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Keeping home ownership within reach – Address to the Urban Development Institute of Australia (UDIA), Sydney

Check against delivery

Thank you for your introduction.

There are three important economic goals that Australians aspire to. To have a job to support and care for your family, to be independent in your retirement and to own your own home.

As a Government we share and want to facilitate Australians being able to realise these aspirations.

Our national economic plan is focused on driving the investment we need to support growth and jobs and to boost real wages to allow Australians and their families to get ahead.

Our retirement incomes policies ensure a fairer and more sustainable pensions and superannuation system that supports Australians to become and remain independent in their retirement, while ensuring a reliable safety net for those who will always need it.

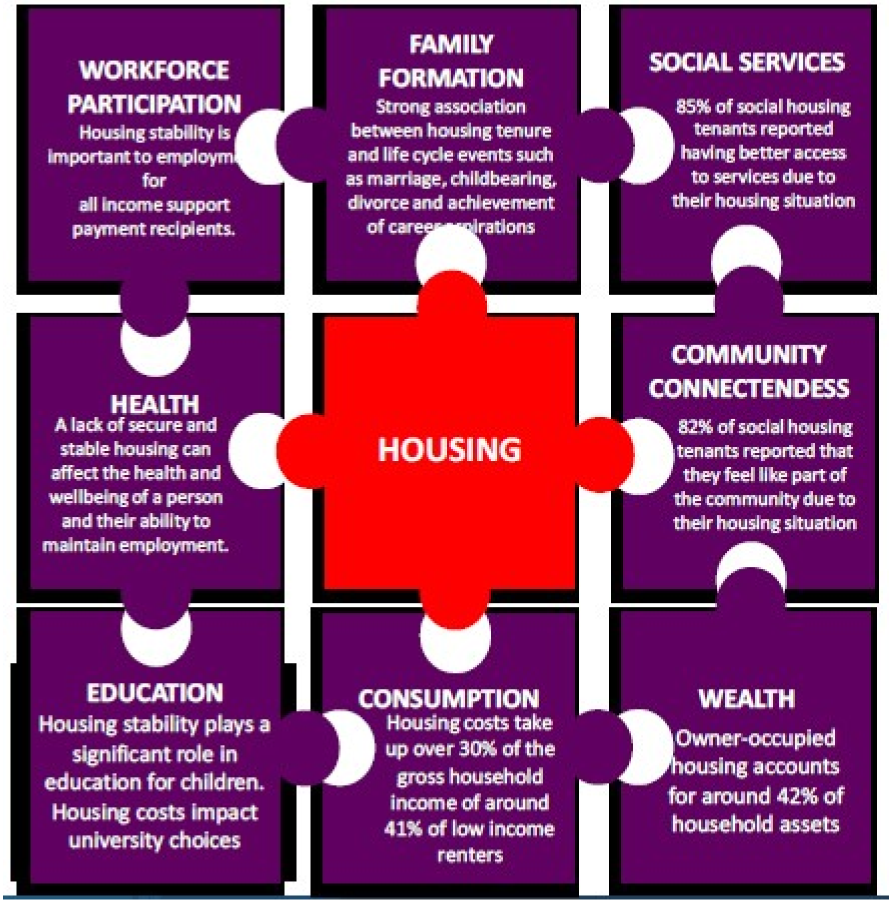
But while the majority of Australians live in a home that is either owned or being purchased by their household, for each new generation this aspiration is proving more and more difficult to realise. That is why housing affordability will be an important policy focus of the Turnbull Government in this parliamentary term. And it is important we get it right.

At the last election our opponents put forward an ill-considered proposal to abolish negative gearing on established housing that offered false hope to those increasingly frustrated in reaching their housing goals.

Labor's proposal was based not on a clear eyed analysis of what was occurring in our housing markets and how to address it, but politics. Labor sought to demonize property investors, portraying negative gearing as a concession for the rich, rather than the reality of being a long established tax principle predominantly used by mum and dad wage earning investors, such as nurses, teachers, police and defence force personnel, while leaving professional investors untouched.

It was designed to undermine the value of people's homes by removing 1 in 3 buyers from the market. This not only would break the purchase chain on which the development of new stock depends, but undermine consumer confidence, drive up rents and weaken our banking system given the extensive exposure our banks have to the housing sector.

Housing affordability is also not just a problem for prospective home buyers.



As younger people and families are delayed or frustrated in purchasing their first home, this is placing pressure on the private rental market and, in turn, concessional or affordable housing accommodation and ultimately social housing.

The challenge of not being able to access secure and affordable housing has flow on effects to so many other social and economic policy areas. It impacts educational outcomes, health, work force participation, social cohesion, welfare dependency, family formation and household consumption to name a few.

