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What are the benefits and risks of home ownership for low-moderate income households?

FEWER LOW-MODERATE INCOME HOUSEHOLDS CAN BUY A HOME COMPARED TO 30 YEARS AGO, AND THOSE THAT DO PURCHASE EXPERIENCE SIGNIFICANT FINANCIAL RISKS (PARTICULARLY IN THE EARLY YEARS OF PURCHASE) WHICH HAVE TO BE WEIGHED AGAINST THE NON-FINANCIAL BENEFITS SUCH AS GREATER SECURITY AND STABILITY.

KEY POINTS

- Home ownership confers benefits for low-moderate income households in terms of building long-term financial wealth, and is also valued by these households for the psycho-social benefits of security, control and stability.
- Low-moderate income households who enter home ownership now face far greater financial risks than households with equivalent incomes 30 years ago. Almost 45 per cent of these households experienced mortgage stress (using the 30/40 rule) in 2007–08 compared to 21 per cent in 1981–82.
- Mortgage stress is a broad brush measure of financial risk. The research found a continuum of financial risk facing low-moderate income purchasers when other housing and non-housing expenditures and debt levels are taken into account. This explains why high rates of mortgage stress do not translate into high rates of mortgage arrears and defaults.
- Low-moderate income purchasers have been increasingly constrained to purchase in outer urban areas. Although they have built wealth, house prices in these areas have not increased as quickly as houses in middle and inner urban areas. Analysis of repeat sales data for metropolitan Melbourne shows that one in eight of all sellers lost money in real terms

This bulletin is based on research by ***Associate Professor Kath Hulse, Professor Terry Burke, Ms Liss Ralston*** *and* ***Dr Wendy Stone*** *of the AHURI Swinburne-Monash Research Centre. The research examined trends in home purchase for low-moderate income households from the 1980s to the present.*

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and that there is greater risk of making a loss for dwellings in outer urban areas and if the dwelling is sold in the first three years. Low-moderate income households are most at risk in this respect.

- There is evidence that home purchase rates for low-moderate income households are declining, particularly for first time buyers and younger families. Furthermore, low-moderate income purchasers are more likely to be still paying off houses after retirement age. This has implications not only for housing policy but also across a range of policy areas including retirement incomes.

CONTEXT

In Australia, governments encouraged home ownership as the main housing tenure in the post-war period to the early 1980s through a range of policy levers, such as regulation of interest rates for loans to owner occupiers, financial assistance to first home buyers, sale of public housing to sitting tenants and the development of affordable home ownership lots by state land developers.

Starting in the 1980s, the influence of market liberal ideas, which see markets rather than governments as the most efficient means of allocating resources, meant that some of these policies for supporting affordable home ownership were abandoned. For example, in 1986, there was final deregulation of interest rates for owner occupiers, and removal of assistance to first home buyers in 1993. The First Home Owners Grant was introduced in July 2000 primarily to offset the negative impact of the new Goods and Services Tax (GST).

Despite these policy changes, there has remained an assumption that home ownership is uniformly beneficial across a wide range of household incomes. The aim of this research was to test this assumption, including whether low-moderate income households realise the projected benefits of home ownership and the extent to which these are offset by additional risks associated with their incomes. This question became more pertinent as the effects of the US sub-prime crisis became apparent.

RESEARCH METHOD

The research involved detailed analysis of a range of secondary data sets to assess how low-moderate income home purchasers fare in relation to mortgage stress, wealth and household debt. These sources included the Australian Bureau of Statistics Housing Expenditure Survey 2003–04 and Survey of Income and Housing 2007–08, and the Victorian Valuer-General's Property Sales Statistics. The study also involved a supplementary qualitative component in which recent purchasers were asked about their views, expectations and experiences of home purchase in lower house price areas of Melbourne.

KEY FINDINGS

Low-moderate income households face much greater financial risk than equivalent households of three decades ago

Using various affordability measures, it is possible to identify a continuum of financial risk associated with home purchase for low-moderate income households: mortgage stress, financial risk and financial crisis represent these increasing levels of risk.

Mortgage stress: This is defined to occur where a household in the lowest 40 per cent of the income distribution has a mortgage that exceeds 30 per cent of their income. It is estimated that 45 per cent of low-moderate income households experienced mortgage stress in 2007–08, increasing from 21 per cent in 1981–82 and much higher than for middle-higher income purchasers (12% in 2007–08).

Mortgage stress abates for most households over time, but it takes longer for those on low-moderate income: almost one in five low-moderate income purchasers were experiencing mortgage stress after 14 years.

Financial hardship: Defined as where a household finds it difficult to meet housing expenses once basic needs are met, around a quarter of low-moderate income purchasers are estimated to experience financial hardship. This method also reveals that the capacity to purchase is greater above about $60 000 p.a. than is suggested by the 30/40 affordability benchmark. This explains why low-moderate income purchasers have been able to continue to buy, but families with children are being squeezed out of the market due to their higher non-housing expenditures.

