A long view of Australia’s housing affordability crisis

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Rapid growth in the cost of housing in Australia has priced many, particularly the young and lower-income Australians, out of the housing market. The issues of housing affordability were addressed in a 2017 CEDA policy perspective on Australia’s housing, *Housing Australia*.

In a presentation before the launch of the report, its consulting economist, Dr Judith Yates, outlined future consequences for the Australian economy if current issues are not addressed. She advocated for a system that recognises housing as “a social good and a basic human right”, and recommended a housing system that is fairer and more accessible.
Thanks for the invitation to speak today.

My assigned task today is to provide an evidence-based, forward-looking presentation on housing affordability. I’m going to start with an overview of past trends – I hope that much of this material will actually be familiar to you – and I’m doing that because I think to look forward you actually need to take a long-term perspective, and hence the reason for the title of my presentation.

I’m going to start 40 or 50 years ago and focus initially on housing prices and some of the points I’ll make have actually been picked up already by the (Federal) Treasurer and the Assistant Minister to the Treasurer in a number of their speeches on housing, both before and after the Federal Budget.

What I hope to do is to add value to their contributions by putting the policies that they’ve proposed into a broad perspective and by giving you a sense of what policies might be needed if they’re going to have a lasting impact on housing affordability.

Since the 1970s, Australia-wide dwelling prices have risen faster than incomes, which most people are very familiar with. At the moment, we’re now at the stage where the dwelling price to income ratio has doubled at around a ratio of six or seven.

Now, there’s a substantial body of evidence that dwelling prices increase basically as a result of demand pressures.

There are:

- Demographic trends, such as rising populations and household growth; and

- Economic drivers, such as growing real incomes, growing real wealth, low interest rates and fiscal policies, particularly taxation policies, that treat housing favourably.

Since the financial deregulation of the mid-1980s, demand has been facilitated by very favourable financing conditions.

These demand pressures, which are basically underlying fundamental pressures, have a bigger impact on price when supply is more inelastic – that is to say, the more supply is constrained in responding to rising prices. Short-run supply constraints – examples are planning delays – will increase housing price cycles, but it’s the interaction of underlying demand pressures with long-run supply constraints that generate the upward trend in housing prices.
In Australia, long-run supply is constrained because of our urban settlement pattern. Two-thirds of our population live in a capital city and 40 per cent alone live in Sydney and Melbourne. Structural change, with a shift away from agriculture and mining towards the service sector or service-based economy, has contributed to an increasing proportion of the population living in urban areas.

Increasing urbanisation has resulted in what might be called “diseconomies of scale”. These arise because location matters. Increasing demand puts pressure on well-located land, and because of the contribution that land makes to total housing costs, adds to the cost of housing where well-located land is scarce.

This shows up in increasing housing price gradients in our major cities, which have increased dramatically in the last three decades.

In Melbourne, the rise in housing price gradients has been quite dramatic over two decades. And it’s not just Melbourne; it’s in basically all our major cities. That increase in the dwelling price gradient has been affected by increasing income and wealth inequalities because, basically, prices increase most in locations where people with the biggest capacity to pay want to live, and that’s usually where there’s little vacant land.

So, what are the implications of these trends? The first outcome, as we all know a lot about from the media, is that increasingly many new households are unable to afford to buy.

Despite generally declining interest rates since about the mid-1980s, the borrowing capacity of middle-income households has failed to grow at the same rate as the median housing prices.

With today’s interest rates, a household on an income of about $80,000 (roughly equal to current median household income) might be able to borrow about $300,000, which leaves a deposit gap of around about $200,000 – considerably more than twice median household incomes. This deposit gap is much bigger, especially if you’re in Sydney or Melbourne, because $500,000 is not a particularly realistic median dwelling price for Sydney and Melbourne.

Now, some households bridge that deposit gap by relying on the bank of mum and dad. Current policy proposals suggest they might bridge it through additional contributions of superannuation. However, these solutions really aren’t always feasible.
An alternative for middle-income households is to lower their aspirations and look for a dwelling that costs less than $500,000. However, many will be constrained in their dwelling type and location choices by family or work reasons. Suitable affordable dwellings may not always be available.

For example, fewer than 25 per cent of dwellings in Sydney sell for less than $500,000 and most of these are located in Sydney’s outer ring or as far afield as Wollongong or Newcastle. The same applies in other major cities. So, a second outcome is that the middle-income households who do access the market are moving to the fringes of our bigger cities.

