

Australia's housing shortage and its economic consequences

Presentation to a Housing Affordability Forum
organised by Gold Coast Housing Company and UDIA (Qld)

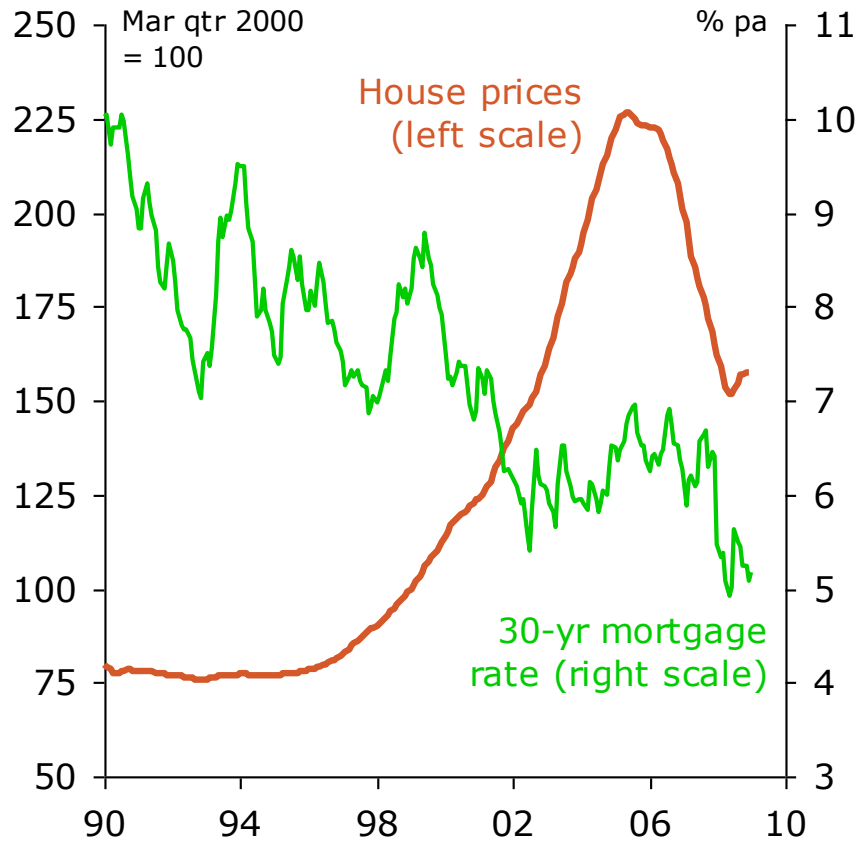
Bond University, Gold Coast, Queensland
5th February 2010

Saul Eslake

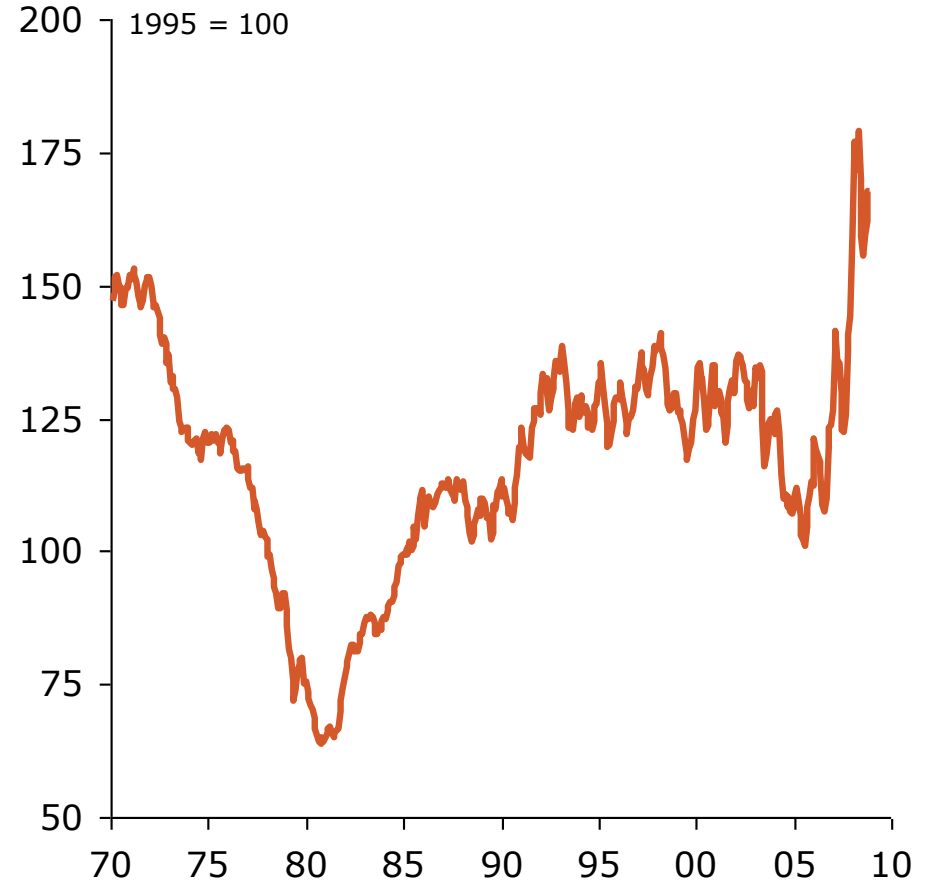
Note: Views expressed herein are those of the presenter and do not necessarily represent those of any organization with which he is associated including the Grattan Institute and the National Housing Supply Council (of which he is a member).

The US has solved its housing affordability problem – but not in a way that Australia would like to emulate

US house prices and mortgage rates



US housing affordability index

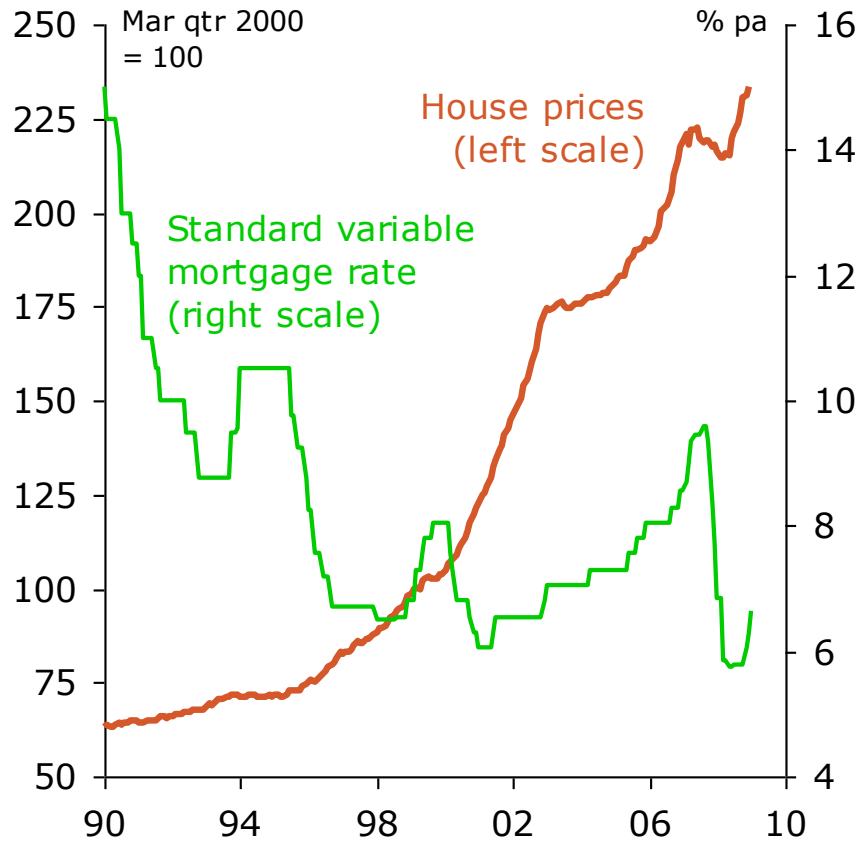


Note: House price index is the S&P Case-Shiller index for 10 major cities.