Financial crisis: Households in mortgage stress who also experienced more than three of the six financial stress indicators used in the ABS Household Expenditure Survey were deemed to be in financial crisis. Examples of these indicators are inability to pay utility bills and needing to borrow money from friends or family. Eight per cent of low-moderate income home purchasers were in financial crisis (compared to 2% of middle-higher income earners).

Low-moderate income purchasers still receive a net financial benefit from home ownership but are increasingly constrained to buy in outer locations where the potential to increase wealth through housing has been lower and there is a greater risk of making a loss on property sales in the short term

A case study of metropolitan Melbourne reveals that from 1981 to 2006, low-moderate income earners have experienced real increases in their wealth. The extent of increase has depended on when and where they moved during this period, as there has been an increasing price differential between inner, middle and outer suburbs. The rates of increase in some gentrifying suburbs have exceeded those recorded in more expensive suburbs, though many outer suburbs have had lower rates of uplift. Relatively low rates of house price increases in outer areas means that the households' future capacity to move is constrained, thus leading to spatial disadvantages for this group and increasing socio-spatial polarisation. Despite this, it appears that even in outer urban areas, low-moderate income home purchasers have financial advantages compared to continuing to rent, and in some cases these financial benefits can be realised within four years of purchase.

Problems occur when a household needs to move in the early years of purchase, particularly for low-moderate income households who are able to purchase in an increasingly limited number of outer growth areas. Forty one per cent of households who purchased in outer growth areas of Melbourne in 2005–06 and sold within two to three years made a loss (based on analysis of repeat sales data).

Trade-offs made by low-moderate income home purchasers compromise their ability to realise the non-financial benefits of home ownership

The interviews with low-moderate income home purchasers indicate that the main driver of home purchase among these households is the non-financial benefits of home ownership including psycho-social benefits of security, control and stability associated with living in 'a place of your own', with mixed results as to whether these flow on to indirect benefits for health and wellbeing.

While many low-moderate income home purchasers compromise on location to enter the market, they are less willing to compromise on dwelling type, with a strong preference for a detached house on a separate block. Among those interviewed, the locational trade-off did not undermine the sense of achievement and improve security that home ownership can provide. However, there was some indication that the sense of control and stability can be threatened when households live with extensive financial strain or a precarious income.

Access of low-moderate income households to home ownership is diminishing

Since the early 1980s, the share of low-moderate income purchasers and owners as a proportion of all purchasers and owners has remained stable at roughly 25 per cent. Nevertheless, low-moderate income first time buyers as a share of all purchasers and owners has declined (from 1.0% in 1981–82 to 0.2% in 2007–08).

Low-moderate income purchasers are also older than in previous decades. Whilst this reflects, in part, the demographic ageing of the population, it means that a growing number of these households risk still having a mortgage when they leave the workforce and their income reduces.

In 1981–82, most low-moderate income purchasers were families with children; now they are singles and couples without children. Some of this is explained by broader demographic change, but it may also reflect the fact that it is more difficult for families with children to enter home purchase in view of their other expenditures. Given that the stabilising effects of home ownership is thought to be beneficial for families, this is a concerning development.

POLICY IMPLICATIONS

Programs such as the First Home Owners Grant encourage low-moderate income households to buy their first home. However, these households need to be aware that they can lose wealth and there is risk of mortgage stress, financial hardship and even financial crisis, especially in the early years of mortgage. There are a range of policy issues around lender practices and informed consumer behaviour. These issues are compounded given that the psycho-social benefits of home ownership are undermined by financial stress and its consequences.

Even so, home ownership confers financial benefits for low-moderate income households as well as for middle-higher income households, over the longer term; whether the increase in housing prices of the past three decades will continue into the future is an open question. It is apparent that current policy levers are failing to sustain levels of home purchase for low-moderate income households, especially younger families who might benefit from the psycho-social benefits of home ownership.

It appears that more low-moderate income purchasers will reach retirement age with debt still outstanding against the property they live in. A different set of policy levers will be required to address this. The higher housing costs for older people who either have a mortgage, or remain in the rental market, could be seen to have positive effects in view of an economic imperative to retain people in the labour force for longer. However, it is important to consider that due to deteriorating health, many will not have this choice. This may require some adjustment of policies in relation to retirement incomes.

One approach is to change the settings for the rental sector to provide more secure sustainable housing for those who are unable to purchase a home and will rent over the long term. This is particularly pertinent for older Australians, who will be required to rent their housing on a retirement income when they are no longer able to work. Otherwise, a focus on developing policies to enable households on low-moderate incomes to enter and remain in home ownership is warranted, for example, through shared equity arrangements.

Addressing problems associated with spatial disparities in wealth generation through home ownership in the future will require more than housing policies. This is an issue for urban policy, including greater equity in amenity throughout an urban area rather than focusing public and private investment in high value inner city areas.

FURTHER INFORMATION

This bulletin is based on AHURI project 50514, *The advantages and disadvantages of home ownership for low-moderate income households*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or by contacting AHURI Limited on +61 3 9660 2300.

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