Residential Property Prices
A Survey of Events leading to the present

by

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presented at

Pacific Rim Real Estate Society
Ninth Annual Conference
19-22 January 2003
University of Queensland
Brisbane, Australia

Abstract

Residential property represents a major proportion of the wealth held by Australian households. Compared with the rest of the world, home ownership in Australia represents a comparatively larger proportion of personal wealth. The benefits of home ownership are not only important in the creation of wealth and the satisfaction and enjoyment derived from owning one's own home, but can also provide an important financial buffer during retirement. Home ownership is seen as desirable by the vast majority of Australians and has been enthusiastically supported by governments of both political persuasions. Indeed, the fortunes of the housing industry are frequently linked to that of the wider economy. This survey examines the changing structure of the housing market over time and how it has been impacted by a number of key factors.

Introduction

The residential property market is the principal source of private wealth for most Australians. Changes in dwelling prices therefore reflect changes in wealth. The measurement of changes in prices across time has significant implications for determining the wealth levels of home owners. Property price indices, which are typically locally based, are a common reference point for establishing value, particularly as only a small proportion of dwellings are transacted in the market at any given time.

Property values tend to change in unison for the simple reason that if a property is priced too highly, buyers will choose from more favorably priced properties that are closer to current market prices, that is, closer to the *market average*. If the increase in property prices in a particular location is about 8 per cent, on average, there is a general acceptance that any property in this location will have increased by approximately 8 per cent. The same logic cannot be applied to the share market. If the sector index has moved up by an average amount, then some companies will have moved by more than the average and some may have even decreased. Knowing the average movement in stock prices provides very little information about how a particular company has performed.[1] Consequently, an index of prices has much more important implications for those who are active in the property market.

Property prices are locationally dependent. The national average, or even a state average, does not usually provide a very accurate measure of what is happening in specific neighbourhoods or locations. Property represents a bundle of characteristics which include locational attributes. Two locations, each with schools, shops and other amenities, may each have properties that are very different in price. The desirability of one location over another is influenced by the perceived attractiveness of each to would-be purchasers. The price commanded in the market is the expression of buyers' willingness to own a property in a particular location. Faster rates of growth in prices in one location over another are the result of purchasers' preferences and the benefits they perceive from owning property in a specific location. The presence of *sub-markets* has implications for the approach taken in index formulation.

The heterogeneous nature of property makes it difficult to determine the value of a particular property. Property, while being heterogeneous to a large extent, possesses characteristics that make comparisons among properties meaningful. This is usually the province of an experienced valuer who takes his benchmark from recent sales in the local area. A local sales database should therefore provide a mechanism for the determination of property value. The professional valuer takes account of several

[1] Stock prices are much more widely reported and changes in the benchmark index will reflect movements in an investor's portfolio of stocks, particularly if the portfolio is well diversified.

factors to arrive at a value for a specific property. Some of these factors would include size of land and building, type of construction, age, condition and many others.

The next section provides an overview of the nature and structure of home ownership in Australia and how it compares with other countries. This will provide a useful insight into personal wealth creation and the role of residential property in building retirement wealth. Home ownership is the preferred form dwelling adopted by the citizens of most European countries, Britain and North America.

The institutional framework that has evolved to support the provision of housing in these countries provides some useful benchmarks to compare with the Australian experience. Home ownership is central to the Australian way of life and, over time, an institutional framework to encourage this outcome has evolved. Dwelling prices are influenced by the usual demand and supply factors, such as, population growth, employment opportunities and general economic prosperity. There are other less obvious factors, including government policies, reform of the financial system, inflation, lifestyle preferences and competition among lenders, which have had a significant impact on the ownership of dwellings and their prices.

Overview of the Housing Market in Australia

The residential property market is a major source of wealth for Australians, whether as home owners or investors. Australians ranked among the highest hoarders of housing wealth during the twentieth century, with this form of investment preferred over other forms. Up to the 1990s the share of private wealth in housing was between 60 and 65 percent.[2] By contrast, private wealth held by the average middle-class household in the United States is in a more liquid form, with households preferring to hold their wealth in shares and bonds (refer Table 1). In 1995 housing represented 59 percent of all private sector wealth in Australia, double the proportion of wealth in business capital (28%), and roughly ten times the wealth held in either consumer durables or government securities.

