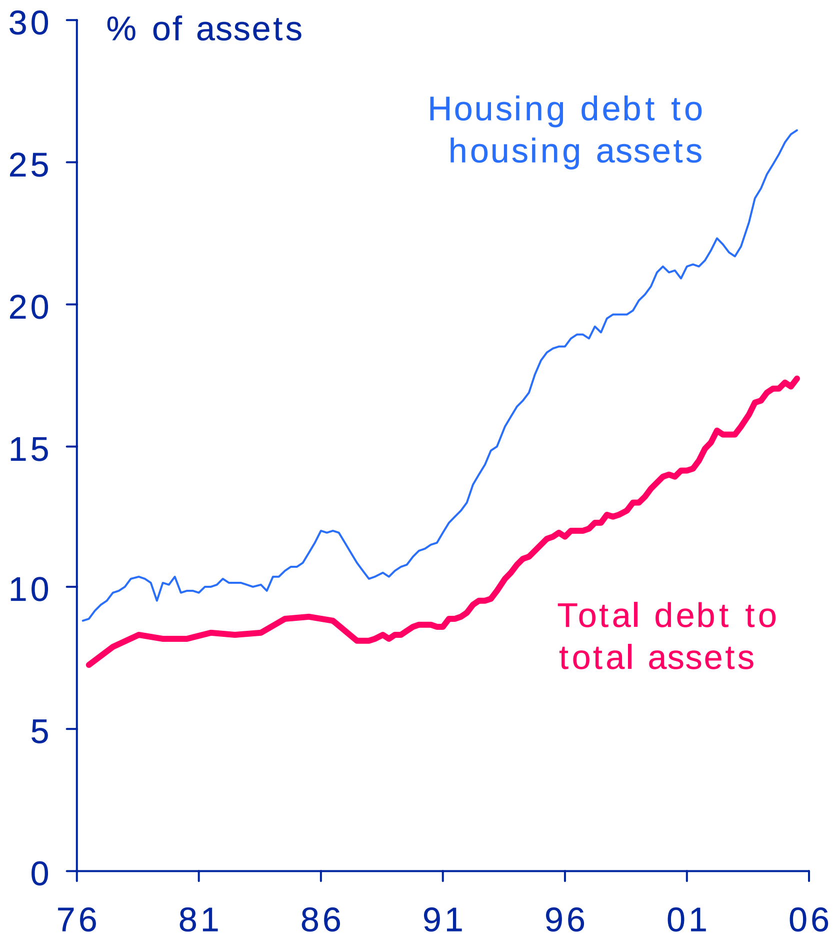
Australian households now have relatively high debt-income ratios by international standards



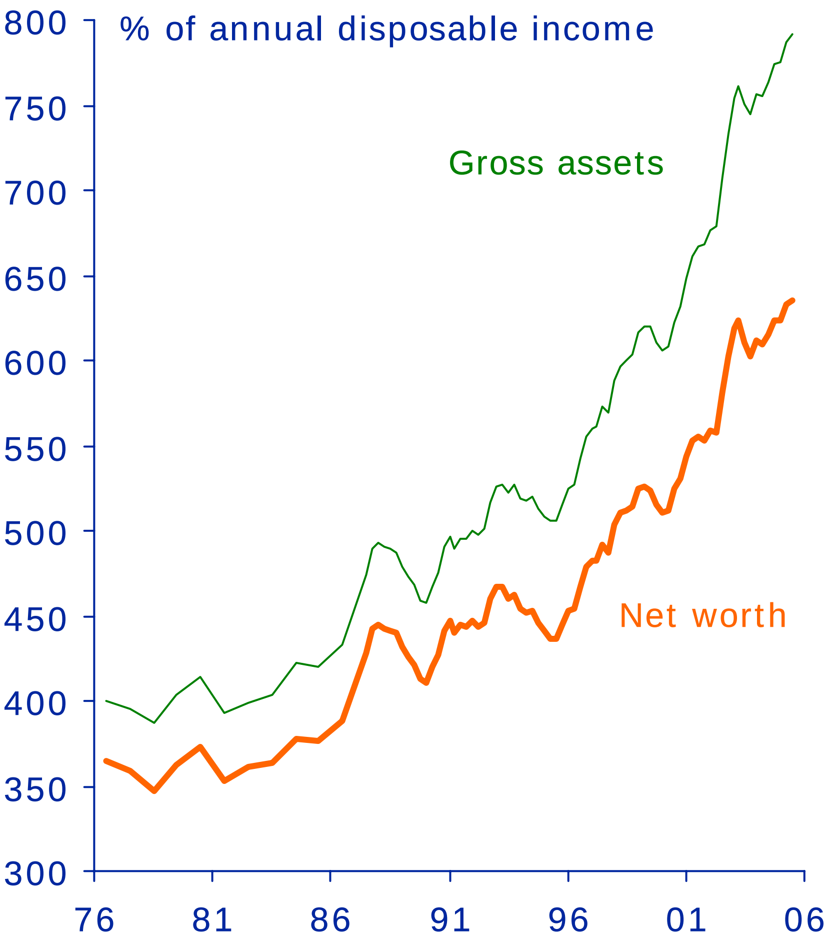
Sources: ABS, Thomson Financial Datastream.