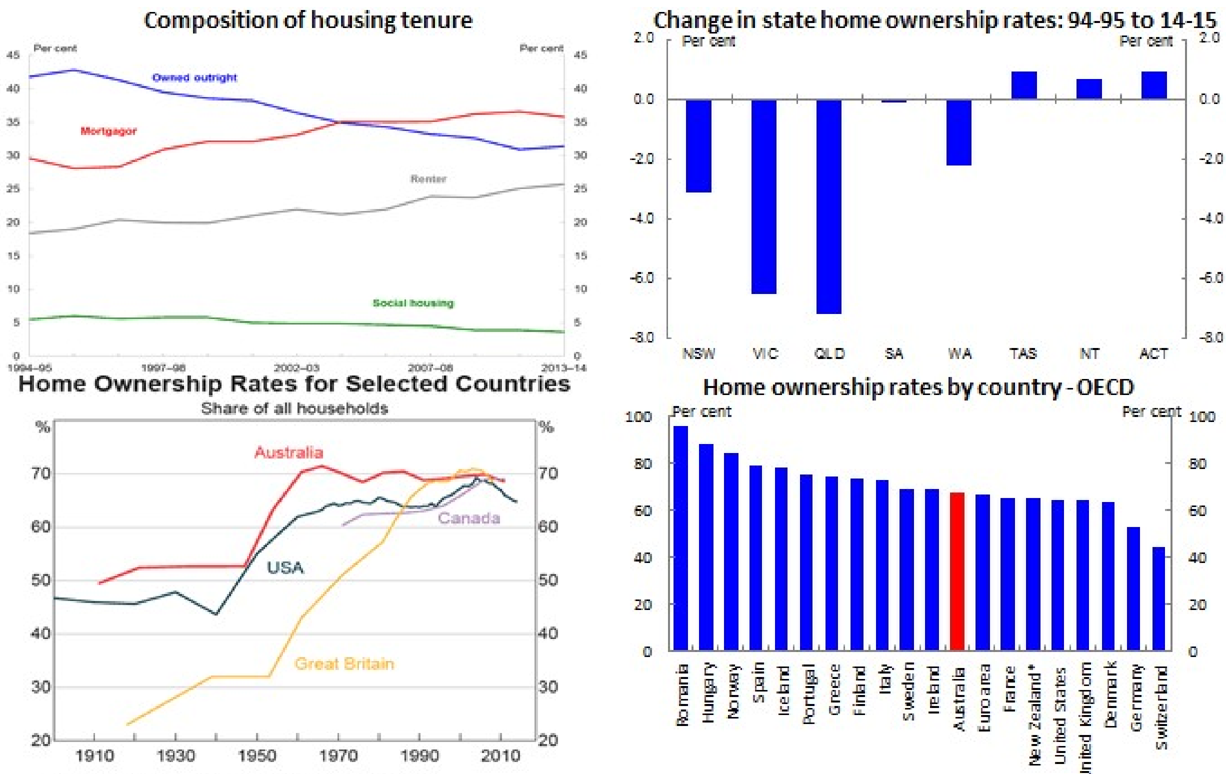
Improving housing affordability right across the housing spectrum must therefore be a key policy goal for Governments at all levels, including the Commonwealth. Our response must be well targeted and ensure that the actions of each level of Government is integrated and uses the levers they have in a way that best addresses the challenges faced.

Housing affordability is not a new problem, it has never been easy to buy a home, especially in our major metropolitan areas. And over the years there have been many attempts to address this issue. Some have helped, many have failed and taxpayers have paid for it.

One lesson from these experiences is that as we move forward it is important to properly diagnose the problems we are trying to solve. As a result, I would like to spend some time today, rather than announcing new initiatives, setting out how we are seeing the challenge of addressing housing affordability in Australia as a first step to explaining our policy response.

Australians either own outright or with a mortgage, they rent in the private market, possibly with Government assistance or they are housed in social housing.

Home Ownership in Australia



Sources: ABS; RBA; Statistics Canada; US Census Bureau

Over the past twenty years the proportion of outright owners has declined while those paying off their house or renting in the private market has increased. When combining both outright ownership and those paying off a mortgage, the proportion of Australian households that own their own home has fallen from 71 per cent to 67 per cent over the past twenty years.