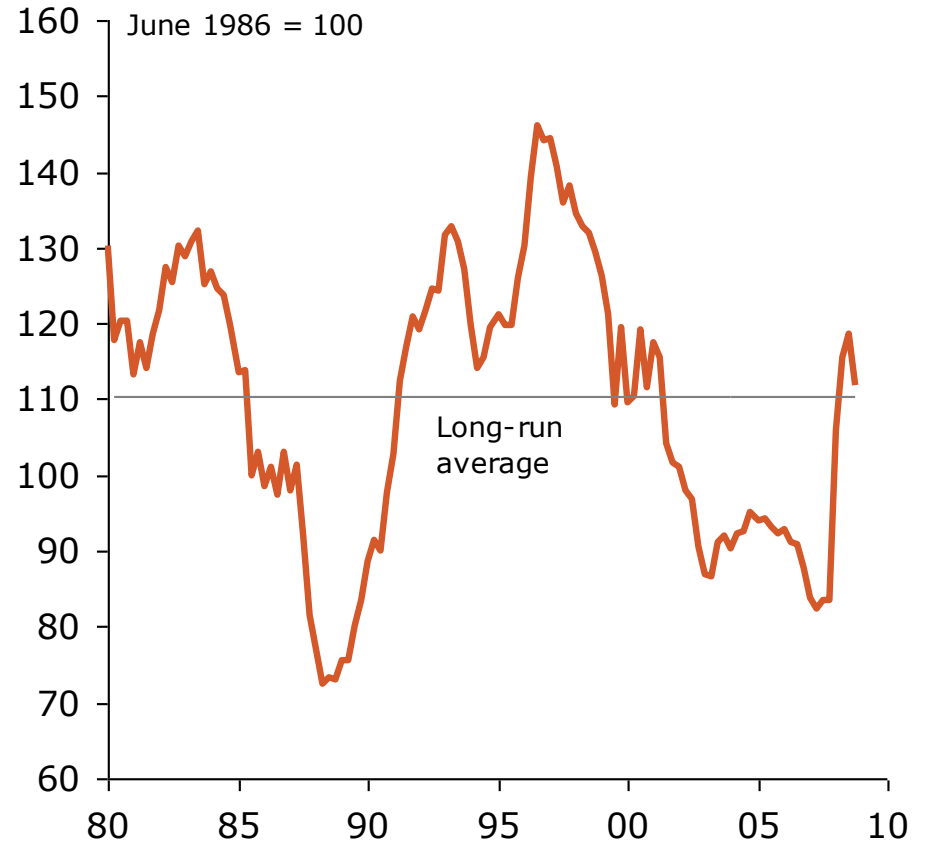
Sources: S&P; US Federal Reserve Board; US National Association of Realtors.

Australia still has a significant 'affordability' problem – one which is getting worse as now that house prices and interest rates are rising again

Australian house prices and mortgage rates



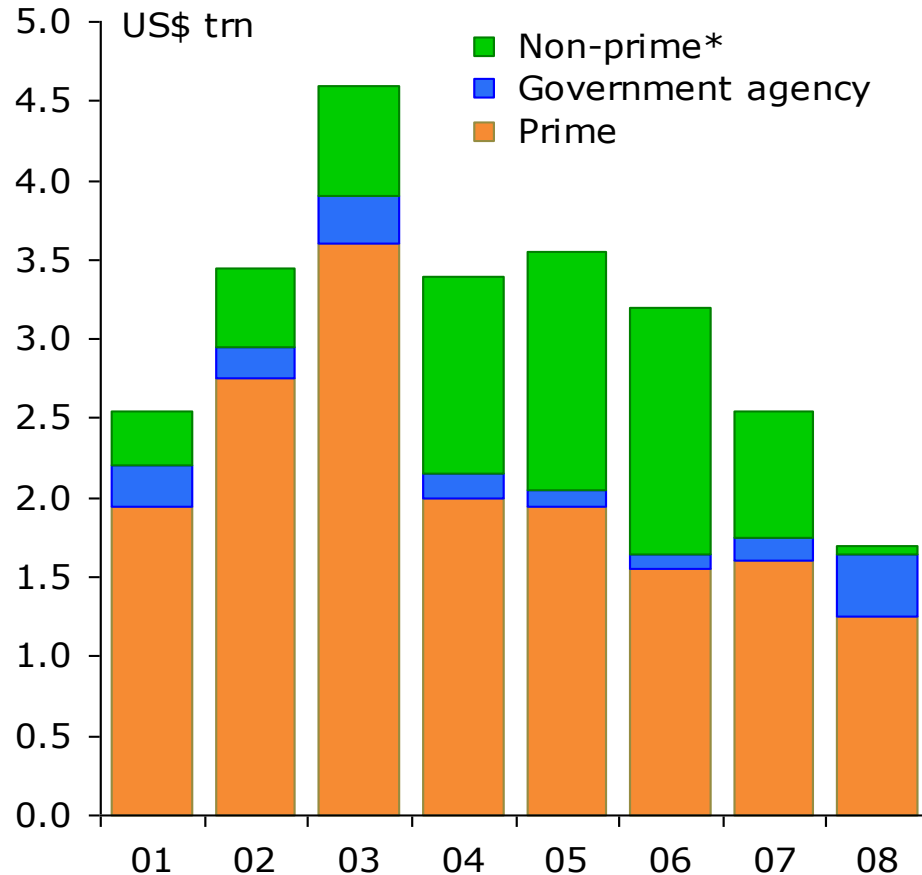
Australian housing affordability index



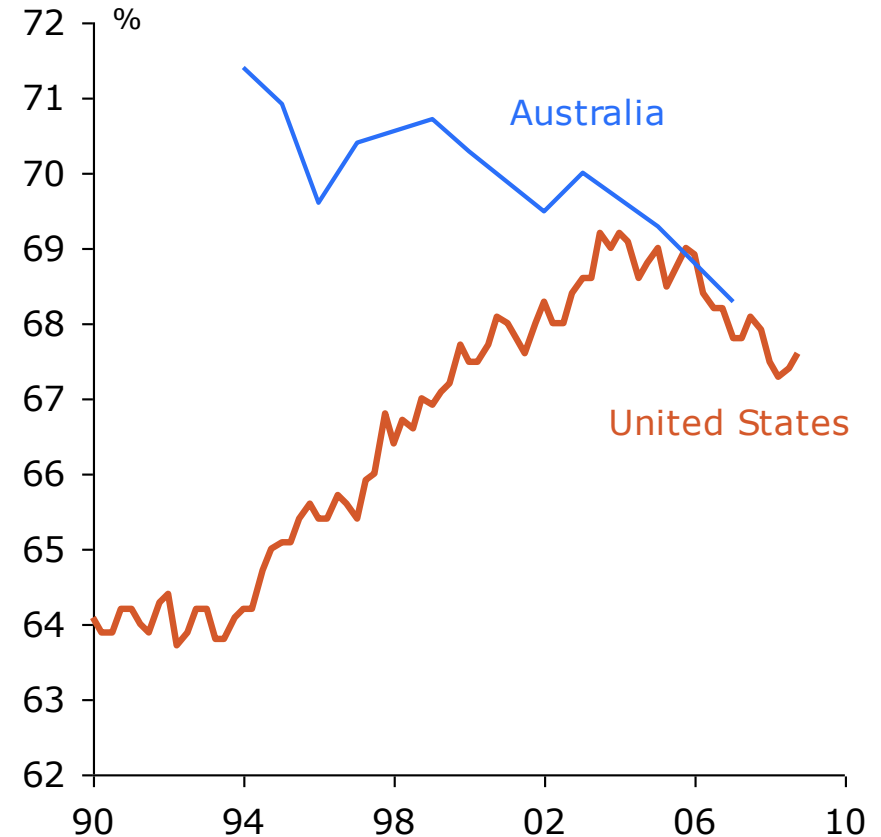
Sources: Residex (house price series indexed to March quarter 2000 = 100); Reserve Bank of Australia.

The US housing bubble was partly driven by a deliberate lowering of credit standards which temporarily boosted home ownership rates