On the other hand, the value of household assets has also risen substantially

Household debt to assets



Household gross and net assets

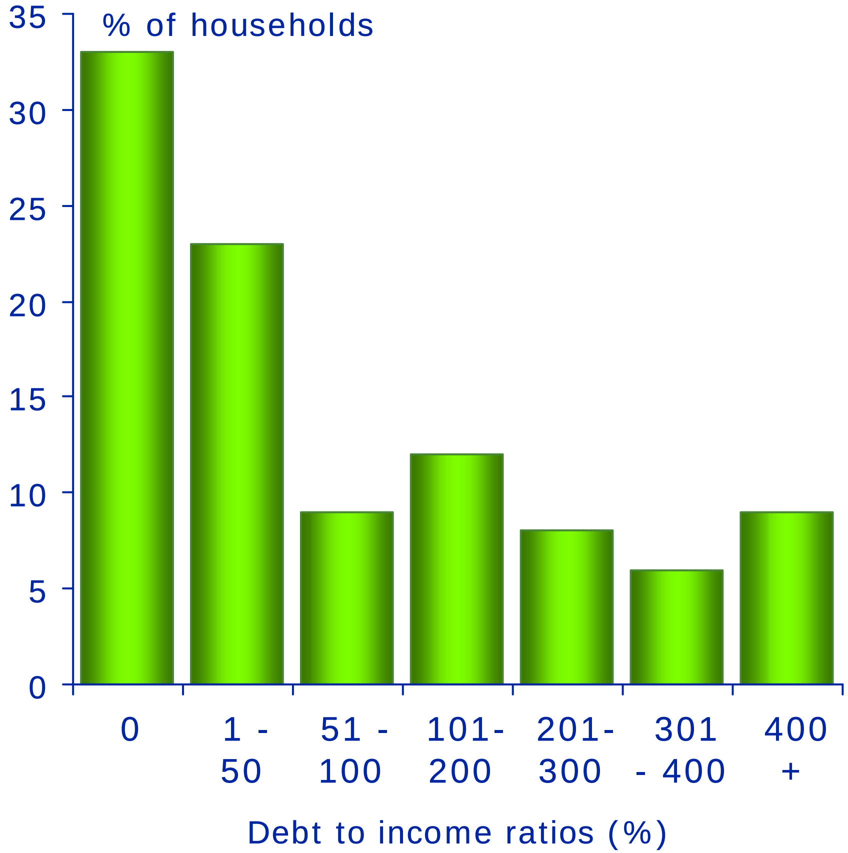


Sources: Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.

economics@ANZ

High levels of household debt are concentrated among households who can service it