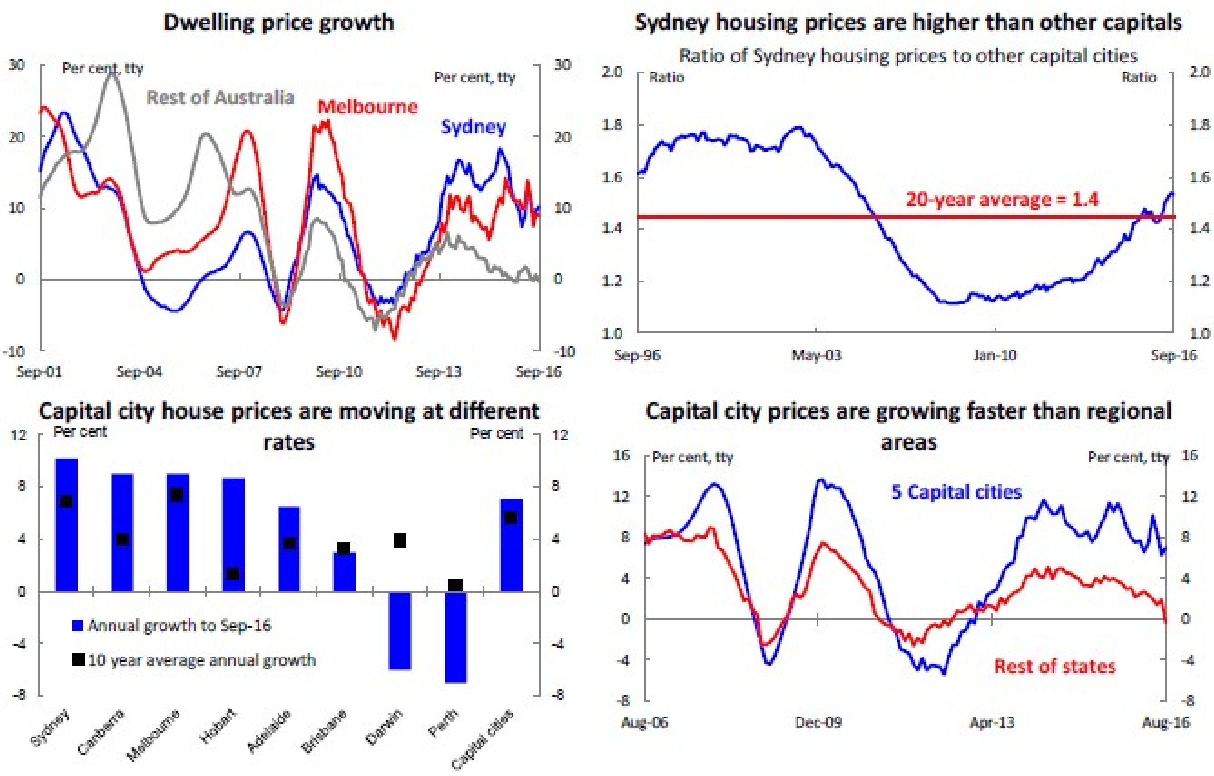
Home ownership rates are falling across all age cohorts, but particularly for young Australians. Between 2002 and 2014, Australian home ownership among 25-34 year olds declined from 38.7 per cent to 29.2 per cent. That is more than 160,000 young people that would otherwise be home owners. For 35 to 44 year olds it fell from 63.2 per cent to 52.4 per cent.

When we look at the change in home ownership by state, the largest falls over the last twenty years have been in Queensland and Victoria, rather than NSW, which declined only slightly more than WA. In the other states home ownership has actually remained neutral like in South Australia or has improved.

Despite this, Australia's home ownership rates are still consistent with trends in other like advanced economies.

The decline in home ownership has been accompanied by a steady increase in housing prices. However, it would be wrong to suggest that these price impacts have been consistent across the diversity of the many housing markets that exist across Australia, as there is no single housing market in Australia.