US single-family mortgage originations by type



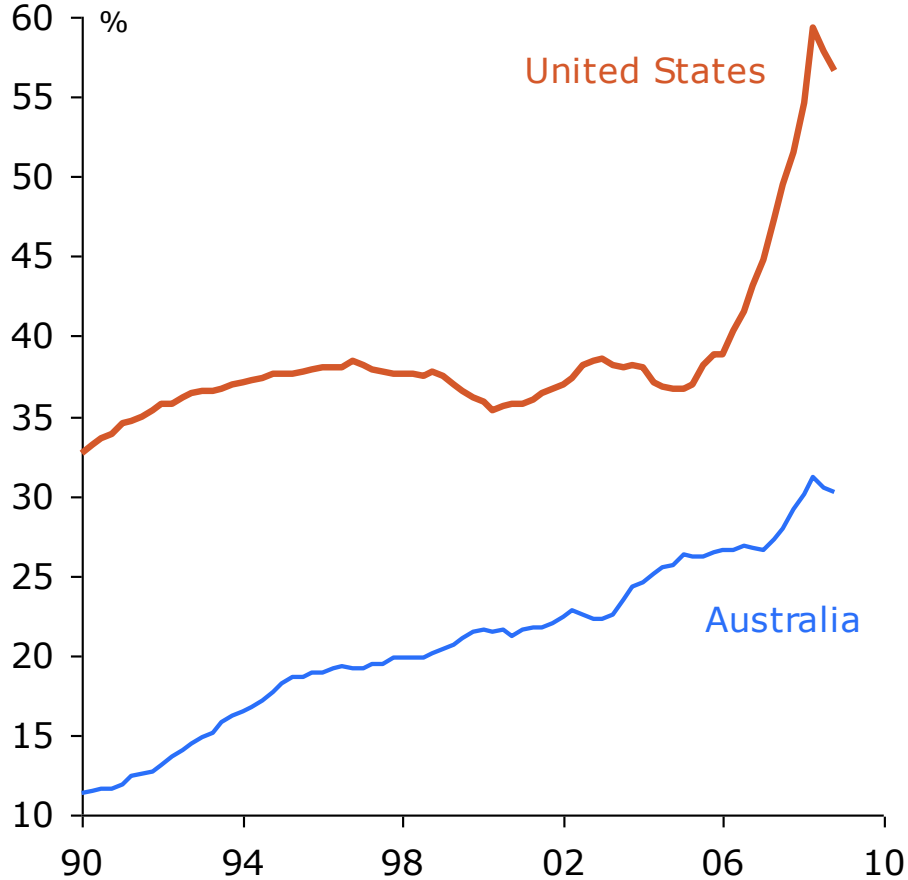
Home ownership rates



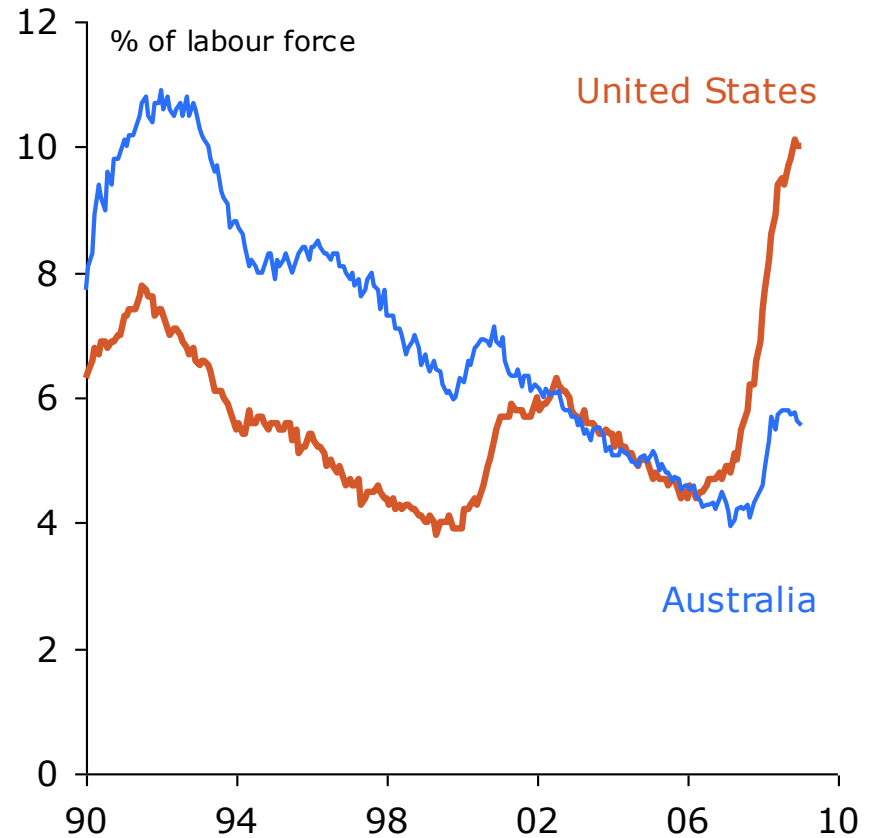
Note: 'Non-prime' loans include sub-prime, 'Alt-A' (the equivalent of low-doc or no-doc, 'jumbo' mortgages (loans above the ceiling for insurance by FNMA or FHMC) and home equity loans. *Sources:* Harvard University Joint Centre on Housing Studies, *State of the Nation's Housing 2009*; US Commerce Department; Australian Bureau of Statistics (*Housing Occupancy and Costs survey 4130.0*).

Higher leverage and a much sharper increase in unemployment made US home buyers much more vulnerable than their Australian counterparts

Housing debt as a pc of value of housing assets



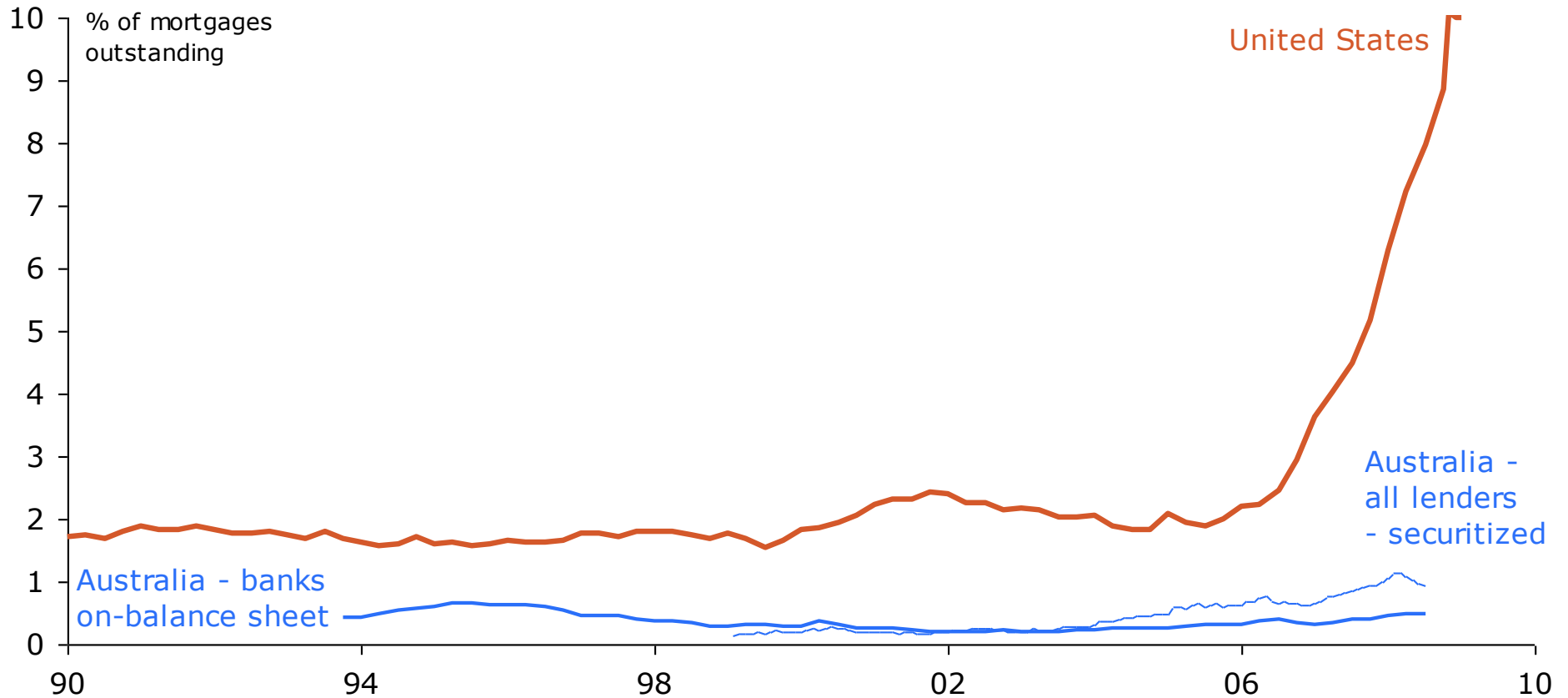
Unemployment



Sources: US Federal Reserve Board; Reserve Bank of Australia; US Bureau of Labor Statistics; Australian Bureau of Statistics.

Mortgage delinquencies and 'forced' or 'distressed' sales put much more downward pressure on house prices in the US than in Australia

Mortgage delinquency rates

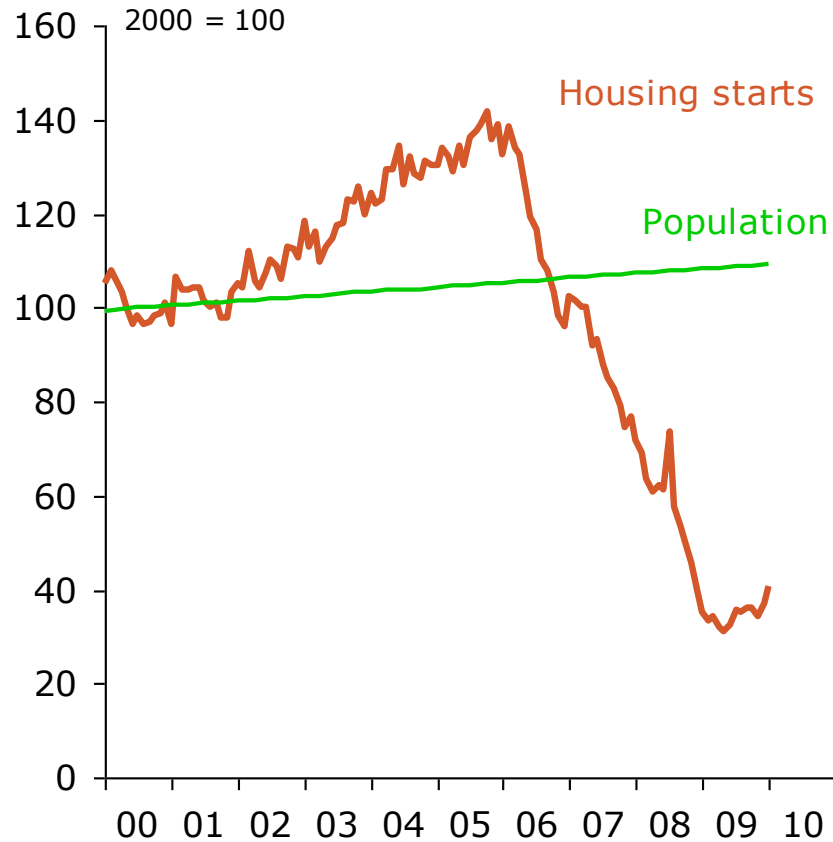


Note: 'delinquent' mortgages are those 90 days or more past due.