Housing is unlike any other commodity that is purchased. In addition to providing a place to eat, sleep and store possessions, its proximity to work, shops, schools, parks and other amenities as well as the potential for increased capital value, makes for a complex differentiated product. The value stored in real estate derives from the intrinsic qualities of the land itself – position, suitability for development, natural features, etc. – and from the investment in the assets that are built upon the land. When urban development takes place, the gains from the investment activity surrounding a property are capitalised into the value of real estate.

Housing policies pursued by various state and federal governments since the post second world war (WW2) period have ensured that owner occupation is the dominant

[2] Badcock, B., and Beer, A, page 1.

form of tenure by providing very little support for renters, only a marginal public housing sector, and substantial tax incentives for home owners. A consistent finding of surveys of satisfaction levels amongst home owners and tenants, reveal that owner-occupation is overwhelmingly the tenure of first choice for Australians.[3]

Table 1: Housing tenure, including owner-occupation, in selected OECD countries, mid-1990s (%)

Country	Owner-occupation	Private rental	Social/ public rental	Home* ownership rates
Australia	70	24	6	70.1
Britain	68	11	21	69.0
Canada	63	30	7	63.7
Denmark	60	21	19	na
France	57	19	24	56.0
Germany	39	42	19	43.0
Netherlands	45	13	42	na
Sweden	41	21	38	56.0
United States	65	30.5	4.5	67.4

Source:reproduced from Badcock and Beer, 2000, page 2.
* Home ownership rates are taken from Ellis & Andrews 2001, page 8

Those born shortly after WW2, the so-called Baby Boomers, experienced a long period of sustained economic growth, which has given them greater access to home ownership. This has enabled them to achieve considerable increases in personal wealth due to sustained increases in house prices over time. With the advent of globalization, corporate downsizing and redundancies that characterised the 1990s, the focus on home ownership has changed. The children of the Baby Boomers, born in the 1970s and known as Generation X, are experiencing a very different economic environment to their predecessors. Permanent full-time employment is rapidly disappearing and even the most highly skilled are more likely to face the prospect of short-term contracts and greater geographical mobility. This generation is less likely to take on the long-term commitment of a mortgage which typically requires secure employment without having to relocate. The pattern of future home ownership is likely to change with renters emerging as a much larger group (refer Table 2).

Table 2: Rental Patterns from 1947 to 1999

1947	1954	1961	1966	1971	1976	1981	1986	1991	1996	1997-98	1999
44%	34.3%	27.7%	26.7%	27.9%	25.9%	25.7%	25.7%	26.6%	28.7%	26.0%	27.3%

Source: Australian Bureau of Statistics Housing Survey, Catalogue No. 4182.0

[3] Burgess, R. and Skeltys, N., ***The Findings of the Housing and Locational Choice Survey: An Overview***, p.29 (This survey, carried out 1991, is cited in Badcock and Beer, 2000, p. 13.)

Home ownership has played an important role in wealth creation for a great many Australians, being the only significant form of saving for many. Australia as a nation has a much lower level of savings relative to other advanced countries. The superannuation guarantee levy was introduced by the Keating Labor government in July 1992 to improve the savings ratio. This has had the effect of directing funds away from the housing sector towards other forms of investment such as stocks and bonds, which are the major asset classes held by super funds.

With the introduction of compulsory superannuation there has been a change from acquiring wealth through home ownership to investing in more liquid assets, such as shares and fixed interest securities. During the five-year period from 1993 to 1998, the Australian Stock Exchange All Ordinaries Index increased by about eighty percent, whereas the index of established house prices increased by only eighteen percent.[4]

The general movement in housing prices determines when, and to what extent, the aggregate value of national housing wealth is expanded or diminished. It is the amount of credit available for housing investment in relation to the underlying demand that ultimately determines the general movement of house prices relative to other commodities within the economy. Growth in real wages and expansion in net overseas immigration are the primary reasons for increases in house prices. If incomes rise, new entrants to the market can afford to pay higher entry costs, pushing up house prices. Capital growth in residential property is thus achieved by higher real incomes and the extent to which wage earners commit their increased earnings to housing expenditure. New buyers therefore transfer wealth to buyers of earlier generations.