Household debt to income ratios, 2002

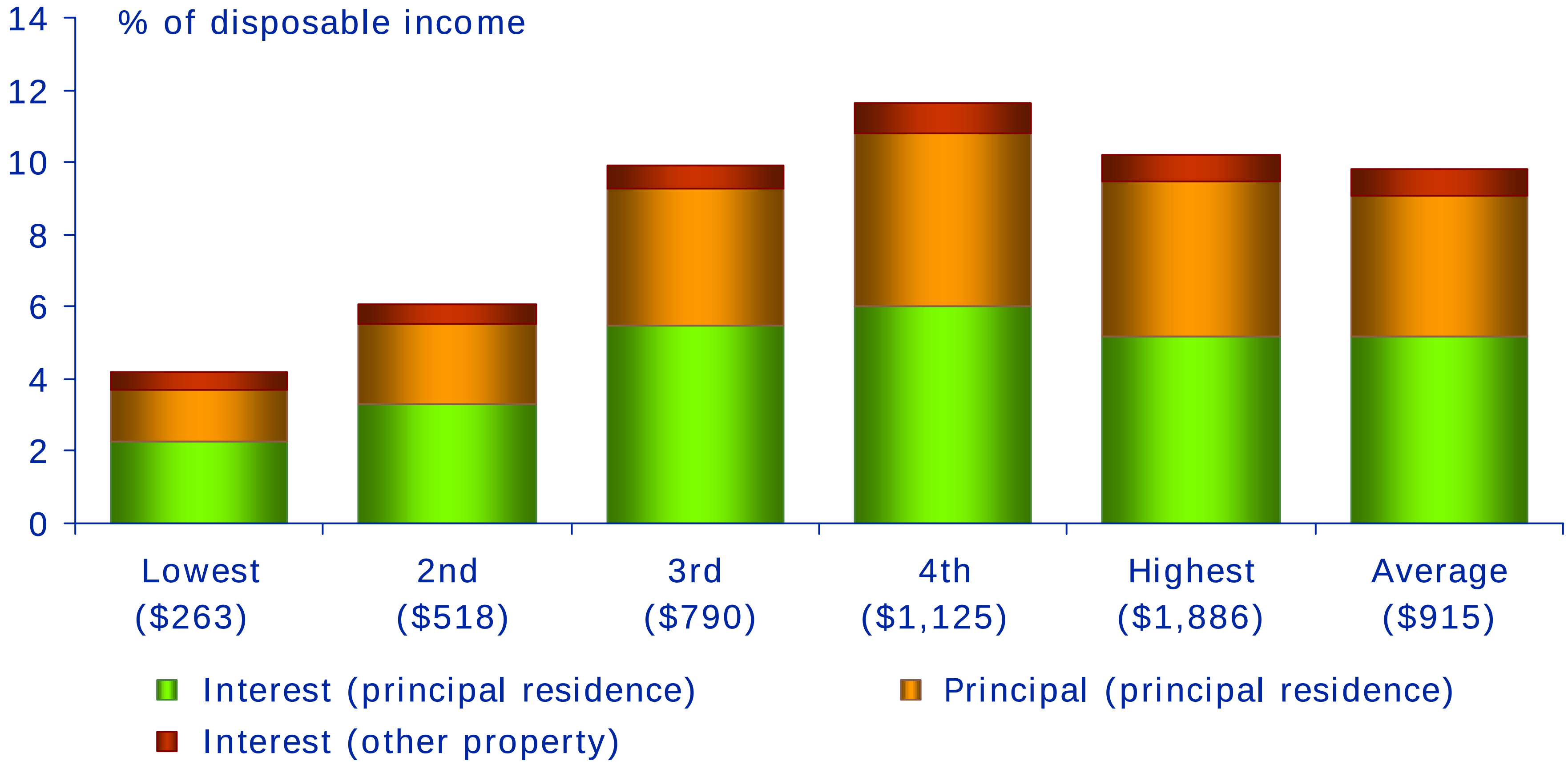


Source: Bruce Heady & Mark Wooden, *Income, Wealth and Joblessness: Insights from the HILDA Survey*, Paper presented to "Sustaining Prosperity" Conference, 31 March 2005.

- **55% of households have a debt-income ratio of less than 50%**
- **The median level of debt among the least wealthy 20% of households is just $2,000**
  - **and they account for just 4% of total household debt**
- **Only 9% of households have a debt-income ratio of over 400%**
  - **about half of these purchased their home within the past five years**
  - **no evidence (in 2002) that these households were reporting above-average levels of financial stress**
- **Only 2.4% of households had debt-service ratios over 50%, and only 4.2% had gearing ratios over 75%**
  - **only 0.4% exceeded both**

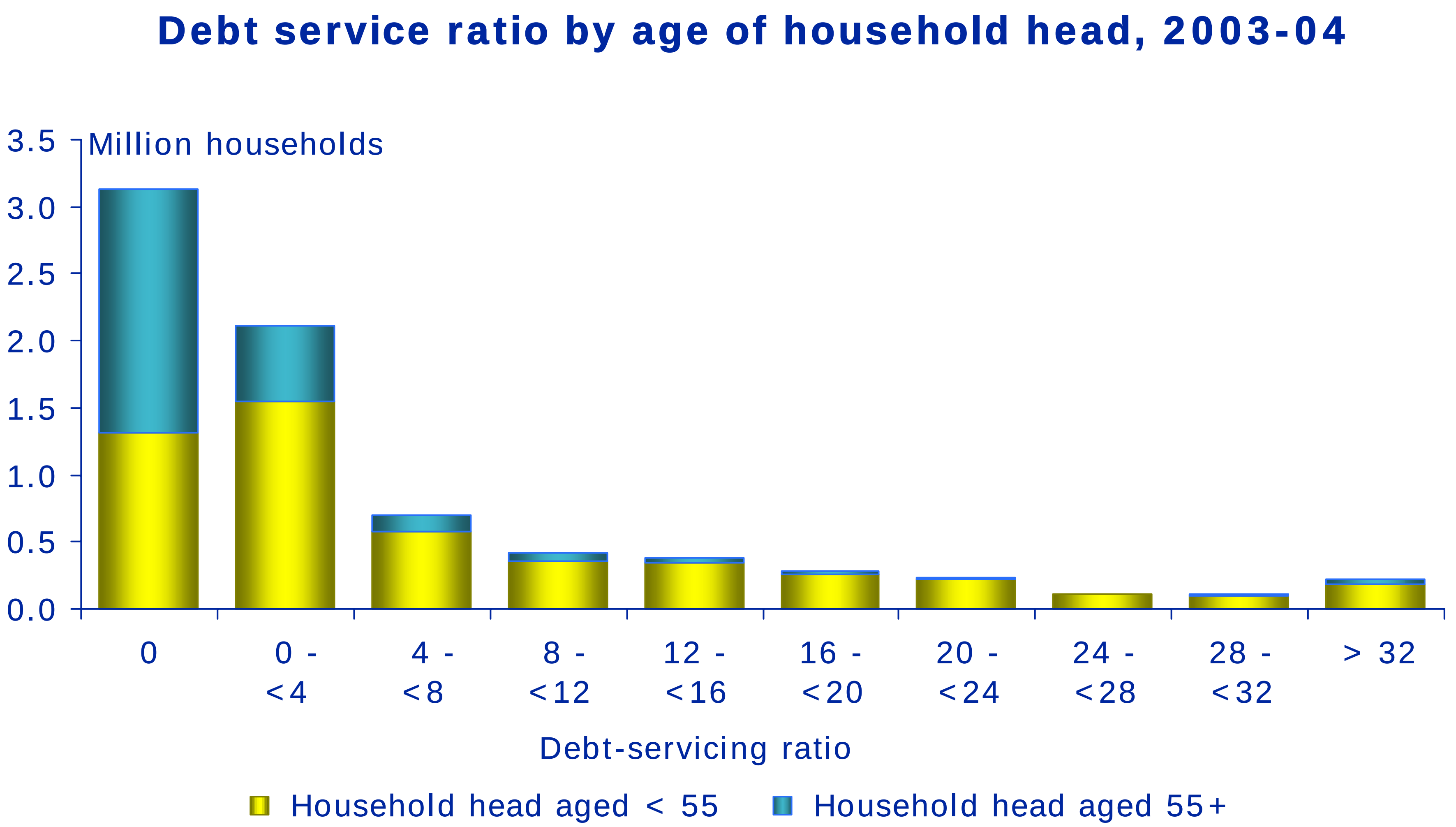
High levels of household debt are concentrated among households who can service it