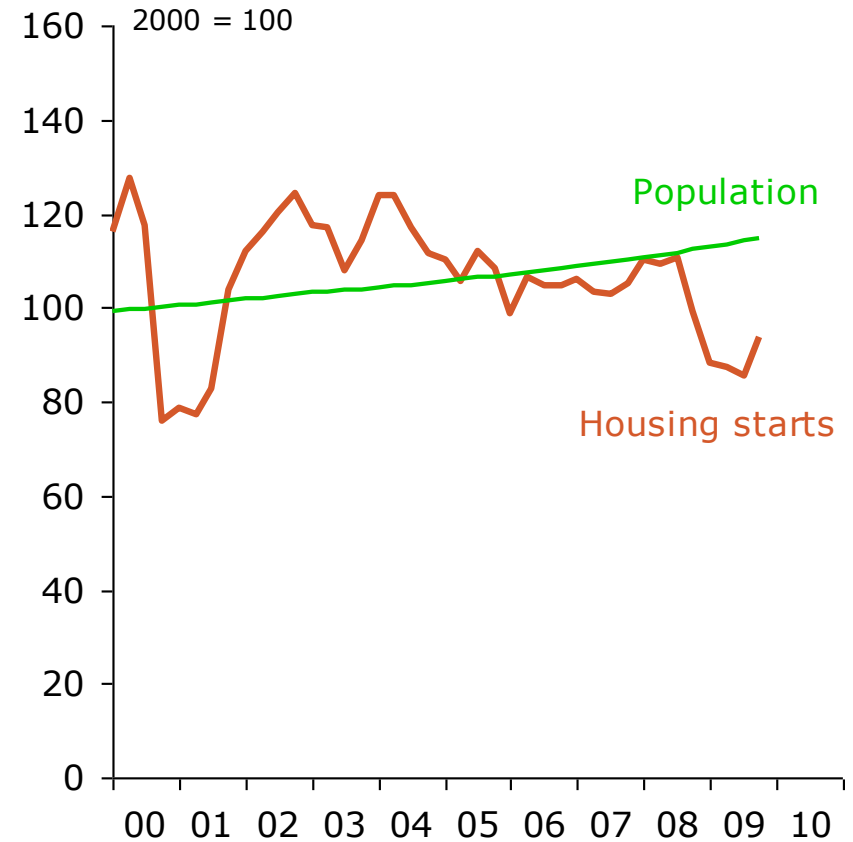
Sources: US Mortgage Bankers' Association; Australian Prudential Regulation Authority; Standard & Poors; Reserve Bank of Australia.

Higher leverage and a much sharper increase in unemployment made US home buyers much more vulnerable than their Australian counterparts

Housing starts and population – United States



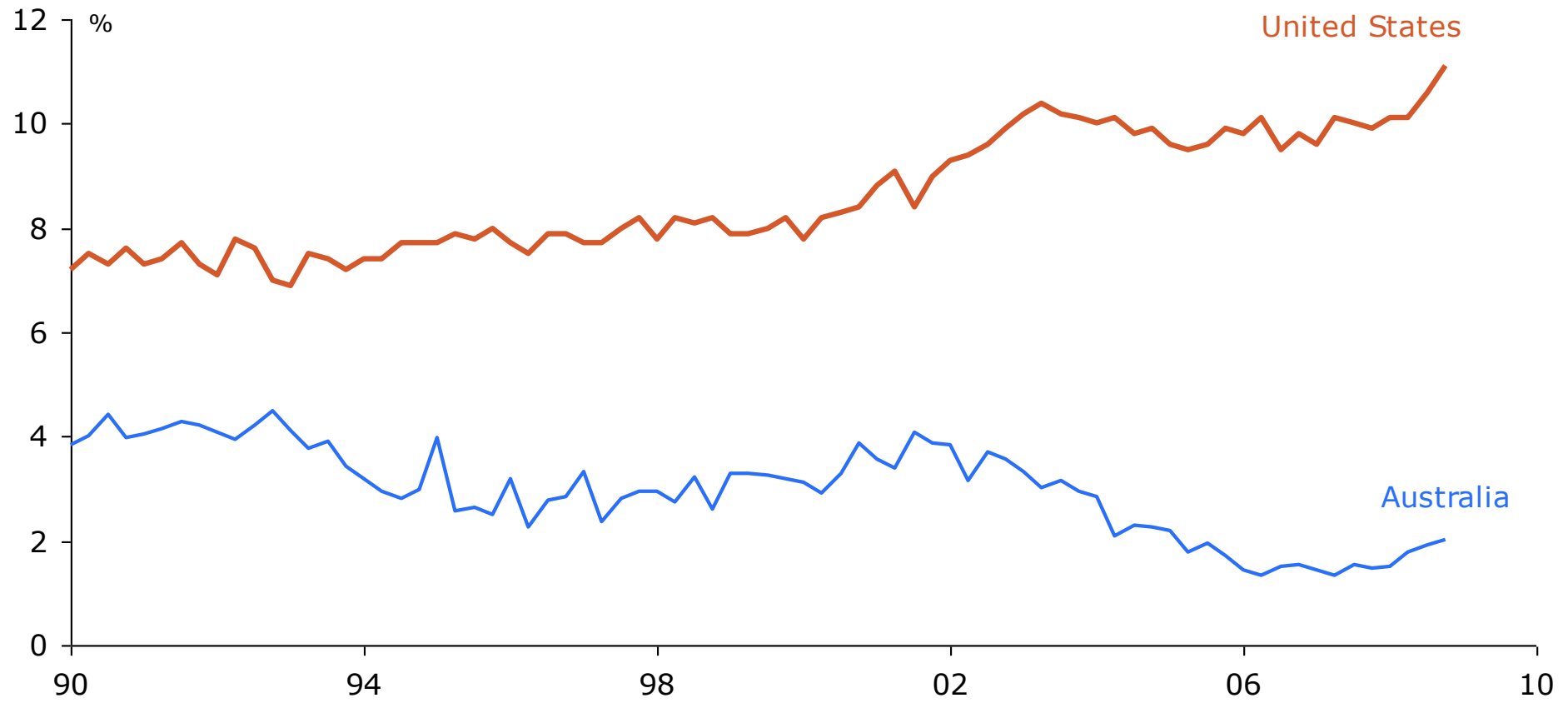
Housing starts and population – Australia



Sources: US Census Bureau; US Commerce Department; Australian Bureau of Statistics.

Australia's rental vacancy rate is also substantially lower than that in the United States