The belief that home ownership has resulted in significant financial benefits for those who have owned their home for a considerable period of time is based on the simple notion that its market value today, compared with the median price of similar houses in the neighborhood, is some multiple of its purchase price. Thus, for example, if a home was purchased for $50,000 some twenty years earlier, and comparable houses in the neighborhood are now selling for $500,000, it would be assumed to have increased in value by a multiple of 10. Measuring financial benefits in this manner ignores both the time value of money as well as the opportunity foregone from investing elsewhere and the costs of maintaining the property over time.

The rate of growth in house prices varies significantly from city to city, and within any one city, several reasonably distinctive sub-markets typically perform at different rates of appreciation. The high and low performers within a city's housing market normally comprise suburbs that share similar developmental and social class backgrounds, or have been targeted for special attention by investors or home buyers.

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[4] Hans Baekgaard, "The Impact of Increasing House and Share Prices on the Distribution of Household Wealth in Australia", Paper presented at the Twenty-seventh Annual Conference of Economists, 28 September 1998, University of Sydney, quoted in Badcock & Beer, 2000

The Existence of Sub-Markets

Buyers attracted to suburbs at the low end of the market include those who qualify for home purchase assistance. In times of economic downturn these suburbs are especially vulnerable as many residents experience the brunt of the downturn through unemployment. This leads to difficulties in meeting financial commitments and mortgagee sales that depress local house prices. During the decade of the 1990s there was a strong trend to inner city living and the apartment sub-market experienced strong growth in the major capital cities. Attempts to explain the presence of sub-markets, or special variations in house prices, within a given city have identified three factors and the part these play in the creation and transfer of housing wealth. These factors are:[5]

- the exclusivity of high status suburbs in the urban housing market
- the capitalisation of public and private investment into house prices, and
- the linkage between labour and property markets

The exclusivity factor is the result of excess demand for a limited supply of properties that come on to the market infrequently, in a specific desirable location. The most obvious examples in Australia are cliff-top homes fronting Sydney harbour. The last decades of the 1990s experienced a greater concentration of demand for inner city housing. Sydney's inner city zone experienced real price growth for housing that exceeded the outer locations by a multiple of 2.4 between 1982 and 1990. Between 1990 and 1996 this escalated to a multiple of 7, causing an implicit transfer of housing wealth from home owners in outer suburbs to those owner-occupiers and investors in the inner suburbs.[6] Melbourne, and to a lesser extent Adelaide, experienced similar transfers of housing wealth.

Home owners benefit from the construction of new improved dwellings or the renovation of existing houses in the immediate area. New physical infrastructure, such as a regional shopping center or other community facilities can add value to properties in a neighborhood area. Some aspects of new development, such as a large component of public housing, new freeways or airports, can have a detrimental effect on housing prices. In cases where the urban externalities are positive, home owners can enjoy localised price rises in excess of those normally set by the forces of supply and demand.

A comparative study[7], between 1989 and 1993, of Glasgow in the north, and Luton in the south, of England showed that during a period of recession, house prices in Luton

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[5] D.W. Harvey, 1973, ***Social Justice and the City***, Edward Arnold, London, quoted in Badcock and Beer, p.31.
[6] Badcock and Beer, 2000, pp. 35-36.
[7] Badcock and Beer, 2000, p. 40-41. The impact of industrial restructuring, affecting regional labour markets in Britain, spilled over into the domestic property market. This is illustrated in a case study, cited by Badcock and Beer, by H. Mackay, ***Generations: Baby Boomers, their Parents and their Children***, Macmillan, Sydney, 1997.

decreased significantly while those in Glasgow firmed. In Australia, housing prices in Sydney and to a lesser extent in Melbourne, have outstripped the other major capital cities. Both cities have a stronger industrial and financial base than the other cities and are the preferred locations for over half the immigrants arriving in Australia. Most of Australia's population is concentrated in the capital cities, with 42 percent living in Sydney and Melbourne.