Interest and principal repayments as a p.c. of disposable incomes, by income quintiles 2003-04



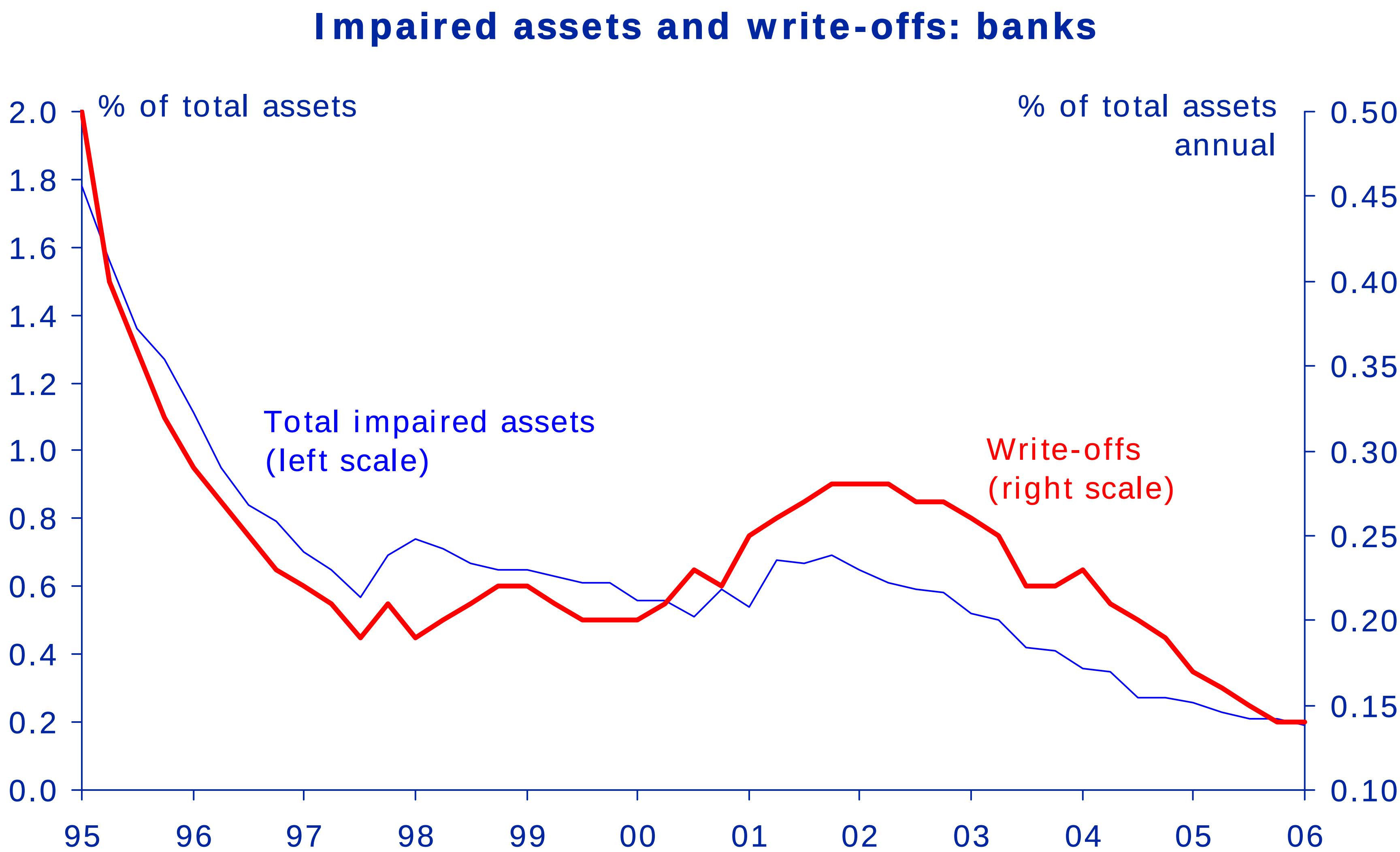
Note: Figures in parentheses show average weekly household disposable income for each quintile. *Source:* ABS; Economics@ANZ.

Two thirds of Australian households have little or no debt



Source: ABS (unpublished data from *Household Expenditure Survey*; Economics@ANZ.