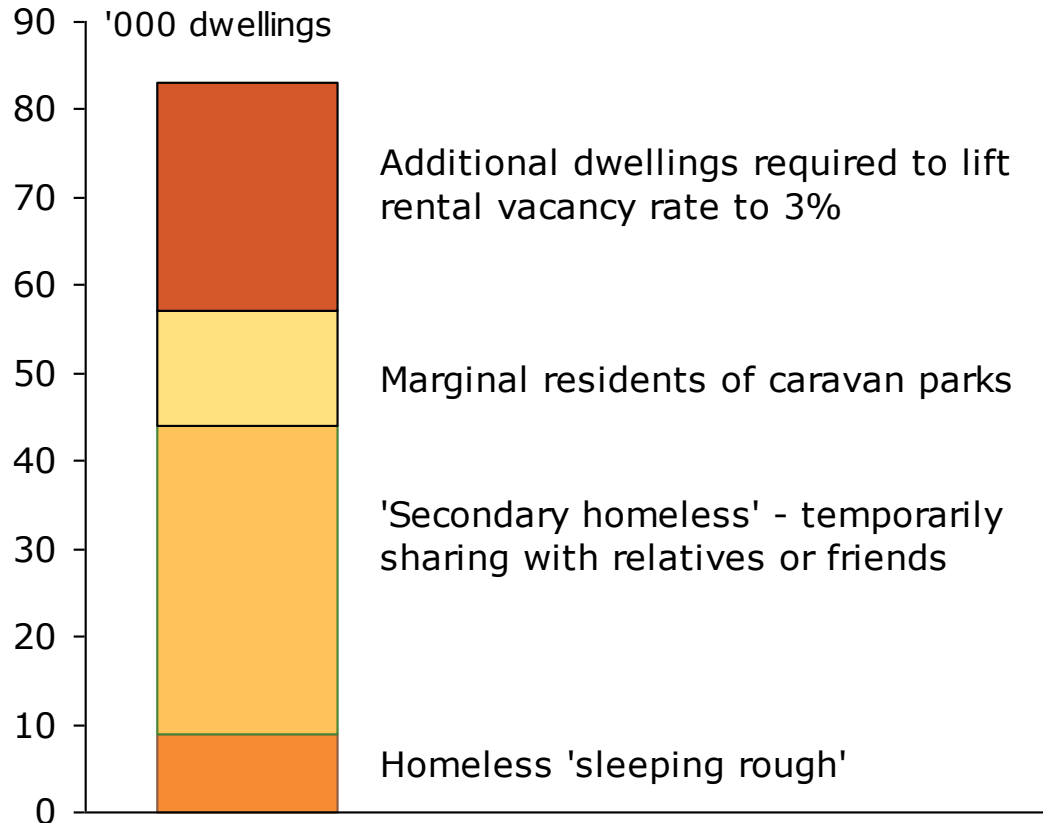
Rental vacancy rates



Sources: US National Association of Realtors; Real Estate Institute of Australia.

Australia's housing shortage is estimated to have been between 85,000 and 140,000 as at June 2008 ...

Australia's housing shortage

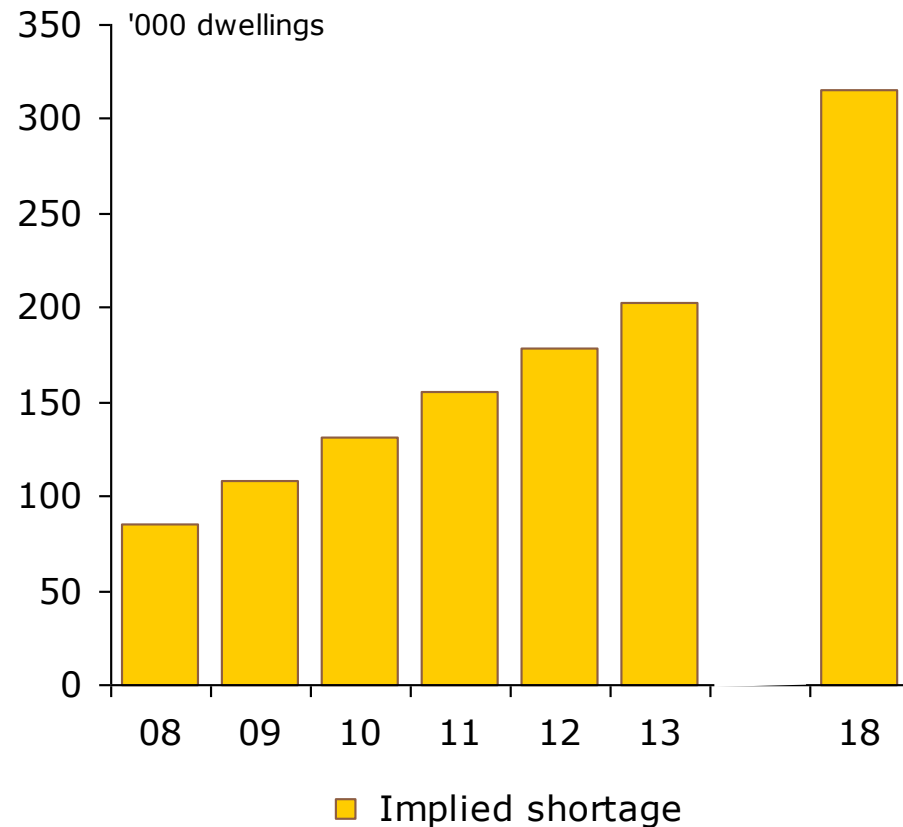
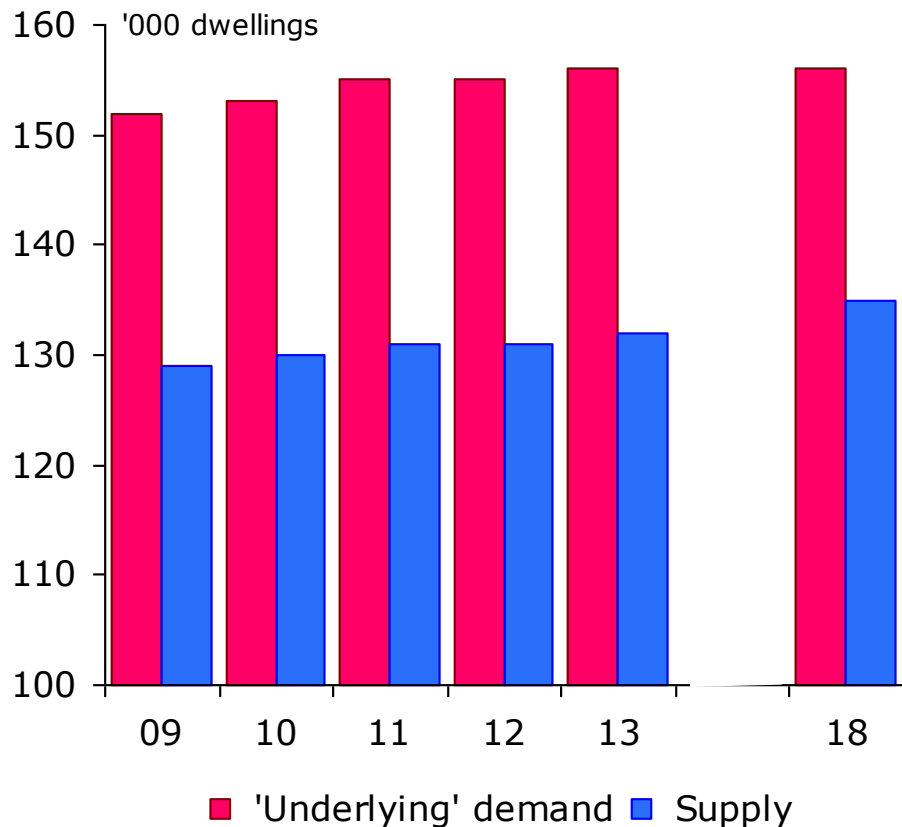


- The National Housing Supply Council's first report estimated Australia's housing shortage at ~85,000 dwellings as at June 2008 using a 'bottom up' methodology
- NHSC's second report to be released next month will provide an updated estimate
- Private sector estimates of the housing shortage typically use the cumulative shortfall between completions and 'underlying demand' from a selected starting point
 - using this approach BIS-Shrapnel estimates Australia's housing shortage at 93,000 as at June 2008 and 129,000 as at June 2009
 - ANZ estimates the housing shortage at 140,000 as at June 2008 and 200,000 as at June 2009

Sources: National Housing Supply Council *State of Supply Report 2008* (March 2009); BIS-Shrapnel, *Australian Housing Outlook 2010-12* (October 2009); ANZ Economics & Markets Research, *Australian Property Outlook* (December 2009).

... and this shortage is likely to get worse over the next decade

Projected housing supply and demand



Note: underlying demand and supply projections based on 'medium' scenarios (assuming net immigration of 180,000 per annum and net additions (completions less demolitions) averaging 131,000 per annum in line with the trend from 1980 to 2007). *Source:* National Housing Supply Council *State of Supply Report 2008*. Note that new estimates will be released in the Council's second report due in March.

Housing shortages will be most acute in New South Wales and Queensland

Housing shortages by State and Territory



Sources: National Housing Supply Council *State of Supply Report 2008*.

Under most plausible alternative scenarios Australia's housing shortage will get worse over the next few years ...

Projected housing shortage as at 30 June 2013 under alternative scenarios for 'underlying' demand and supply

'Underlying demand'	Supply		
	Low (101,000 pa)	Medium (131,000 pa)	High (156,000 pa)
Low (140,000 pa)	194,000	45,000	-83,000
Medium (154,000 pa)	267,000	118,000	-10,000
High (174,000 pa)	367,000	218,000	90,000

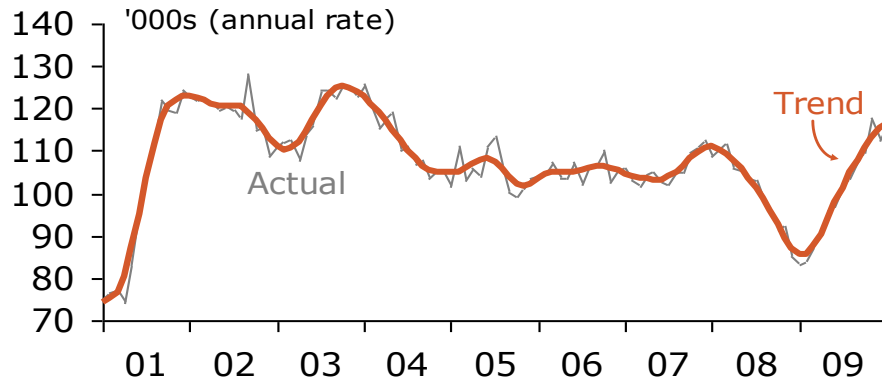
Note: Low underlying demand scenario assumes migration rising gradually from 120,000 in 2008 (to 160,000 pa by 2028); 'medium' demand scenario assumes constant net immigration of 180,000 pa; and 'high' demand scenario assumes constant net immigration of 230,000 pa. Low, medium and high supply scenarios are based on the lowest, trend and highest annual number of completions minus demolitions between 1980 and 2007. Negative entries imply a projected excess supply of housing.

