Housing finance in Australia

Presentation to
Bank for International Settlements
Markets Committee

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

**Australian housing tenure, 2005**

- Owned outright
- Owned with mortgage
- Private rental
- State rental

**Composition of household wealth, 2006**

- Land
- Dwellings
- Other ‘real’ assets
- Life insurance & pension funds
- Shares
- Other financial assets

**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.

Australian capital city established house prices

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

Housing completions

190
180
170
160
150
140
130
120
110
100
71 76 81 86 91 96 01 06
000 units (annual rate)

Sources: ABS; Economics@ANZ.
... but so has the number of households requiring accommodation

Sources of population growth

Average number of persons per household

Falling household size has resulted in the creation of over 500,000 more households than suggested by 'raw' population growth

Sources: ABS; Economics@ANZ.
Thus the supply of housing has barely kept pace with the increase in underlying demand

- 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

**Number of households and number of dwellings**

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*Note:* Dwelling stock estimates for 1991, 1996 and 2001 based on census figures; other years interpolated using completions data.

*Sources:* RBA; ABS; Economics@ANZ.
Since the early 1990s mortgage rates have halved while real incomes have grown by 11½%.
‘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

- 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

Note: data are for the June quarter each year. Sources: ABS; 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 (e.g., 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**

- **% per annum**
- **Standard variable mortgage rate**
- **Mortgage rate subject to regulatory ceiling**
- **RBA cash rate**

**Mortgage lenders’ margins**

- **% points**
- **Standard variable mortgage rate over cash**
- **Effective mortgage rate over cash**

Sources: RBA; Economics@ANZ.
Australian households are repaying mortgage principal more slowly

Mortgage repayment rate

% of principal outstanding (4-qtr moving average)

Sources: ABS; 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.
The tax system has encouraged investment in rental property especially after 1999

17 Note: Data are for fiscal years ended 30 June.
Sources: Australian Taxation Office; Economics@ANZ.
Investment property lending grew rapidly, especially after the 1999 tax changes.

**Finance commitments to owner-occupiers & investors**

- Owner-occupiers (excl. refinancing)
- Investors

**Loans to investors as a pc of total commitments**

*Source: ABS.*
Borrowing for housing has grown rapidly over the past fifteen years

Mortgage credit to households

Nominal

% change from year earlier

'Real'

Average new mortgage

A$000 (trend estimate)

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**

<table>
<thead>
<tr>
<th>Year</th>
<th>% of annual disposable income</th>
</tr>
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<tbody>
<tr>
<td>76</td>
<td>25</td>
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<tr>
<td>81</td>
<td>75</td>
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<tr>
<td>86</td>
<td>125</td>
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<td>91</td>
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<td>96</td>
<td>225</td>
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<tr>
<td>01</td>
<td>275</td>
</tr>
<tr>
<td>06</td>
<td>325</td>
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</tbody>
</table>

**Interest payments to income**

<table>
<thead>
<tr>
<th>Year</th>
<th>% of annual disposable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>76</td>
<td>0</td>
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<tr>
<td>81</td>
<td>2</td>
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<td>86</td>
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<td>01</td>
<td>10</td>
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<td>06</td>
<td>12</td>
</tr>
</tbody>
</table>

**Total**

Housing

**Sources:** Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.
Australian households now have relatively high debt-income ratios by international standards

Household ‘debt to income’ ratio

% of annual disposable income

90 92 94 96 98 00 02 04 06

Australia
UK
US
New Zealand
Canada

Sources: ABS, Thomson Financial Datastream.
On the other hand, the value of household assets has also risen substantially.

Sources: Australian Bureau of Statistics; Reserve Bank of Australia; Economics@ANZ.
High levels of household debt are concentrated among households who can service it

- 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

Debt service ratio by age of household head, 2003-04

Source: ABS (unpublished data from Household Expenditure Survey; Economics@ANZ.
Total loan delinquencies and write-offs remain at extremely low levels

Impaired assets and write-offs: banks

Source: RBA
Rising loan delinquencies largely confined to mortgage originators

**Major banks**

- 31-60 days
- 61-90 days
- 90+ days
- TCLB

**Regional banks**

- 31-60 days
- 61-90 days
- 90+ days
- TCLB

**Other banks**

- 31-60 days
- 61-90 days
- 90+ days
- TCLB

**Non-bank originators**

- 31-60 days
- 61-90 days
- 90+ days
- TCLB

Source: S&P
Despite the increase in ‘buy-to-let’ housing investment, rental markets remain tight.

**Rental vacancy rate**

% (4 qtr moving average)

**Median rents**

$ per week (4 qtr moving average)

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**

- Standard variable
- 3-year fixed

**Fixed-rate loans as a pc of total new loans**

% of total (12-mth moving average)

*Sources: RBA; ABS; Economics@ANZ.*
The proportion of mortgages at floating rates in Australia is high by international standards.

Variable interest rate loans as % of all loans, 2004

Source: OECD
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