Total loan delinquencies and write-offs remain at extremely low levels

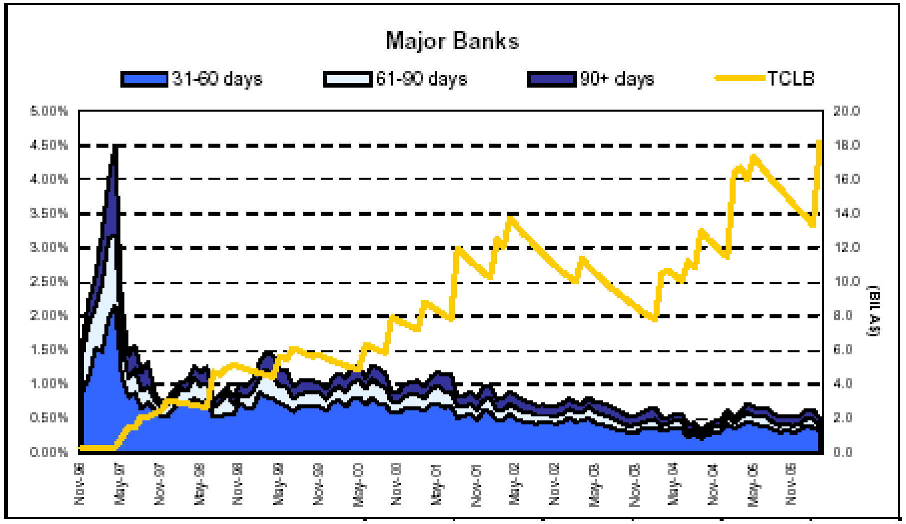


Source: RBA

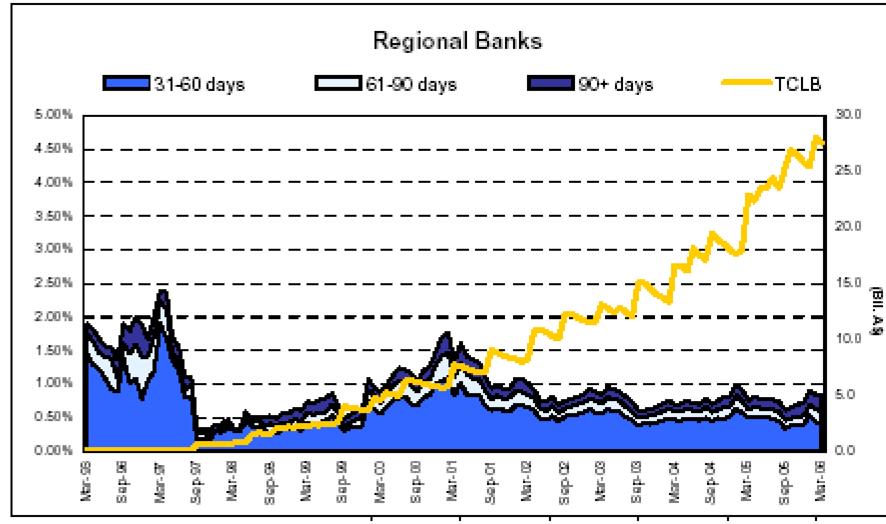
economics@ANZ

Rising loan delinquencies largely confined to mortgage originators

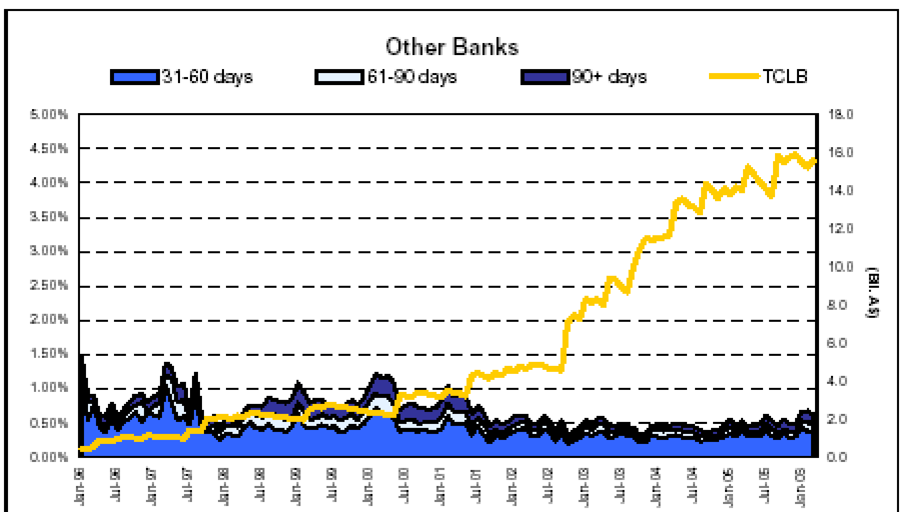