But not all can do this; not all can afford to purchase a home and not all want to live where they can afford to buy, and that means there’s been a marked decline in home ownership rates among younger households over the past 30 or so years.

Home ownership rates for the under-35s used to be as high as 60 per cent in the 1970s and 1980s. They’re currently below 40 per cent according to the latest survey data. This decline is most pronounced for lower-income households who just can’t buy anywhere.

What you can see here (figure 1) are home ownership rates from the mid-1980s through to the present time by income quintile – the drop in home ownership rates for the lowest income quintiles are really dramatic. Also, the

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**FIGURE 1**

HOME OWNERSHIP RATES BY INCOME FOR YOUNGER HOUSEHOLDS

Source: ABS income and housing survey data, results derived from basic CURF data

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middle-income, and even higher-income households, are experiencing lower home ownership rates because there are a significant number of higher-income households who can afford to purchase somewhere but they’re choosing to rent because they can rent a better dwelling or in a better location or better regions of the city which have better access to jobs and services.

So, the shift of middle- and higher-income households into the rental market, for lifestyle reasons, reinforces a third outcome of the long-term housing market trends, and that is that lower income households are squeezed out of well-located dwellings.

Increasingly, rental housing that is affordable for the bottom end of the market, for low- to middle-income households, is disproportionately located outside of the major capital cities or is poorly located on the city fringes.

For lower-income households it’s even harder. For a pensioner basically nothing in Sydney, nothing in Melbourne is affordable. And in addition to that, the supply of affordable rental housing is just going, it’s disappearing.

And there’s been no growth in social rental housing, which traditionally has been the solution for housing lower-income households. So, an inadequate supply of affordable rental housing means that large numbers of lower income households face unacceptably high housing costs. An increasing number of households are paying more than 30 per cent of their income in housing.

Now, 30 per cent of a high income, means you’ve got enough left over to do almost anything. Thirty per cent of a middle income on housing means you’ve got nothing left. So low income renters don’t have any options. They don’t have the choice of reducing housing costs by living in smaller dwellings or even in less well-located dwellings; there just aren’t any dwellings for them.

So, like middle-income purchasers, lower-income renters are being forced to the fringes of our cities or to non-metropolitan regions where jobs are less plentiful and less highly paid. This means they’re either forced into longer and costly commutes into job-rich areas such as the CBD, or they have to accept lower-paid or part-time jobs closer to where they live. In other words, they’re being forced to make location choices that are likely to reinforce their current income status.

Okay, so, what of the future? Looking forward there can be little sense of optimism about housing affordability outcomes in the future. Demand pressures are likely to continue, economic growth is projected to continue over the next 40 years, although at a slightly lower rate compared with the last 40 years.
Australia’s population is projected to grow at only a slightly lower rate than over the past 40 years.

Supply constraints – these are the long-term supply constraints – are likely to remain. Urbanisation trends are expected to continue with the proportion of people living in Australia’s capital cities projected to rise from the current 66 per cent to almost 74 per cent in the next 40 years.

Jobs are projected to grow in service and knowledge-based industries, with skilled labour favoured over unskilled. This means the steady growth in earnings inequality that Australia has experienced since the mid-1970s is likely to continue.

So, increasing population, increasing economic growth, and an increase in concentration of well-paid employment opportunities, therefore, are likely to continue to put pressures on well-located land in our metropolitan regions. This pressure will be reinforced:

- Through the continued increasing of income and wealth inequality;
- By a tax transfer system that encourages established households to hold onto the growing equity in their owner-occupied housing, and to increase their housing wealth by borrowing to invest in residential property; and
- By a housing finance system that remains biased to those most able to pay.

Pressures on the private rental market will continue as low- and middle-income households are excluded from home ownership and as higher-income households choose to rent.

So, before I have a brief look at housing policy I think there’s a fundamental question we should ask: what is the housing affordability problem we’re concerned about? My concern, which I think is most probably a little bit obvious from what I’ve been saying, is that because of the way our current housing system operates, we face the danger of a downward spiral in terms of income and wealth, which as suggested both by the OECD and the IMF, will work against the jobs and growth agenda set by our current Government. Housing actually has an impact on the way our economy performs as well as the impact that it has on individuals.