Average dwelling prices are high relative to household income.[8] The higher concentration of the population in the major capital cities contributes to average dwelling prices being relatively higher and households having a higher share of their wealth concentrated in housing assets. The expensive cities drag up the average level of dwelling prices more than in other countries, resulting in a higher share of wealth in housing. Since most property is situated in the big-city property markets, housing has a greater asset value than if the population was more decentralised. A high level of home ownership tends to increase average housing prices because owner-occupiers internalize the cost of wear and tear they create in their home, while renters may not fully bear such costs.[9]

Housing is both a consumption and investment good and its spatial fixity means that it is imperfectly substitutable across locations. Sydney and Melbourne account for a much larger proportion of Australia’s total urban population than is the case in most other developed countries. Ellis and Andrews (2001) contend that the more important are the larger cities in the total population, the higher will be the national average level of dwelling costs. The dominance of the larger cities may help explain Australia’s susceptibility to housing-price booms. In countries with a lower urban population concentration, price booms have less effect on national averages.

Identification of growth locations has important implications for property investors and owner occupiers. The choice of location can mean the difference between no return or an above average return from property.

Impact of Inflation

Australia's high inflation rates during the 1970s and 1980s encouraged investment in assets that could hold their real value. Housing prices generally kept pace with inflation while the real value of mortgages was eroded. From the 1970s through to the early 1990s real house prices outstripped the general inflation rate in every capital city, with the possible exception of Hobart. Property has generated attractive returns over a long period (Table 3). These returns become much greater in magnitude when they are based on owners equity instead of property value. When the effect of inflation on debt is considered, additional benefits to home owners occur due to the

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[8] D. Andrews, “City Sizes, House Prices and Wealth,” Reserve Bank of Australia, ***Bulletin***, December 2001, page 1.

[9] This point is made, without discussion, in Ellis and Andrews, 2001, page 10. They cite as their reference Henderson J V and Y M Ioannides, 1983, “A Model of Housing Tenure Choice,” ***American Economic Review***, 73(1), pp.98-113.

erosion effect of inflation on debt. Inflation however, does have an impact on the cost of debt servicing through higher nominal interest rates. Since property prices outstripped inflation in most capital city locations inflation, the difference between the price and the shrinking mortgage, which represents the home-owners equity, increased at a faster rate because of inflation.

Table 3: Dwelling prices over time

	Sydney	Melbourne
Average dwelling price in 1979 (in 1992 dollars)	$151,000	$93,700
Average dwelling price in 1992 (in 1992 dollars)	$225,000	$123,700
Percentage increase	49%	32%
Source: Badcock and Beer, page 104.		

Periods of high rates of inflation constrain household debt since nominal interest rates are high and nominal interest rates are used by lenders to determine the payment ratio. The typical maximum loan payment in Australia corresponds to a repayment-to-income ratio of around thirty percent, limiting demand for owner-occupied housing. Inflation benefits those who are already dwelling owners. Property prices tend to keep pace with inflation while the real value of the debt, as well as the mortgage payments, is eroded over time. On the other hand, during periods of very low rates of inflation, there is an increase in the demand for owner-occupied housing since the up-front hurdle of servicing a mortgage for new entrants is less and existing home owners can more easily upgrade. Ellis and Andrews (2001) suggest that deregulation and low inflation have enabled dwelling wealth to reach its long-run equilibrium level. "This may explain why Australia's dwelling wealth-income ratio has increased relative to other countries, from around the international average to well above it."[10]

Government Policy

Home ownership has become one of the most important means available to the average Australian household for creating personal wealth. The immediate postwar generation enjoyed state-supported housing assistance and regulated interest rates to provide low interest housing loans. Successive governments have targeted the housing sector to help kick-start the domestic economy. Governments of both political persuasions see the housing sector as having an important influence on the general economy. Dwelling investment in Australia has been a little over 5 percent of gross domestic product[11] during the last twenty years and the housing industry has sometimes been used to regulate the rate in growth of the domestic economy.