There is no single housing market

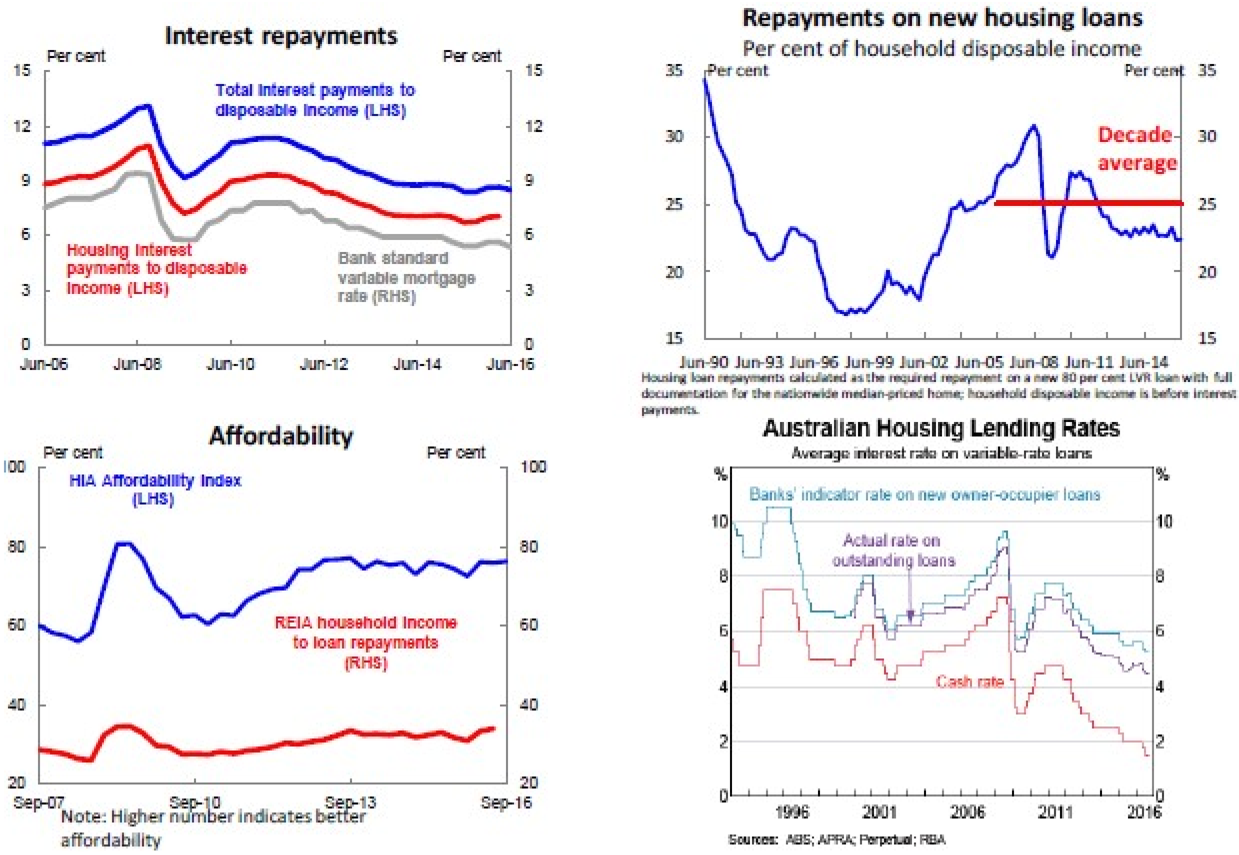


Capital city prices have grown far more rapidly than in the rest of the country. Sydney price growth has been greater than all the other capitals, followed closely by Melbourne. In Sydney and Melbourne prices have risen around 65 per cent and 40 per cent, respectively, since their early 2012 lows. While Sydney and Melbourne prices have grown by around 10 per cent in the past year, in Perth and Darwin they have fallen by up to 7 per cent after very strong increases fuelled by the mining boom.

While house prices are expensive, growth in capital city dwelling prices appears to be moderating after several strong years. Prices grew by 7.1 per cent through the year to September 2016 compared with growth above 11 per cent per by annum at various times over the past three years, and 5.6 per cent over the past 10 years.

This increase in prices has also increased relative to incomes. In some regions of Sydney, median prices are as much as 9 times higher than disposable incomes. This has also seen the average mortgage increase as a share of annual median income. In Victoria and NSW it has increased from just three times and almost four times respectively in 1996 to almost seven times today. For the other states and territories it has increased from three to five times annual median income over this period.

Affordability for existing owner occupiers has stabilised



Despite this, lower mortgage rates means for those who have already purchased a home, mortgage serviceability remains better than its 20-year average. This is similarly borne out in the REIA affordability index and is also true for new home loans, where repayments today are below the decade long average, falling from over 30 per cent before the GFC to 22.4 per cent today.

According to the RBA, the average buffer in mortgage offset accounts and redraw facilities has risen to around two and a half years' worth of scheduled repayments at current interest rates. However, these buffers tend to be bigger among high income households and many households remain vulnerable to higher interest rates in the future or to changes in their employment status.

Digging beneath these aggregate figures shows that the pressure of servicing a mortgage is greater for some groups than others. For younger age groups, the share of median household income spent on mortgage payments has increased by more than half for 25-34 year olds between 1981 and 2011 and more than doubled for 35-44 year olds, with each paying around 25 per cent or more of median household income on their mortgages.

It is also interesting to note that the proportion of home owners aged over 45 with a mortgage has increased significantly over the past twenty years. It's taking longer for people to own their own home and be free of their mortgage. This trend has the potential to undermine retirement incomes, with superannuation cashed in on retirement to clear the mortgage or having mortgage costs eating into retirement income or undermining their ability to save more as they approach retirement.

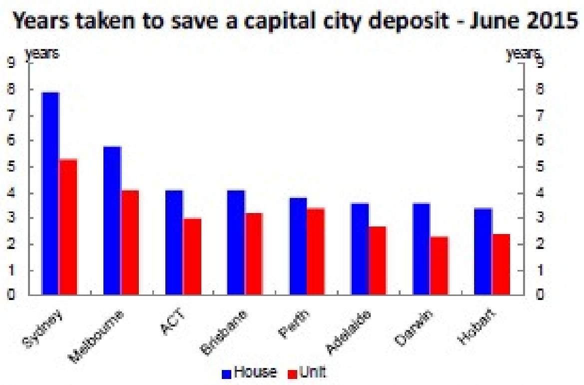
The Productivity Commission noted in 2015 that the most frequent use of superannuation lump sums was to fund housing, including paying down mortgages and renovations.

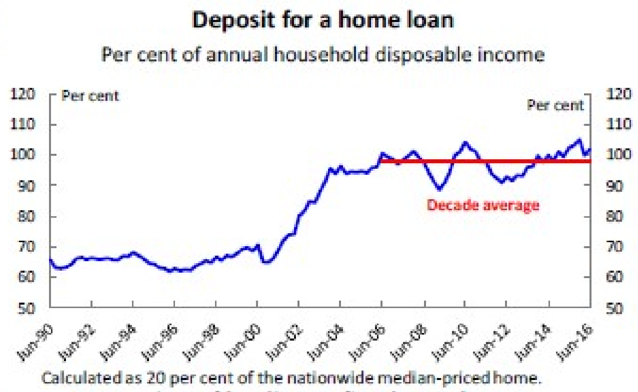
These trends are further evidence of the cascading impact of housing un-affordability.