Increasingly, it is being recognised that solutions to Australia’s housing affordability problems are not simple. As both the Treasurer and the Assistant Minister have said, “There’s no silver bullet”. Demand side policies – such as increasing grants to first home buyers, introducing concessional saving
schemes or allowing access to superannuation – all aim to increase income or reduce the deposit gap. Their main effect will be to enable a few marginal buyers to purchase bigger homes in better locations. They’re band-aid solutions. They might be politically popular in the short term, but they’ll be ineffective in the long run. They won’t change the fundamental causes of declining affordability.

A similar observation can be made regarding some of the so-called supply side measures, for example, allowing asset-rich home owners to downsize without losing any of their socially-generated capital gains is, of itself, unlikely to increase the supply of affordable housing. Downsizing depends on there being an adequate supply of lower-valued housing in a location to which older households are prepared to move. This requires increased dwelling diversity in all locations, and needs appropriate planning policies to achieve this.

Likewise, of itself, releasing land at the fringe of the cities will do little to reduce the cost of well-located land. A complementary, fast, affordable transport system from where land is available to where there are jobs is needed if pressures on land price gradients are to be reduced. Like regional policies, transport policy is not always seen as a housing supply side policy.

Some supply side policies, however, are clearly within the domain of housing policy. An example is the current proposal to establish a housing finance corporation to encourage institutional investment in affordable housing. This is a welcome initiative, but it’ll only be effective if there are sufficient resources to fund the gap between what lower-income households can afford and the cost of providing them with adequate and well-located housing. Policies need to ensure that affordable housing is provided in locations where it’s needed – in locations that provide access to employment opportunities as well as the basic services. Inclusionary zoning policies make a good start in this direction. However, if inclusionary zoning is to provide a long-term solution for affordable housing, caveats will be needed to ensure that the housing that’s provided remains affordable not just for five or 10 years, but in perpetuity.

In general, any incentive to encourage private involvement in affordable housing provision will be successful in the long run only if there are mechanisms in place to assure that affordability is sustained over time. Affordable dwellings need to be protected against profit-taking when land values increase.
Our current system of fragmented land ownership, which allows owners to choose when and to whom to sell, means that development is difficult in in-fill locations. Attempts to assemble development sites run the risk of being held to ransom by individual land owners holding out for higher prices. Maybe we need to be less precious about our right to hold land, to hold onto our property no matter what. Maybe we need caveats to be placed on all land, and not just that used for affordable housing, to ensure that it cannot be disposed of at an inflated price.

Such caveats may not be needed if we are prepared to be more adventurous in constraining demand by following the call made earlier this year by the United Nations Special Rapporteur on adequate housing. She called for a shift away from the financialisation of housing and the role that it currently plays as a form of wealth, wealth accumulation, and the reclamation of it as a social good and as a basic human right.

This means we need to decrease demand for housing as an asset. However, many solutions that might do this on the demand side are often seen as being politically difficult or as an undesirable form of market intervention.

We question, but do little to constrain, the rights of our financial institutions to lend as much as they think is profitable for housing, or at least as much as their regulators regard as prudential. We have mortgage insurance that protects lenders but we do little to protect borrowers affected by economic circumstances beyond their control. We don’t even consider the possibility of re-regulation, which might put lifetime limits on borrowing for housing, or introducing a compulsory insurance that protects borrowers.

We allow existing property owners to expropriate all the monopoly land rents that arise as demand pressures push up the price of scarce, well-located land, and yet we often expect new entrants into the market to pay for the cost of releasing more land.

We dismiss too quickly the question of whether continued maintenance of individual property rights over land is consistent with a fair economic system in which the benefits of economic growth are shared by all.

We debate the merits of limiting negative gearing for investors but focus too little on the 50 per cent capital gains tax discount that makes positive or negative gearing worthwhile. We entirely ignore the 100 per cent tax discount on capital gains for owner-occupiers.
We fear the options of extending land tax to include owner-occupied housing or the introduction of a wealth tax or inheritance tax.

We’re nervous about the idea of including owner-occupied housing in the assets tax for the main Age Pension.

Without a fundamental shift towards redistributing the unearned or monopoly rents that accrue to scarce land in response to demand pressures, Australia’s housing system will continue to contribute to growing intra- and inter-generational inequalities in income and in wealth.

And I’ll conclude with reminding you of the Treasurer’s words in his post-Budget speech to ACOSS, and I quote. “Fairness is the first and fundamental role of government.”