Major banks



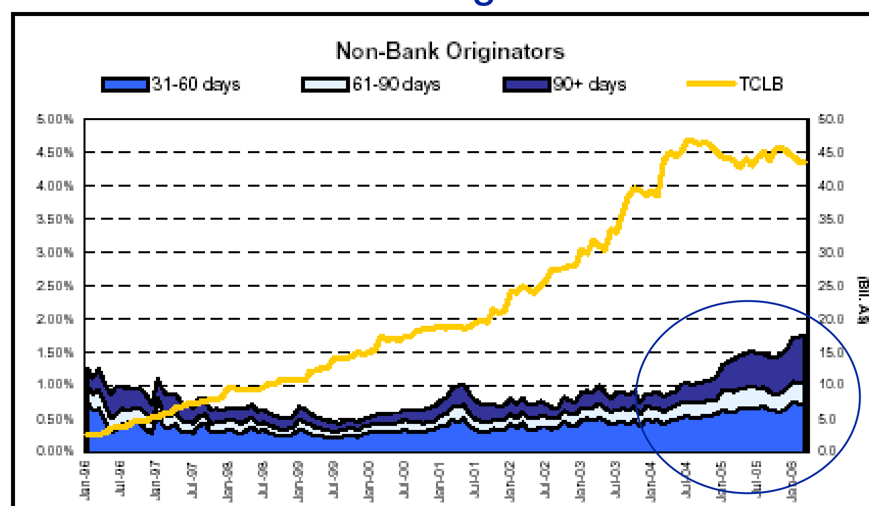
Regional banks



Other banks



Non-bank originators

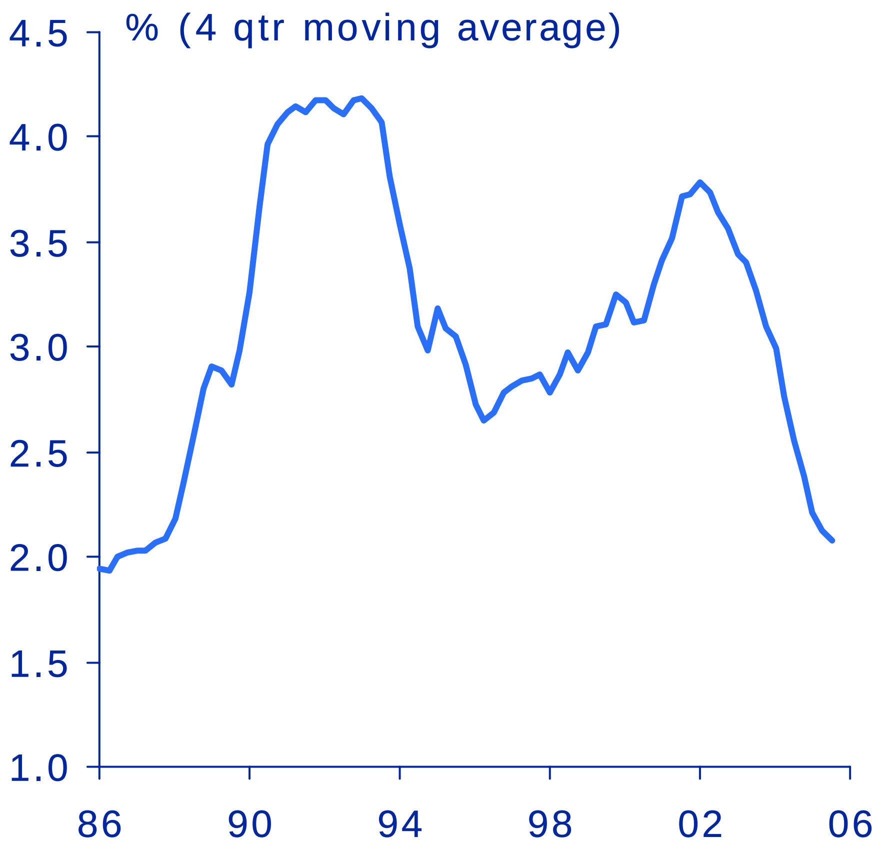


Source: S&P

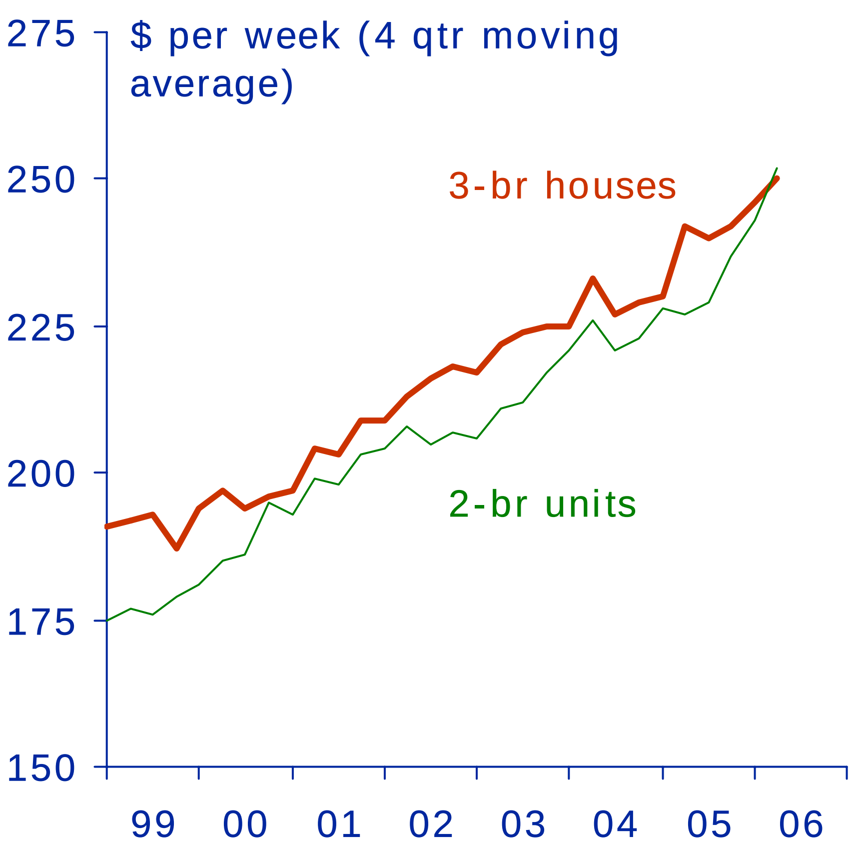
economics@ANZ