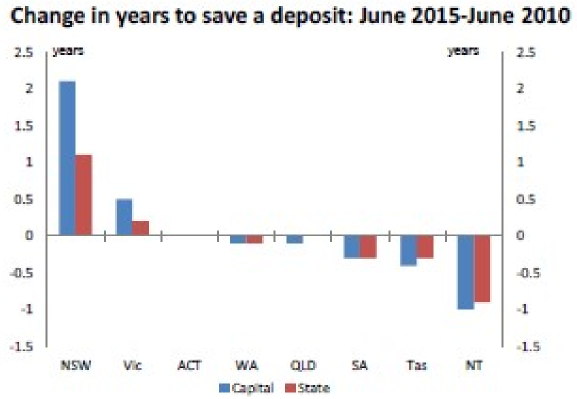
The real pinch point is for Australians being able to get into the housing market in the first place, which is affecting many would-be first home buyers. While low interest rates may make it easier to pay down a mortgage, they also make it harder to save to get one in the first place.

As house prices have risen relative to incomes, this is making it more difficult for first home buyers to keep up and save an adequate deposit. Even if first home buyers are more likely to buy a cheaper house than the median, this is nonetheless much higher than in the past and, again, these aggregate figures likely mask regional differences and the acute pressures of those contemplating entry into the Sydney market in particular.

Households are struggling to buy their first home







The proportion of home loans that are being provided to first home buyers was 13.4 per cent in August 2016, well below its long-term average of 19.4 per cent.

In aggregate, across the country, a 20 per cent deposit on the nationwide median home loan is more than 100 per cent of annual household disposable income. This is slightly above the decade average, but well above the 60 per cent levels that were the norm prior to 2000.

Between June 2010 and June 2015, the time taken for a dual income couple to save for a 20 per cent deposit in Sydney increased from 5.8 years to 7.9 years. In Melbourne it increased from 5.3 years to 5.8 years. However, outside NSW and Victoria, the change in the number of years to save for a deposit actually fell. So once again, the impacts are not even across the country. Highlighting the risk that tailoring a solution to deal with house prices in Sydney and Melbourne can have the reverse effect on markets in other areas.

All of this can seem very unfair. The market is getting away from people. No matter how hard they work or save or even earn, they are finding it harder and harder to get into the market.

To develop a sensible policy it is important to separate out the forces that have been causing house prices to rise.

Housing in Australia, especially in Sydney, Melbourne and Brisbane, is expensive and increasingly unaffordable, but that does not mean it is over-valued.

Around 65 per cent of the major bank's domestic loans are supported by residential property. Equally, 90 per cent of household debt, which has recently risen to 186 per cent of household disposable income, is housing debt, supported by the asset values of people's homes. If these asset values were not real, this would be a significant risk which has implications for the stability of our financial system and economy.

Also, the value of people's homes play a critical role in supporting consumer confidence and household consumption that has been the single largest contributor to our uninterrupted economic growth over the last twenty five years.

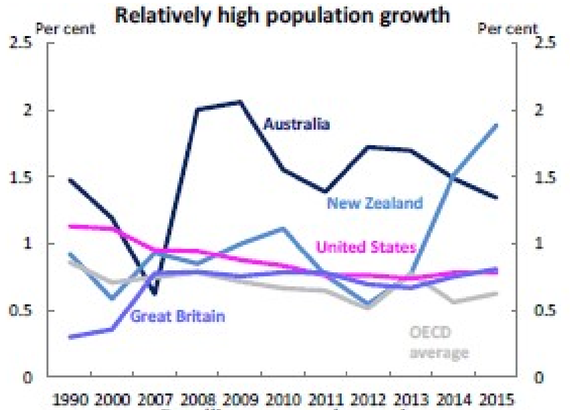
Having made the sacrifice to get there, homeowners are not about to welcome the value of their single largest investment being undermined.

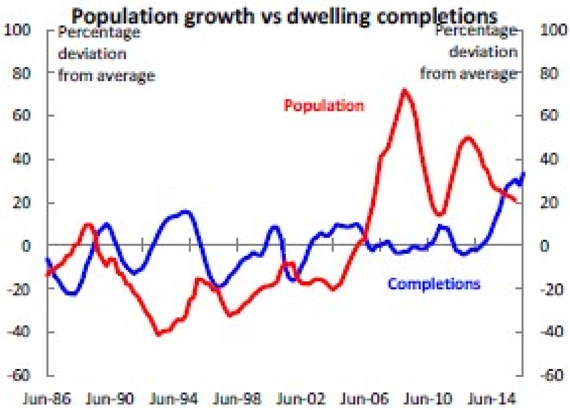
You don’t address housing affordability by crashing the housing market or your economy. Rather the objective is to have policies that mitigate the artificial inflation of asset prices, ensure that supply is not restricted from responding to genuine demand and that enable homebuyers, through their own efforts, to make more rapid progress to being able to enter the market.