[10] Ellis and Andrews, 2001, page 26. This occurred in the post-deregulation environment in the period of the late 1980s and throughout most of the 1990s. The term disinflation is used by Ellis and Andrews. For a brief period during the early 1990s inflation hovered about zero and dropped below zero for one quarter.
[11] Badcock and Beer, 2000, page 114.

At the beginning of the 1980s, the federal Labor Government offered various incentives to first home buyers to engender a housing led recovery. Another example of government policies to encourage the housing industry has been the introduction, in July 1985, of the accelerated building depreciation allowance of 4 percent on newly-constructed rental housing. This allowance was reduced to 2.5 percent for construction initiated after September 1987. In July 2000 with the introduction of the Goods and Services Tax (GST) the Liberal Government made available a first home buyers grant of $7,000 as compensation for higher costs arising from the GST. Later the grant was increased to $14,000 for first home buyers who purchased newly-constructed dwellings.[12] The strong economic performance by the Australian economy during 2001, a growth rate of approximately 4 percent, is largely attributed to housing sector growth and its indirect impact on the economy through related industries. Home ownership is strongly linked with the economy. The construction industry contributes directly to employment and indirectly through the whitegoods and furniture and fittings that are installed in homes. These goods and materials are primarily supplied by local industries, providing greater job opportunities for Australians.

Case et al. (2001) investigated the impact of the US housing market on consumption and concluded that its influence was greater than that of the stock market in developed countries. Financial innovations, such as lines of credit and redraw facilities, have made it easier to extract cash from houses for consumption expenditure. A recent article in The Economist[13] suggests that the impact of the current world recession has been less severe due to the increased equity available to home owners arising from the wealth effects of increased property prices during 2000 and 2001. "If there is one single factor that has saved the world economy from a deep recession it is the housing market."[14]

Table 4 compares increases in house prices during two periods of rapidly rising house prices. The inflation adjusted figures indicate that price increases during the five-year period ending December 2001 were much more evenly distributed across the major capital cities, with the exception of Melbourne which was almost double the national average increase during this period. Melbourne's rate of growth during the latter five-year period was significantly greater than that for the five-year period ending March 1989, whereas Sydney prices grew substantially more in the earlier period. A significant imbalance between Sydney and Melbourne had developed at the end of the 1980s when Sydney property prices moved ahead more rapidly. The differential in prices still persists but to a lesser extent as we enter the new millennium.

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[12] Eligible applicants are entitled to receive an additional grant of $7000 if they purchase or build a new home and the contract was signed between 9 March 2001 to 31 December 2001. From 1 January 2002 to 30 June 2002 this additional grant was reduced to $3000. Details of the grant are available at the government web site: http://www.firsthome.gov.au

[13] "Going Through The Roof," The Economist, March 30th 2002, Special report on house prices.

[14] <u>Economist</u>, March 30, 2002, p. 61.

Table 4: Percentage Change in House Prices Over Five-year Periods

	Nominal Five year period to: Mar 1989	Nominal Five year period to: Dec 2001	Real Five year period to: Mar 1989	Real Five year period to: Dec 2001
Sydney	140.4	47.7	68.0	33.2
Melbourne	122.2	93.1	55.3	74.1
Brisbane	47.9	46.3	3.4	32.0
Adelaide	43.9	37.4	0.6	23.9
Canberra	42.8	42.5	-0.2	28.5
Perth	142.0	34.6	69.1	21.4
Australia	113.9	56.8	49.5	41.4

Source: Reserve Bank of Australia, ***Bulletin***, May 2002, page 30.

Most western countries offer attractive tax incentives to home owners. In Australia owner occupiers, that is, where the property is the principal place of residence, are exempt from capital gains tax (CGT). CGT exemption can make owner-occupied dwellings relatively more attractive than other forms of investment. However, deductibility of mortgage interest payments, considered as providing a strong incentive for owner-occupiers, which is permitted in the US and many European countries, is not allowed in Australia.[15] It may be argued on equity grounds that owner-occupiers should be entitled to receive a tax deduction for mortgage interest in the same manner as property investors. Owner-occupiers are, on the other hand, exempt from tax on imputed rents, that is, the amount the owner would receive if the house was rented out. As a consequence of the taxation arrangements each owner-occupier, in the period 190-91, received an average subsidy of $2,000 per annum, compared with $1,000 for purchasers who are investors, $990 for private tenants and $3,020 for public tenants.[16] These taxation benefits are capitalised into house prices and have further encouraged home ownership.

