

Sent: 14 January 2004 3:45 PM
To: Savvides, Janet
Subject: FW: Comments to Draft Report on Housing Affordability

Submission

-----Original Message-----

From: p.wellby
Sent: 14 January 2004 9:48 AM

Subject: Comments to Draft Report on Housing Affordability

Dear Sir/Madam,

I wish to submit the following comments in regard to the Draft Report on Housing Affordability

Are Rising House Prices Beneficial?

"When prices rise sharply, as they have done since the mid-1990s, existing home owners - around 70 per cent of Australian households - benefit from increased wealth,..." (Overview, Page XI)

Comment: This is a widely-held but fallacious view. It needs to be firmly knocked on the head to prevent the whole topic of rising house prices being treated dismissively ("We are all getting richer so where's the problem, blah, blah, blah.")

Most home owners, those who own only one home (the family home), do not benefit from rising prices. The only way they can "benefit" is by selling and exiting the home-ownership state for life. For most people this is only palatable upon death. A small minority are happy to "down-shift" to a caravan park or similar later in life and thus do benefit from rising home values. However the vast majority of Australian homeowners are aspirationalists and for most of their lives they are wanting to trade-up to a better (= more expensive) home. Rising prices are bad news for them because the price of their target home rises faster than their current home, meaning that the price gap simply widens. Rising prices are also bad news for those who don't really want to move but are compelled to by employment prospects, family circumstances, etc. Selling your current home and buying another for about the same value will incur up-front costs of about 10% (since transaction costs such as stamp duty, agent commission, advertising costs are largely proportional to the value of a home). The higher the price, the larger the real dollar cost of moving.

The Impact of Economic Growth, Immigration and Low Interest Rates

"Since the early 1990s, real average household income has increased by 1 per cent a year; the number of people in full-time jobs has grown by over 900,000 and, in aggregate, real household disposable income has risen by about 30 per cent. The implication is that, apart from the effects of cheaper and more accessible credit, a sizeable proportion of the burgeoning demand for housing

has come from higher incomes and more jobs - in short, economic growth." (Page XVI, also Section 4)

Comment: This is a shallow argument. There have been many periods in Australian history where there has been strong economic growth - and no explosion in real housing prices. Similarly there have been periods in the past of much higher immigration and population growth which were not accompanied by an explosion in real housing prices.

"Lower interest rates and innovations in home lending have reduced the costs of purchasing a home, made housing a more attractive investment, and made it easier to borrow." (Page 33 and elsewhere)

Comment: This is also a shallow argument. Low interest rates in the 1950s and 1960s did not lead to price booms.

"Cheaper and more accessible housing finance has been of major benefit to Australian households, notwithstanding the effects on house prices. As such, these beneficial market developments do not require policy action." (Page 44)

Comment: This is pure ideological claptrap. How can something (cheap, unregulated credit) be beneficial when it has raised the price of something else (houses) dramatically? Cheaper and unlimited access to housing finance (particularly by investors) has only enabled genuine home buyers to enter a bidding war that has driven prices up to the limits of affordability at a time of historically low interest rates. What happens when interest rates rise? All that has been achieved is that home buyers have been put on a bigger tread-mill for the rest of their working lives.

The Impact of the First Home Owner Scheme

"In an extreme case, if there were no capacity to increase the supply of housing in the face of a jump in demand, the entire grant could be capitalised into house prices, lifting the price of a property valued at \$250,000, for example, by a little under 3 per cent. However, given that median house prices have increased by 18 per cent per year since the grant was introduced, it is clear that the FHOS is at most a minor contributor to the recent surge in prices." (Page 58)

Comment: This is a simplistic and thus erroneous analysis. Correct analysis must consider the level of gearing applied, e.g.

"First home buyers rely heavily on debt finance - in the three years to 1999, the average deposit paid was 10 per cent of the purchase price. Of those paying a deposit, nearly 80 per cent had saved it." (Page XIV, Box 2)

Consider a first home buyer purchasing a property for \$200,000, with a 10% deposit and facing a 4% stamp duty. He thus needs \$28,000 cash up front. Suddenly the Govt chips in with a \$14,000 hand-out, thus lifting his cash-in-hand to \$42,000 and hence raising his purchasing power by 50% to \$300,000. As the vast majority of his competitors are in the same boat, the price of \$200,000 properties is quickly bid up to \$300,000. Such rapid appreciation naturally attracts the attention of investors who now also seek to enter the market. So now we have created a situation of substantial excess demand in a market fed by totally unregulated credit growth - the result, naturally, a runaway, self-perpetuating boom.

CONCLUSION: THE FHOS HAS BEEN AN UNMITIGATED DISASTER FOR FIRST HOME BUYERS.
AS AN INDEPENDENT, PROFESSIONAL, COMPETENT, CONSTRUCTIVE, "WITHOUT FEAR OR
FAVOUR" ADVISER ON GOVERNMENT POLICY YOU SHOULD HAVE THE COURAGE TO SAY SO,
RATHER THAN INDULGE IN WIMPISH COP-OUTS LIKE "the FHOS is at most a minor
contributor to the recent surge in prices."

Yours sincerely,
Peter Wellby
Qld