Despite the increase in ‘buy-to-let’ housing investment, rental markets remain tight

Rental vacancy rate



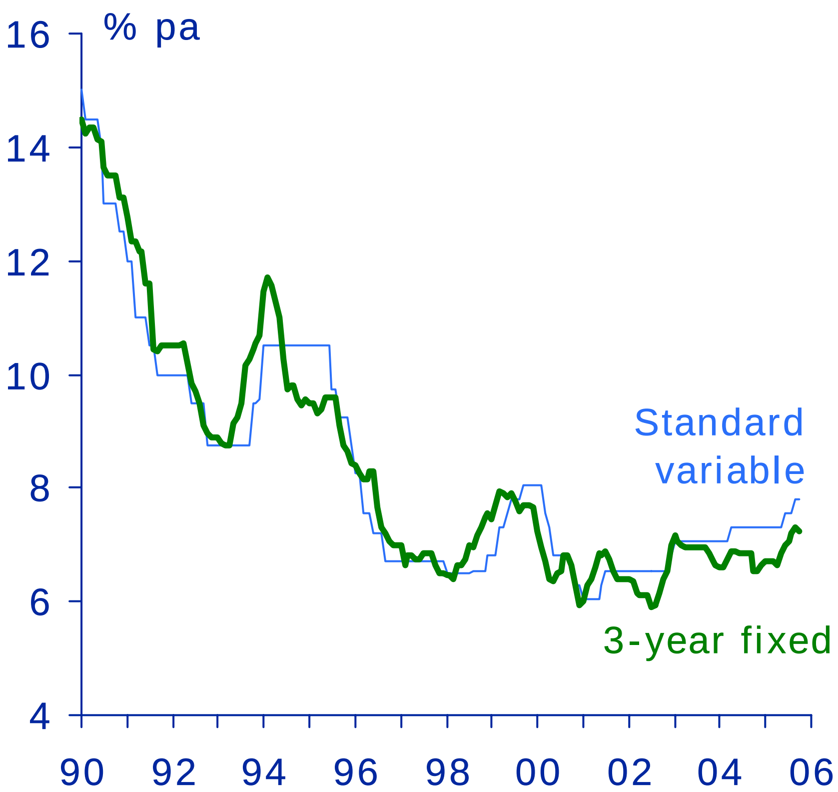
Median rents



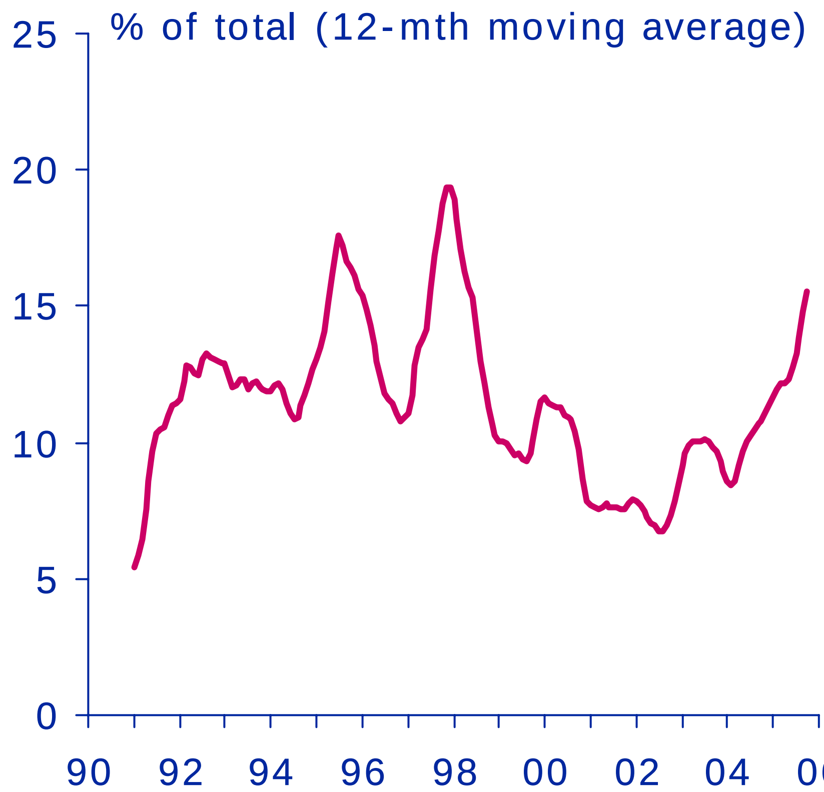
Note: data are weighted average of eight capital cities.
Source: Real Estate Institute of Australia.