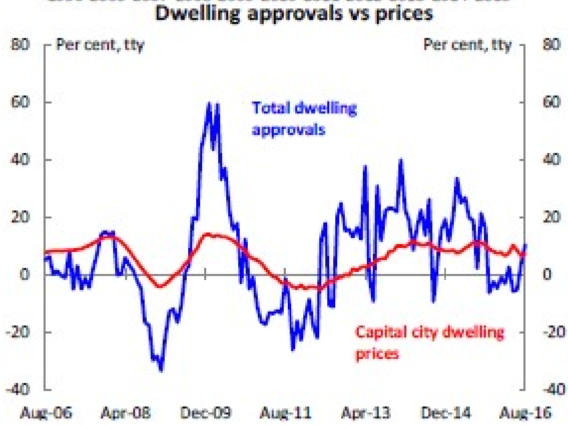
Australia's housing markets may be expensive, but in aggregate they are substantively sound, reflecting the natural tension between the forces of supply and demand.

While many countries have in the past experienced issues with speculative demand, Australia faces a very different set of circumstances.

But high prices reflect underlying value







Over the past decade housing demand has been underpinned by economic and population growth. Australia's population grew at an average annual rate of 1.6 per cent between the start of 2005 and the end of 2014. Between 2005 and 2010, Australia had the highest average rate of population growth in the OECD, except for Israel.

More recently, interstate migration patterns have reversed from flows towards the mining states to flows back to Sydney and Melbourne where the labour market is stronger as the economy transitions away from mining investment-led growth towards the non-mining sectors. For example, there was net interstate migration out of Western Australia in both 2014 and 2015, the first time this has happened since the early 2000s. At the same time, over the past few years population growth in New South Wales and Victoria has been well above their 20-year averages. This, in turn, has added to housing demand in these capitals that have seen the strongest price growth in recent years.

Longer-term demographic factors are also likely to have underpinned demand in recent decades, such as increased labour force participation, which has led to more two-income households who are then able to afford to enter the housing market.

Research by AHURI shows that the percentage of purchasing households aged under 44 that are dual income has risen from just over 50 per cent in 1981 to more than 80 per cent in 2011, while the proportion of single income households fell from around 50 per cent to less than 20 per cent over the same period. In many markets, buying a house without a dual income has become an almost unreachable goal.

Another factor that has supported demand for housing over the last few decades is that the average number of people living in each dwelling has declined slightly, so the demand for dwellings has grown even faster than the population has.

Of all the determinants of house prices in Australia, whether cyclical or structural, the most important factor behind rising prices has been the long running impediments to the supply side of the market.

This not only relates to the volume of supply but also the responsiveness, flexibility, diversity and composition of that supply, as housing needs become more complex.

Dealing with supply is not shorthand for the need to just release blocks on the fringe. As Governor Lowe says, “it’s a more complex picture”.

Looking at recent history, a period of weak residential construction activity in the mid-to-late 2000s left many markets undersupplied, particularly in NSW.

We all remember Bob Carr’s famous declaration that Sydney was ‘full’. As a result, NSW approvals declined in the years immediately following the 2000 Olympics to levels not seen since the 1970’s. Supply is now responding strongly but with a longer than usual lag due to the greater proportion of high-density dwelling construction in the current cycle, which takes longer to build. A large volume of construction is already coming on line and much more is anticipated in the next few years.

However, not all of this supply is in the right place or of the right type of housing. Whilst Sydney, Melbourne and Brisbane have record supply – most of this is in the inner city apartment market which is meeting a certain market demand. Unfortunately, we are still seeing a muted supply of detached housing in other parts of our cities.

Supply-side constraints include: complex land planning and development regulation; insufficient land release; the planning, cost and availability of infrastructure provision; transaction and betterment taxes, public attitudes towards urban infill; and, for Sydney in particular, physical geographic constraints.

Most of these factors either increase development costs directly or increase the time between a developer purchasing a site and being able to sell completed dwellings which, when financed by debt, is itself a cost that has to be capitalised into the prices of new dwellings.

While State Governments cannot do much about the physical geography occupied by our cities, they can do a great deal to improve planning processes and the provision of infrastructure, and many are. This is not about putting anyone on notice but a call to work together.

My Department has heard from developers about increasing development times, with one noting that it took 12 years for a recent project on the outskirts of Melbourne to go from the acquisition of vacant land to a new suburb. This was how long it took for the land to be rezoned and for the developer to meet the onerous hurdles required in construction.

While some construction standards are important for maintaining the safety and quality of newly constructed dwellings, some of these hurdles sounded almost farcical. For example, the Melbourne developer wasn't permitted to design the shopping precinct of the new suburb they had built because the Victorian Government required that their own architects did the work (and at their own pace).