Source: National Housing Supply Council *State of Supply Report 2008*. Note that these projections will be updated in the Council's second report due in March.

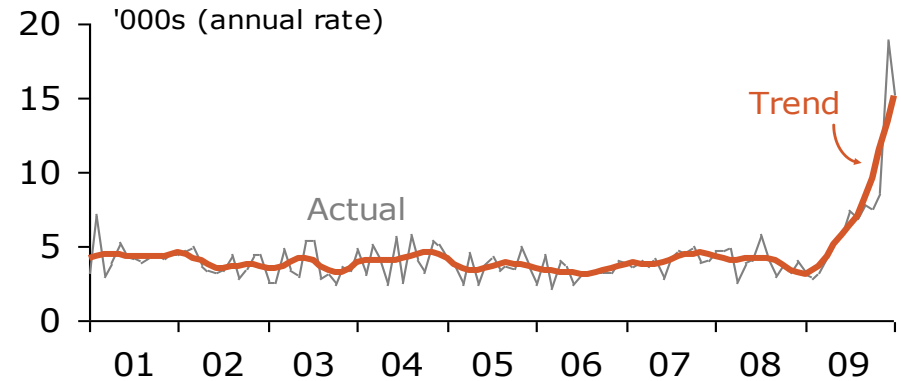
... unless new construction can be sustained (for some years) at levels somewhat higher than recorded in recent months

Residential building approvals

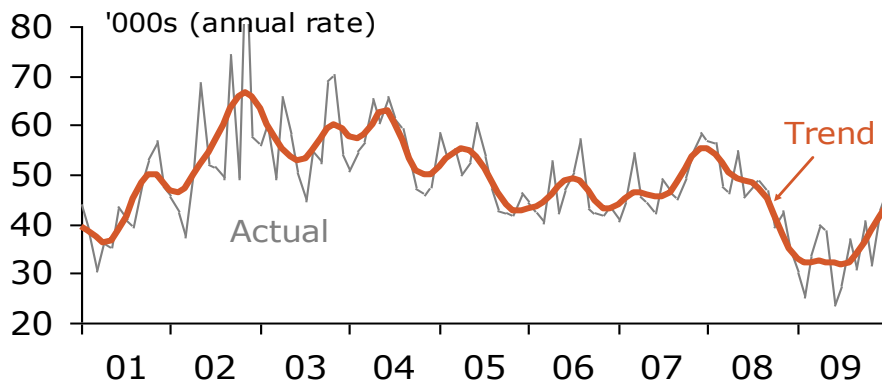
Private sector houses



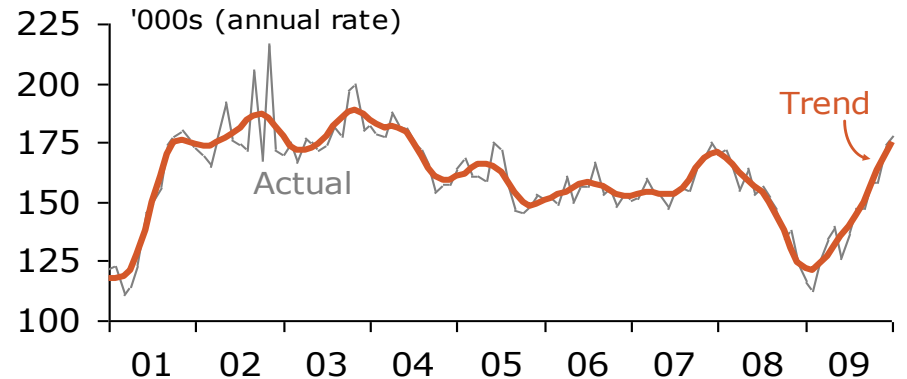
Public sector dwellings



Private multi-unit dwellings



Total dwellings



Factors contributing to the ongoing imbalance between 'underlying' demand for and supply of housing

- 'Underlying' demand has been boosted by steadily rising levels of net immigration
 - note that although this has added to 'underlying' housing demand and upward pressure on prices, lower levels of net immigration would probably have resulted in more intense labour shortages and (perhaps) greater upward pressure on labour costs
- 'Effective demand' (capacity to pay for housing) has been boosted by rising real incomes, lower average interest rates, more readily available mortgage finance and substantial volumes of government assistance
 - the vast bulk of which has been 'capitalized' into the price of housing
- A growing proportion of what has been spent on housing has been spent on replacing demolished dwellings, or on upgrading existing ones rather than building new ones, and on acquiring holiday homes or second homes
- Developers have responded to rising State and local government up-front charges on 'greenfield' developments by building fewer but more expensive dwellings
 - increasingly targeting those seeking to 'trade up' rather than first time buyers
- Zoning restrictions and development approval processes have limited the availability (and increased the cost) of 'brownfield' sites for higher-density housing
 - although State and local governments are usually responding to pressure from existing residents they often have the (unintended) effect of exacerbating shortages of housing
- The recent financial crisis has led to some tightening in the availability of finance for large-scale residential property development
 - hopefully this will be only temporary

There is a particularly acute shortage of 'affordable and available' rental housing for low-income households

Estimated shortage of 'affordable' private rental housing for low-income households as at June 2006

Income range	No. of households	No. of 'affordable' rental dwellings	No. of 'affordable' and available rental dwellings	Implied shortage
Lowest 20% (< \$385 per week)	237,000	91,000	35,000	202,000
Lowest 40% (< \$771 per week)	600,000	830,000	349,000	251,000

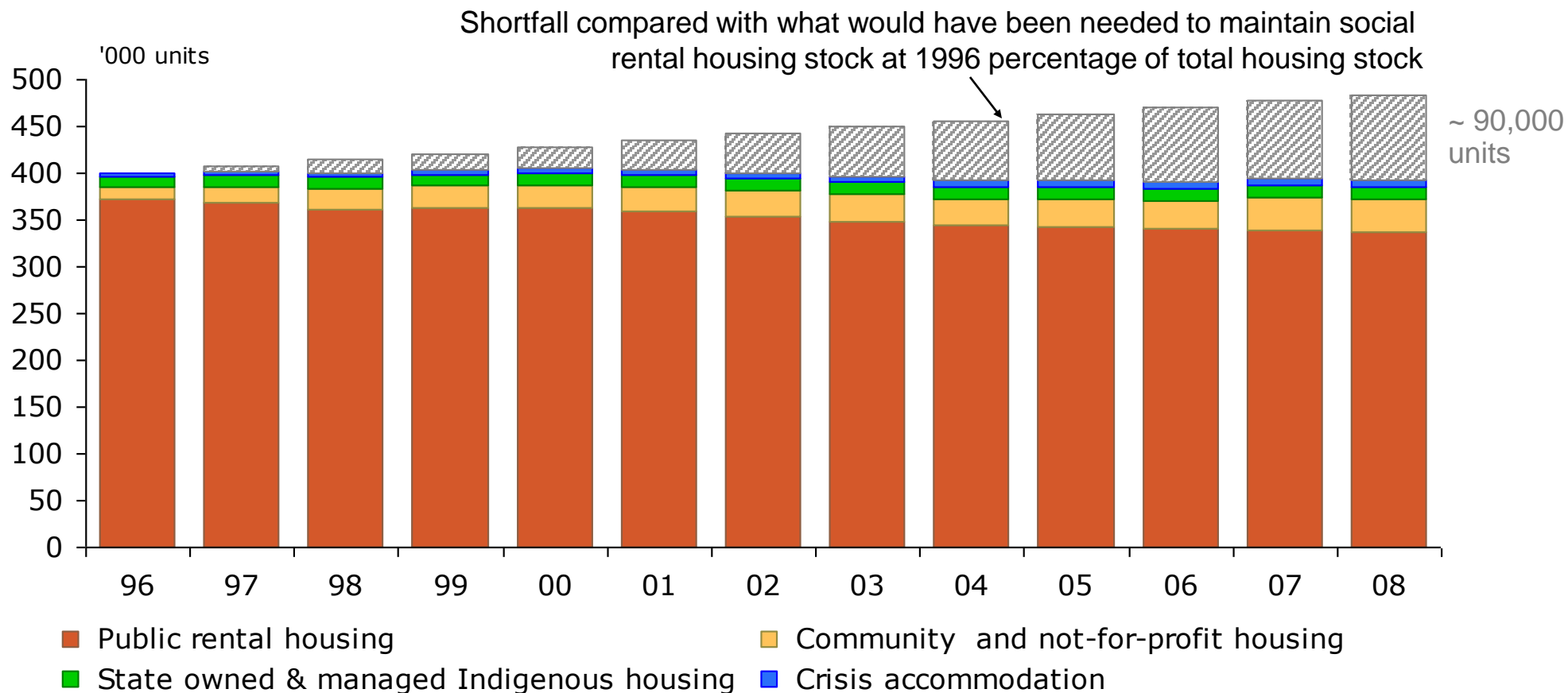
'Affordable' means rent of less than 30% of disposable income

'Available' means not occupied by households in higher income quintiles

Source: National Housing Supply Council State of Supply Report 2008. Note that these projections will be updated in the Council's second report due in March.