While property investors are taxed on capital gains they may offset interest paid on a mortgage against income derived from any source in determining their taxable income. Investors may also claim a tax deduction for building depreciation, referred to as the special building write-off, and depreciation of fixtures, fittings and furniture.[17] A recently introduced change in the tax system enables investors to reduce their capital gains tax (CGT) liability by fifty percent. Prior to the change individuals were taxed at their marginal rate on the inflation-adjusted capital gain. They may now elect to be taxed at their marginal rate on fifty percent of the total

[15] Details of mortgage deductibility and capital gains tax exemptions for a number of countries are provided in Ellis and Andrews, 2001, page 8.

[16] J. Flood, "Housing Subsidies 1990-91", Paper presented to the Institute of Australian Geographers Conference, Monash University, September, 1993, cited in Badcock and Beer, 2001, pp. 113-114.

[17] Information about the special building write-off and depreciation of fixtures and fittings is published by the Australian Taxation Office and available from the ATO in booklet form or from the ATO web site.

unadjusted gain if the tax is less than under the old structure. This change to CGT was adopted by the government in 1999 following the recommendation of the Wallis report on the Australian Financial System.[18] The changes were designed to simplify the calculation of CGT, formerly an *indexed-cost-base* method was applied, and to encourage greater turnover of poorly performing assets in the market which, in turn, increases the productive use of resources.

The available evidence does not suggest that Australians have a greater preference for housing compared with the residents of other countries nor that government policy encourages dwelling investment to a greater extent than does policy elsewhere. Tax policies do not provide a greater incentive for Australians, relative to other countries where mortgage interest is deductible, to become owner-occupiers.

The quality of Australia's housing stock is comparable to that in some other countries, in particular Britain and many parts of the United States of America. Australia's housing pattern is more land-intensive, it has a greater share of detached houses, relative to many of the older cities of Europe, USA and Asia. Due to high population growth the proportion of new homes built is greater than in most other countries, with the exception of Japan, which also has a somewhat higher ratio of persons per room. While dwellings are generally larger in Australia, the number of persons per room does not deviate significantly from most European countries (refer Table 5).

Table 5: Indicators of Housing Quality

	Persons per room	Average Existing dwelling size	Average new dwelling size	Houses	Detached houses	Dwellings with six or more rooms	Dwellings built since 1980
Australia	0.6	131.8	185.5	87.6	78.8	63.5	33.7
Canada	0.5	114.0	na	66.4	55.9	75.0	na
France	0.7	88.0	102.5	56.2	na	16.6	32.0
Germany	0.5	86.7	101.9	45.6	31.0	11.5	22.0
Italy	0.8	92.3	88.7	na	na	na	na
Japan	0.7	89.6	94.3	na	59.2	na	51.8
UK	0.6	84.0	76.0	80.7	25.6	36.8	13.3
US	0.5	156.5	199.7	66.7	60.6	45.2	25.4
Sweden	0.5	89.8	86.0	45.7	na	na	12.0
New Zealand	0.5	132.0	na	83.0	73.0	56.1	na

Source: Reproduced from Ellis & Andrews 2001, page 9

[18] Information on the Wallis Report may be found at the Treasury's web site: http://www.treasury.gov.au. The law relating to the treatment of CGT was amended with effect from 1st October 1999.

Australia's social security system is less generous than that enjoyed by the citizens of many Western European countries.[19] Retired Australians receive much lower incomes, about 25 percent of average weekly earnings, than similar households in Western Europe, where contributions are built around earnings replacement. However, for many Australians there is a significant benefit from home ownership for owner-occupiers, which is as high as 90 percent for some of the older cohorts.[20] Other benefits, such as health and pharmaceutical benefits provide additional offsets for those in retirement. Home-owners can release their housing wealth to subsidize their lifestyle in retirement, which may involve a cheaper form of alternative accommodation that is consistent with their housing and health needs. A byproduct of Australia's housing policy is that the higher level of owner-occupation enables the government to spend less on the provision of welfare and related services.