So even though there have been some signs of a supply response in recent years, particularly in inner-city apartments, more needs to be done to ensure that supply increases more broadly — both in terms of location and type of dwelling — and that the roadblocks to this increased supply are removed.

In 2014, the Government commissioned the Harper Competition Policy Review, the first root-and-branch review of our competition policy framework in a generation. The Harper Review identified regulatory impediments across the economy that unnecessarily restrict competition and reduce productivity.

While the Competition Policy Review did not directly address land-use planning regimes that impact housing supply and instead focused on commercial planning and zoning, we recognise that many residential land-use planning regulations involve similar challenges.

The Government will therefore also be discussing with the states the potential to remove residential land use planning regulations that unnecessarily impede housing supply and are not in the broader public interest.

This will be the strong focus of my discussions at the next Council on Federal Financial Relations that I will convene in early December.

I also note the UDIA's 2016 'State of the Land' report argues the priority for all levels of government should be to deliver a stable policy environment which stimulates investment in new housing supply. We agree and we are embarking on the work necessary to progress better outcomes in these crucial areas.

Only last week the Commonwealth and NSW State Government announced a Western Sydney City Deal, which outlines how we will work together to make Western Sydney more liveable for the community and the businesses that serve it.

This deal will coordinate government action to increase housing in Western Sydney through better planning and density done well and streamlining approvals across all three levels of government.

The Turnbull Government's City Deals initiative is ground breaking reform aimed at making our cities more liveable through more integrated planning and improved delivery of infrastructure.

On the demand side, financial liberalization, starting in the 1980s, has given more Australian households access to credit, including for mortgages to finance the acquisition of real estate.

So while it is true that the average mortgage is much greater as a share of household income than it used to be, access to capital is far more readily available than it used to be.

Currently, the RBA's cash rate is at an historic low, the average standard variable mortgage interest rate is at its lowest point since the 1960s and many banks offer substantial discounts to this standard rate.

There is no doubt the availability of credit has made it easier to invest in residential property post the GFC but to imply that a credit fuelled investor speculative housing bubble is the main driver of house prices is an overly simplistic conclusion.

For this to be true house prices need to have moved by more than some conception of fundamental value. It is only in this case where the overall market is at risk of a severe correction.

This is one of the key differences between what is happening in Australia and what has happened in some other countries that have experienced difficulties in their housing markets. The increase in Australian house prices has largely been driven by fundamental determinants. It has also not been accompanied by the more lax regulation and lending standards witnessed in some other countries.

Australia had a comparable run up in dwelling prices to the US in the early 2000s, but there were some key differences between our experiences. In Australia, our banks applied stricter lending standards than their American counterparts, with fewer low-doc or subprime loans.

Further, unlike in many parts of the US, our lending is based on full recourse financing so that borrowers cannot just walk away from loans and throw their keys in the door as they can in many parts of the US. Aided by these measures, prices did not fall significantly during the financial crisis.

Moreover, our regulators have experience of these kinds of risks and have shown in the past that they can successfully manage them. In fact, the Reserve Bank tightened monetary policy in Australia in 2003 and 2004 with specific reference to developments in the housing market, while APRA increased the intensity of its supervision.

Risks around an oversupply in inner-city apartment markets have also received increased attention in recent times, where the number of new dwellings due to be constructed over the next couple of years appears quite large as a share of the existing dwelling stock. This has raised the prospect of the risk of settlement failures around some new property developments in these areas as the increased supply weighs on property prices.

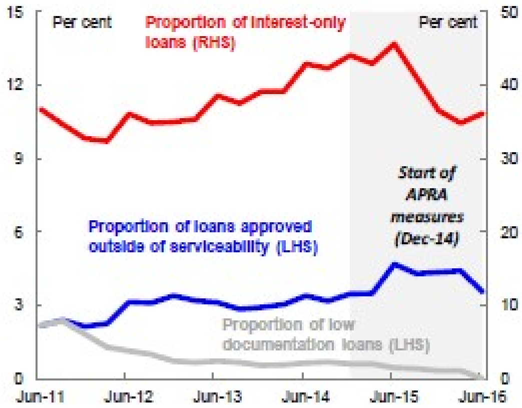
This is an area that both banks and authorities are aware of and are taking actions to mitigate. As the RBA has noted, banks have already taken steps to tighten lending standards and collateral requirements for higher density residential projects, which will help forestall future over-supply in some inner-city areas.

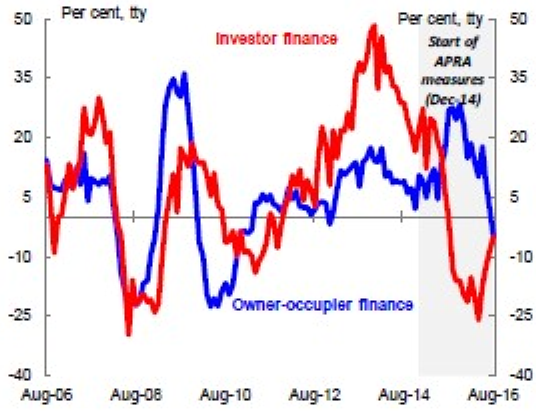
To date, settlement failures remain extremely low and oversupply in Australia is limited to a number of discreet sub-markets in the apartment sector.