'Social housing' has declined significantly as a proportion of the total housing stock since the mid-1990s

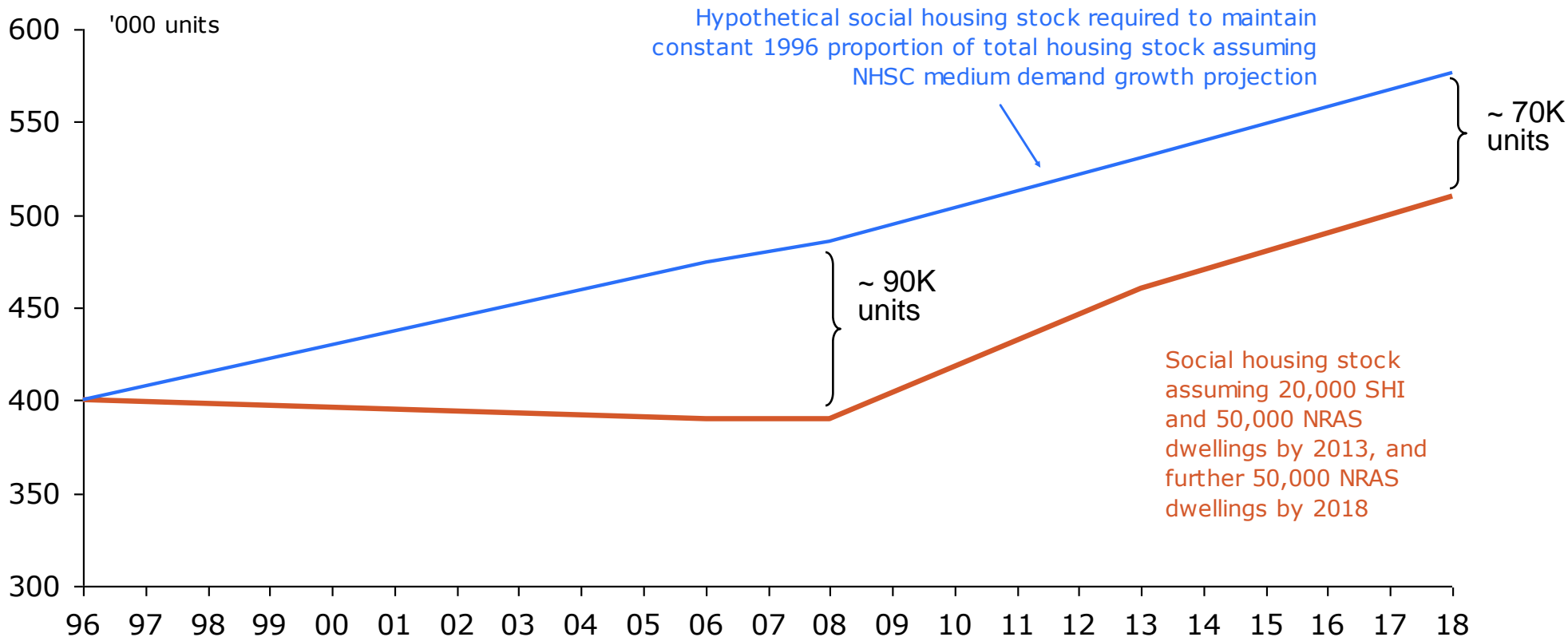
Social rental housing stock



Sources: Australian Institute of Health & Welfare, *Australia's Welfare* 2007; Social housing and HAA Annual Reports; Commonwealth Department of Families, Housing, Community Services & Indigenous Affairs.

Current government initiatives (SHI and NRAS) will reduce this gap but not eliminate it

Social rental housing stock



Note: 'SHI' is Social Housing Initiative; 'NRAS' is National Rental Affordability Scheme, both Australian Government initiatives
 Sources: National Housing Supply Council; Commonwealth Department of Families, Housing, Community Services & Indigenous Affairs.

'Housing stress' is generally more acute among private renters than among home buyers

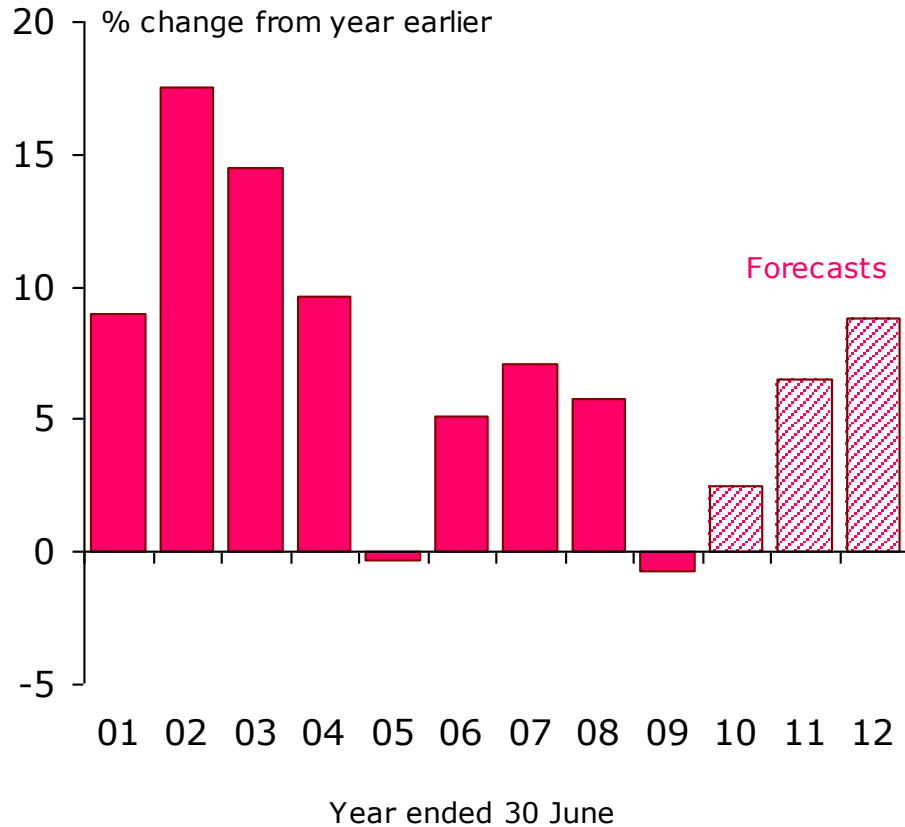
Measures of 'housing stress', 2007-08

Households in the lower 40% of the income distribution	Mortgagees		Private renters	
	Number	% of total	Number	% of total
Paying > 30% of gross income in housing costs	312,000	50	445,000	58
Paying > 50% of gross income in housing costs	161,000	25	172,000	22