Fixed-rate mortgages remain relatively unpopular in Australia

Fixed and floating mortgage rates

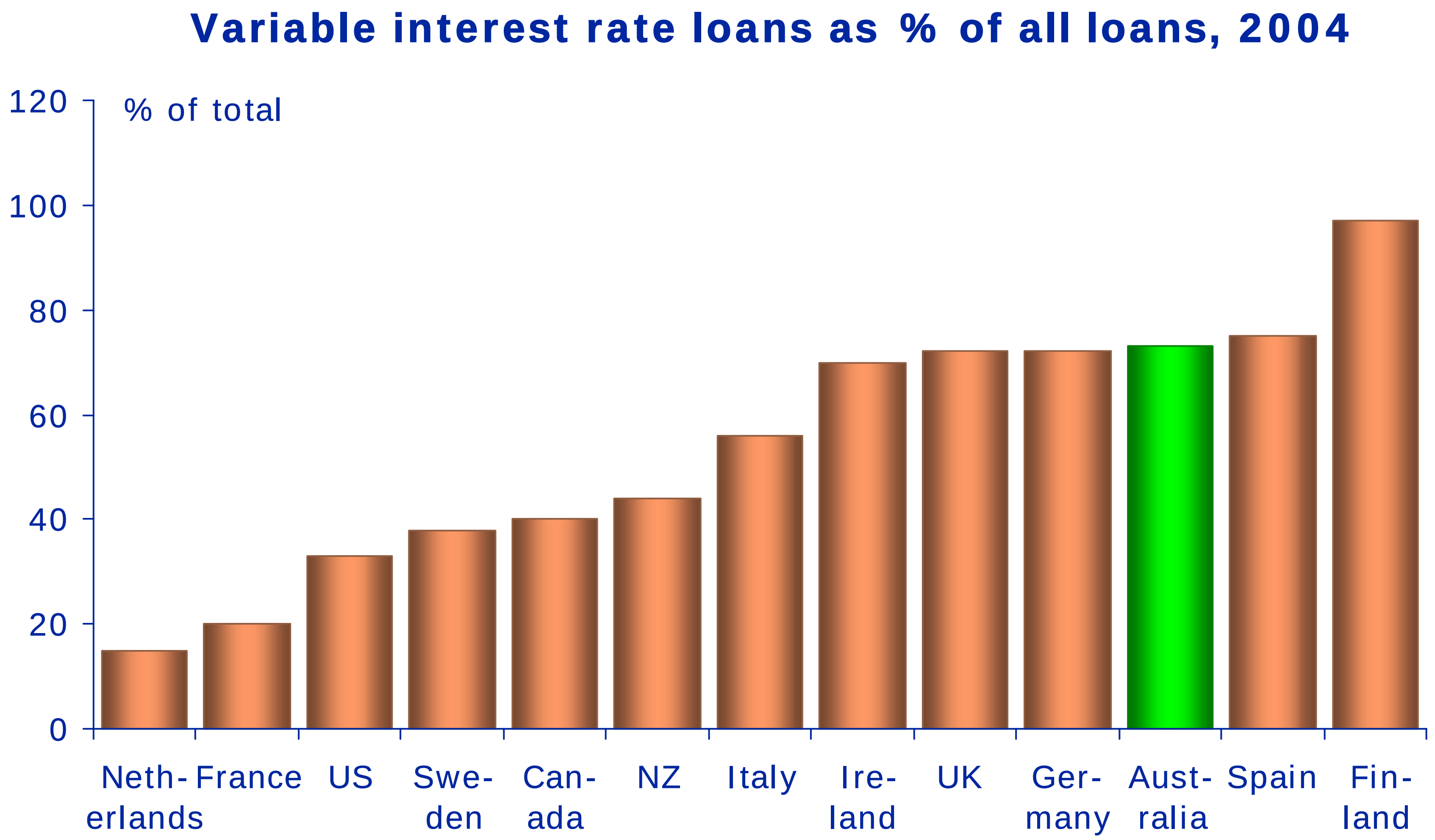


Fixed-rate loans as a pc of total new loans



Sources: RBA; ABS; Economics@ANZ.

The proportion of mortgages at floating rates in Australia is high by international standards



Source: OECD

economics@ANZ

What goes up doesn't necessarily have to come down ….

- Some observers point to the fact that Australian house prices are now at record highs relative to incomes or rents
  - and argue that, just as falls in share prices are often preceded by periods in which price-earnings ratios have been unusually high, high ratios of house prices to incomes or rents mean that house prices must 'inevitably' fall sharply
- This line of reasoning ignores a fundamental difference between the share and residential property markets
  - no-one has a 'natural long' position in the share market
  - but in cultures where home ownership is strongly preferred (such as Australia), the household sector does have a 'natural long' position in the residential property market
- So long as interest rates remain at reasonable levels (and unemployment remains low) – so that currently marginal owners do not become forced sellers – people will not sell their own houses simply because they appear 'over-valued'
- However the 'structural' price gains of the past 15 years are most unlikely to be repeated
- And the increased presence of investors in Australian housing markets could induce greater price volatility