Impact of Financial Deregulation

In 1956 Government-owned banks provided 56 percent of all finance for home ownership in Australia, with most of the remainder coming from building societies, and trading banks. The deregulation of the financial system during the mid 1980s removed control over housing interest rates and led to a wave of corporate restructuring and mergers that eliminated most of the regional banks and saw the privatization of most of the government banks.[21] Building societies, who in the post deregulation period lost the competitive advantage enjoyed during the 1970s and early 1980s by offering cheaper housing loans than the banks, were either taken over by the larger private banks or became banks themselves.

The economic recession at the start of the 1990s created a major problem for those banks that were over-exposed in loans to the business sector, in particular loans provided for commercial property, a sector that was in crisis due to the recession and excess supply of office space. Australia's two largest banks, the Commonwealth Bank of Australia and the National Australia Bank, were not so adversely affected by the recession as most of their property loans were to the housing sector. Westpac and ANZ, who had made substantial loans to the small business sector, sought to increase their lending for housing to aid their recovery. Home mortgages are regarded as very low risk and the level of mortgage default in Australia is very low.[22] In 1996 the home loan market in Australia was worth $176 billion.[23] At the same time, the level of arrears was just under 1 percent, which with mortgage insurance represents a fairly low risk for lenders.

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[19] In 1990 Australia spent 13 per cent of gross domestic product on Social Security payments, compared with the average of 26 per cent for all Europe and 15 per cent for the United States. (Badcock and Beer, page 123)

[20] Badcock and Beer, page. 124.

[21] A report entitled, ***Committee of Inquiry into the Australian Financial System***, Campbell J K Chairman, was published in 1980. This was followed by a number of commissioned reports dealing with specific areas of the financial system.

[22] Borrowers at greatest risk of default, are required to insure their loan with the Housing Loan Insurance Corporation or similar insurer.

[23] ***Australian Financial Review***, "Bank Mortgage Squeeze", pp. 1, 20.

The attractiveness and profitability of the mortgage market has seen banks expand their operations in this area and new, non-bank institutions enter the field. Specialist mortgage provides, such as RAMS, Aussie Home Loans, FAI First Mortgage and Australia Mortgage Corp, now compete with the banks by offering cheaper no-frills loans. The interest differential between the banks and the specialist providers has narrowed significantly and competition between the banks and other providers has led to a boom in housing credit.

Prior to 1993, under Reserve Bank rules, personal and small business loans were rated at twice the risk of home loans, and were therefore double the cost to a bank's balance sheet. With the relaxation of this requirement, banks re-entered the market for personal finance and began to lend against housing equity.[24]

The deregulated financial system has provided access to housing wealth through home equity loans, providing some liquidity and flexibility for property owners. The proportion of non-financial assets, as a share of total assets, held by Australians has increased from the international average, about 55 percent, to 64 percent by 1999. The explanation for this is due to the fact that housing is expensive relative to income in Australia (refer Table 6) The ratio of average dwelling prices to average disposable income has grown considerably during the 1990s, a period of financial deregulation, reaching 378 percent by late 2000. Financial deregulation has brought about lower interest rates and, with the low inflationary environment prevailing during the 1990s, this has enabled more Australians to gain entry to home ownership, to service larger mortgages[25] and acquire more expensive houses.

Table 6: Housing Wealth as a Percentage of Household Disposable Income

	1980	1985	1990	1995	1998
Australia	248	239	281	303	355
Canada	123	-	118	129	129
France	172	-	218	218	227
Germany	-	-	331	302	301
Italy	133	-	170	172	166
Japan	380	397	641	429	381
UK	343	357	361	252	293
US	169	170	173	155	163
Sweden	208	184	245	182	198
New Zealand	185	237	243	278	283

Source: Reproduced from Ellis & Andrews 2001, page 6

[24] Badcock and Beer, page 121.