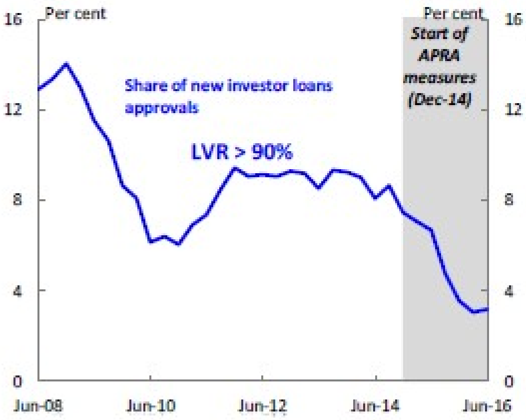
Notwithstanding some regional risks, the current construction cycle would likely have to run-up faster and continue for longer before oversupply became a nationwide macroeconomic risk.

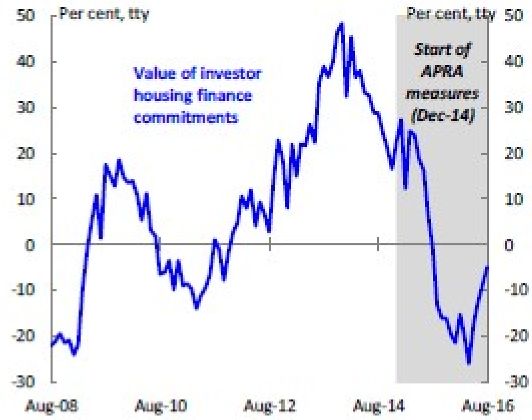
That is not to say that the size and length of the current construction boom won’t warrant attention in the coming months and years.

Investor lending has stabilised









Policy makers are very cognisant of the risks and have been doing something about it.

In fact, the RBA has been calling attention to the risks in its bi-annual Financial Stability Review for some time and the Council of Financial Regulators has been active in tightening prudential supervision.

The intensity of prudential regulation of the mortgage sector has increased markedly in recent years, which should help guard against a systemic deterioration in lending standards.

In particular, you would all be aware that APRA announced in December 2014 that it will further increase its supervisory intensity—increased reporting obligations and on-site visits—and may require banks to hold extra capital if they fail to limit investor growth to 10 per cent, impose minimum standards on a borrower's capacity to meet higher repayments and wind back on high risk lending practices such as an excess of interest-only loans or too many loans at high loan-to-income and loan-to-value, or LVR, ratios.

Largely as a result of these measures, investor credit growth has slowed from 10.8 per cent in May 2015 to 4.6 per cent in August 2016. This measured approach by APRA to cool investor activity is a far more calibrated and preferable response, compared to the sledgehammer of abolishing negative gearing. Indicators of the quality of credit being extended in the mortgage market have also improved.

The proportion of loans made at the highest loan-to-value ratios has declined, low-documentation loans have dwindled to an insignificant proportion of bank lending and new interest-only lending to owner-occupiers has declined sharply.

This has been achieved without undermining the housing market and the value of Australians' investments, like policies that have been touted by some others as a solution to Australia's housing concerns.

In addition, the Australian banks themselves have, to a certain extent, also tightened lending standards independent of some of these regulatory measures. For example, varying maximum loan-to-value ratios for loans in higher risk areas and applying greater scrutiny to foreign sources of income on loan applications. Indeed, all four major banks have announced restrictions on the use of foreign income for housing credit this year.

But our small, relatively open economy will always be exposed to external shocks of one kind or another. Although it is hard to guard against external shocks directly, our highly capitalised banks provide some insurance that the impact of any shock will be lower. This is the direction APRA has and will continue to move in. In addition, the RBA has noted only limited concerns about loan serviceability and has previously noted that the bulk of household debt is held by those households who are most able to handle it.

Of course, house prices and home ownership are only one piece of the puzzle of the Australian housing market. Today I have only had the time to address some of the issues and forces impacting on these areas of the market.

On another opportunity I will lay out how these pressures in the home purchase market are flowing on to the rental sector and the increasing pressures being placed on our social and affordable housing programmes.

In conclusion I want to reiterate the Turnbull Government's commitment to getting more Australians into their own homes.

We do not achieve that goal by embarking upon policies that will hit the housing market, lessening the value of assets that Australians rely upon, as our opponents would do with their effective abolition of negative gearing.

Instead we must understand the core drivers of our housing market and armed with that knowledge lift more Australians into the market by way of effective policies that better improve housing outcomes.

I look forward to working with my Commonwealth, State and Territory colleagues and of course the housing and development industry to achieve outcomes towards this goal.

Thank you for your attention.

Australian Government
The Treasury

Portfolio Ministers

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The Hon Kelly O'Dwyer MP (http://kmo.ministers.treasury.gov.au/)
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