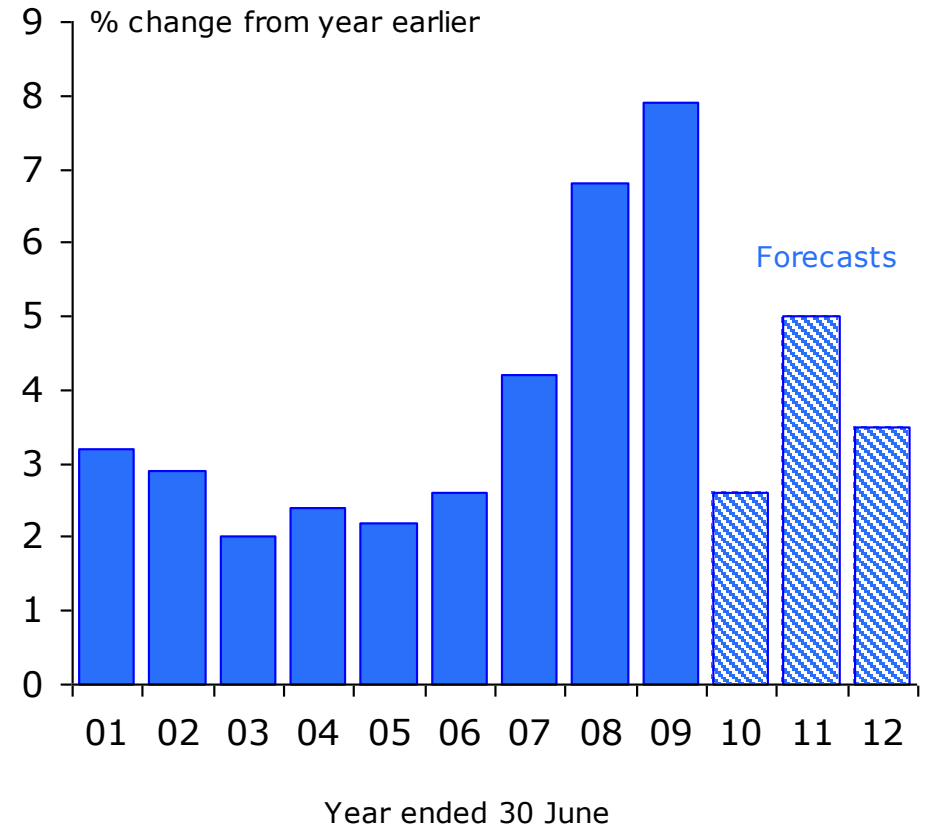
Source: National Housing Supply Council derived from ABS Microdata: Income and Housing (6541.0.30.001)

Persistent housing shortages will result in ongoing upward pressure on house prices and rents

Median house prices



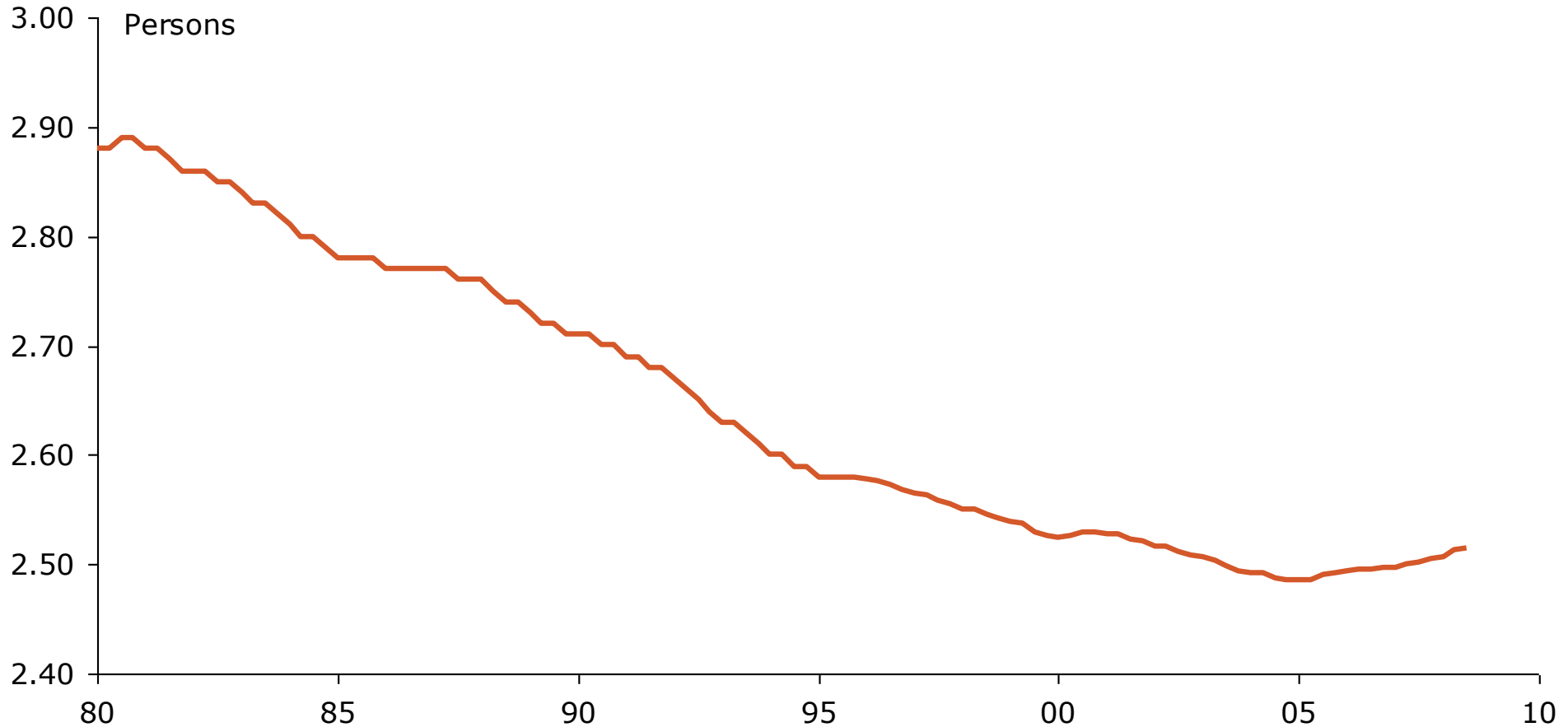
House rents



Note: Forecasts are derived (by author) from BIS-Shrapnel *Australian Housing Outlook 2010-12* (October 2009). Historical data on house prices from REIA and on rents from ABS *Consumer Price Index* (rent component).

In practice, 'things will happen' that bring effective demand into balance with supply ... for example, more people per dwelling

Average number of people per household



Source: Australian Bureau of Statistics; ANZ Economics & Markets Research.

What's wrong with that, from an economic perspective?

- Continuously rising [real] house prices will tend to result in households taking on ever-increasing amounts of debt
 - making individual households more exposed to fluctuations in interest rates and house prices
 - absorbing a larger average proportion of disposable income in interest payments and repayments of principal (and thus potentially detracting from other types of spending)
- Similarly continuously rising real rents will exacerbate economic hardship and social distress among lower income groups
 - and (as with higher mortgage debt service commitments) detract from other forms of spending
- Continuously rising house prices will increase inequalities in wealth distribution
 - because higher income and wealth groups are much more likely to own housing than lower income and wealth groups
- To the extent that increases in house prices are uneven across different regions, people may be 'locked into' or 'locked out of' particular cities and regions
 - adversely affecting people's ability to respond to changing patterns of job opportunities
 - and potentially detracting from productivity growth
- Although (properly measured) Australian house price-to-income ratios are not excessively high by international standards, were they to become so Australia might be perceived as a more risky investment destination
 - adversely affecting Australian banks' ability to borrow overseas and to finance Australia's on-going current account deficit

What can or should be done?

- Reduce and/or more tightly target cash assistance to home purchasers
 - which has conspicuously failed in its stated objective of increasing home ownership
 - which, considerably more often than not, has simply enabled buyers to pay more for the same amount of housing and thus made housing more expensive for others
 - and which has done little if anything to increase the supply of housing
- Redirect funds currently spent on cash assistance to home purchasers to programs which directly increase the supply of housing
 - direct provision of more affordable housing through State authorities or social housing providers (like GCHC)
 - enhanced incentives to investors to increase the supply of housing (such as NRAS, but with more attention to tax incentives that work for superannuation funds, or restricting 'negative gearing' to purchase of new housing)
- Seek to lower 'up-front' charges on developers
 - for example by removing caps on local government rates (in NSW) or allowing local governments more latitude in borrowing for infrastructure provision
- More flexible zoning and planning schemes and regulations
 - will require a considerable amount of communication with local residents and (possibly) a fair amount of 'political will'
- Support pilot demonstrations of smaller/less expensive forms of housing
 - perhaps done through social housing organizations

A concluding thought

“Given the circumstances – the economy moving to a position of less than full employment, with labour shortages lessening and reduced pressure on prices for raw material inputs – this ought to be the time when we can add to the dwelling stock without a major run-up in prices. If we fail to do that – if all we end up with is higher prices and not many more dwellings – then it will be very disappointing, indeed quite disturbing. Not only would it confirm that there are serious supply-side impediments to producing one of the things that previous generations of Australians have taken for granted, namely affordable shelter, it would also pose elevated risks of problems of over-leverage and asset price deflation down the track”.

Reserve Bank Governor Glenn Stevens

28 July 2009

Important information

This document has been prepared by Saul Eslake on behalf of Corinna Economic Advisory Pty Ltd, ABN 165 668 058 69, whose registered office is located at Level 11, 114 William Street, Melbourne, Victoria 3000 Australia.

This document has been prepared for the use of the party or parties named on the first page hereof, and is not to be further circulated or distributed without permission.

This document does not purport to constitute investment advice. It should not be used or interpreted as an invitation or offer to engage in any kind of financial or other transaction, nor relied upon in order to undertake, or in the course of undertaking, any such transaction.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all financial instruments referred to herein. Neither Saul Eslake nor Corinna Economic Advisory Pty Ltd however makes any representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. The author and Corinna Economic Advisory Pty Ltd expressly disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.