[25] Since 1990 the average size of a new loan approved for an owner occupier has increased by about 60 per cent. (Stevens 1997)

Financial deregulation increased effective demand for owner-occupied housing, placing upward pressure on dwelling prices. The median house price in 1993/94 was about $149,000, a mortgage rate of 8.9 percent existed and, assuming a loan to value ratio of 70 percent, some 46 percent of Australian households would qualify for a housing loan. By mid-1997, allowing for the average growth in household incomes, changes in the median price of houses and a prevailing mortgage rate of 6.7 percent, some 55 percent of households pass the same test.[26]

Market Indices and Cycles

Dwelling prices are frequently used as an indicator of more general price pressures. Since many published series abstract from compositional effects, or relate only to specific markets or types of housing, they provide useful information on price movements but are unsuited for determining the market value of total dwelling stock. Price deflators exclude the effect of increasing dwelling quality. The composition of dwellings sold may not be representative of total dwellings if different types of dwellings turn over at different rates. The use of the median, as opposed to the average, causes a downward bias for what is likely to be a left-skewed distribution.

Countries with large public-housing sectors could overstate dwelling wealth by inclusion of these dwellings that are not owned by households. This would also apply in situations where dwellings that are rented from corporations in the private sector are excluded. This is particularly so in countries with low owner-occupation rates. Price indices typically do not take account of these country-specific anomalies, which requires a good deal of caution to be exercised when making international comparisons.

Residential property is sensitive to market cycles which are reflected in prices. Because property is a lumpy asset, small percentages changes can translate into large dollar amounts. A homeowner who purchased when the cycle was in an up-phase and has to liquidate in a down-phase could end up with a very substantial loss. Due to the large entry and exit costs, when calculated as a percentage of equity, associated with property transactions, a substantial price rise is needed to prevent a loss.

Most purchasers are not unduly affected by market cycles as they merely buy and hold, even though the magnitude of their wealth is directly related to the position of the cycle at a point in time. For most homeowners their efforts are concentrated on reducing or eliminating their mortgage. Equity in their home represents a major proportion of personal wealth for a substantial number of Australians, wealth that can be used to fund their retirement. Releasing the equity from a property may be achieved by selling the property or using it as security to raise finance. Irrespective of which option is followed, the value of the property has to be established either by sale or valuation.

[26] G.R. Stevens, ***RBA Bulletin***, October 1997, page 41.

The ageing phase of the Australian population during the coming decades is likely to see an increase in the number of people who will need to convert the equity in their property to a more liquid form. For those home owners who are about to permanently leave the workforce, the residential property cycle will have implications for their wealth at retirement. If this occurs immediately after a major market crash, such as occurred at the end of the 1980s, the choice of lifestyle in retirement may be considerably modified to adopt to their new lower-wealth situation. This problem is perhaps more exacerbate for Australians entering retirement due to the high degree of home-ownership relative to other countries and the less generous nature of the social security system, referred to earlier.

Conclusion

Home ownership in Australia accounts for a greater percentage of personal wealth than it does for most European and North American countries. Despite its comparatively small population and large land mass, house prices in Australian capital cities are comparable to, even exceed, many of the larger European and American cities. While the concentration of urban development in the two major state capitals of Sydney and Melbourne is a major contributing factor pushing up prices. Other factors, such as; government policies and taxation incentives, deregulation of the financial markets and inflationary pressures have also contributed to the sustained increase in prices during the past decades.

Housing wealth in Australia represents some 60 percent of private sector wealth. For many Australians approaching retirement, their home-equity represents a key component of retirement income. For home-owners, the wealth stored in their home may be established by reference to an index of property price changes in their local area. The accuracy of the reference benchmark price index will have implications for the wealth perception of home owners. The decision to sell and relocate to a more desirable retirement location may be influenced by the perception of value communicated by a property price index. If publicly reported property price indices are used as an index of value by lenders, and hence are used to calculate the owner's equity, it is important that these indices reflect the correct movement in prices over time.

During the next decade the Baby-boomer generation will enter the retirement phase and live off their accumulated wealth. Given the dominance of residential property as a component of personal wealth for these future retirees, converting their assets to a more liquid form may have significant implications for residential prices in the long-term.

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