

Predicting the outcomes of home purchase assistance schemes

GOVERNMENT POLICIES THAT PROMOTE ACCESS TO HOME OWNERSHIP HAVE THE POTENTIAL TO LIFT HOME OWNERSHIP RATES IN THE SHORT RUN, PARTICULARLY IF THEY ARE TARGETED TO EASE HOUSE DEPOSIT AND MORTGAGE REPAYMENT CONSTRAINTS.

KEY POINTS

- The Australian Government First Home Owners Grant (FHOG) is predicted to have only a small positive effect on the share of the current Australian population who will be home owners at some point in their lives.
- When the FHOG is at the \$14,000 rate (as it was in 2001) it is highly effective in relaxing the deposit constraints of many potential homebuyers.
- The FHOG, at either the \$7000 or \$14,000 rate, is less effective in easing the mortgage repayment constraints associated with home ownership.
- The FHOG assists people to enter home ownership who would probably have become home owners anyway, but it enables them to make this transition at an earlier age.
- The FHOG is predicted to be of most assistance to younger, middle income single person households in white-collar jobs.
- A shared equity scheme will have a greater impact on the home ownership rate than the FHOG, provided financial institutions are willing to take a high share of the equity in a house.
- A shared equity scheme is more likely to be taken up by lower income households than the FHOG.
- A shared equity scheme is less likely to simply bring forward home purchase decisions.

Based on research by Gavin Wood, Richard Watson and Paul Flatau of the AHURI Western Australia Research Centre. The research uses AHURI's Housing Market Microsimulation Model (AHURI-3M) to assess which tenants might be assisted into home ownership by the First Home Owners Grant (FHOG) or a shared equity scheme. This is one of three Bulletins outlining the findings of this large-scale project.

CONTEXT

The AHURI Housing Market Microsimulation model (AHURI-3M) is the first comprehensive microsimulation policy tool designed for the Australian housing market. AHURI-3M takes into account both the demand side and the supply side of the housing market and is designed specifically to assess the quantitative impacts of housing policy measures.

By simulating the economic impact of policy measures, AHURI-3M is able to provide guidance to policy makers.

AHURI-3M analysis is the basis for the findings in this Bulletin.

FINDINGS

THE FIRST HOME OWNERS GRANT (FHOG)

The FHOG was introduced by the Federal Government on July 1, 2000, to offset the impact of the introduction of the Goods and Services Tax (GST). It was initially set at \$7000, with a higher rate of \$14,000 introduced in 2001 for first home owners who built their home, or purchased a newly constructed home. The \$14,000 grant is no longer available.

There are two requirements to be met by households aspiring to home ownership. They must have sufficient savings to put a deposit on a house – the deposit constraint. They must also have sufficient income to meet mortgage repayments – the repayment constraint.

Simulations conducted using AHURI-3M indicate that the FHOG can have a significant impact on these constraints, particularly at the \$14,000 level. There is a predicted increase in the short run of 6.4 percentage points in the share of income units who will move into homeownership as a result of the \$14,000 FHOG.

At \$14,000 the FHOG helps those who have sufficient income to meet mortgage repayments, but insufficient savings to bridge the deposit requirement. At \$7000 the impact of the FHOG

is small. The buoyant residential construction figures in the period following introduction of the \$14,000 FHOG are consistent with these findings.

Estimates from AHURI-3M predict that the FHOG at \$7000 makes home ownership a feasible financial proposition for 65,854 home buyers in the short run. At \$14,000, the AHURI-3M estimates predict that home ownership becomes a feasible financial proposition for 632,970 home buyers in the short run. Most of these home buyers would eventually become home owners anyway, but at a later date.

With the FHOG set at \$14,000 the poorest 40% of potential first home buyers are predicted to account for only 9% of all grants, while the richest 40% account for 77% of all grants. The FHOG is thus unlikely to assist low-income renters into home ownership.

Almost one-half of those income units forecast to take up the FHOG at \$7000 and \$14,000 were in shared living arrangements, most living rent-free with their parents. As they move into home ownership these income units form new households and generate an increase in the aggregate demand for a range of consumer goods, and thereby have a significant stimulatory impact on the economy. Those making the transition into home ownership with the assistance of a FHOG tend to be young, single, without children and enjoy wage and salary incomes higher than other rental tenants.

Results from AHURI-3M find that most income units predicted to take up the FHOG would have purchased once accumulated savings met deposit requirements, or rising incomes enabled repayment requirements to be satisfied. The FHOG is thus likely to bring forward entry to home ownership of those who would have entered at a later point in time. The households predicted to take advantage of the FHOG and move into home ownership are, perhaps unsurprisingly, on much higher incomes than those predicted to remain as renters.

SHARED EQUITY SCHEMES

Shared equity schemes aim to support home ownership by creating equity partnerships between housing consumers and financial institutions. AHURI-3M has been used to analyse the likely

impacts of such a program. The model is capable of detailed evaluation of a policy's impact in different market segments and for different groups of households. This is a particular strength of AHURI-3M.

In a shared equity arrangement, the government or a financial institution offers to take an equity stake in a home purchase.

- The housing consumer is the *managing partner*, retaining ownership rights with respect to the timing and type of improvements and the timing of any decision to sell.
- As the *limited partner*, the government or financial institution offers to take a percentage equity stake. In return, the managing partner agrees to forgo a pro rata percentage share of capital gains (on realisation) that is a return on the limited partner's equity stake.

Estimates from AHURI-3M predict that the introduction of a shared equity arrangement could result in a substantial 8.8 percentage point short run increase in the share of home ownership, and is more likely to be taken up by lower income households.

Capping the proportion of equity taken by the limited partner significantly reduces the number of tenant income units predicted to enter shared equity arrangements. Hence, any reluctance by financial institutions to purchase high equity shares could severely limit the short-term effectiveness of a shared equity scheme.

Predictions from AHURI-3M suggest that shared equity arrangements will have more significant impacts on housing markets than the FHOG.

CAVEATS

In this Bulletin, the term income unit is used to refer to the decision-making unit for the purposes of housing consumption and investment decisions. In general, this will be either a single person or a couple. It is analogous to the ABS definition used in statistical surveys

AHURI-3M uses data from the ABS 1997 Rental Investors Survey (1934 properties held by 1576

landlords) and the 1996-97 Survey of Income and Housing Costs (9276 housing consumers). However, policy parameters have been defined by reference to the tax-welfare system in July 2000.

The measure used to compare the outcomes from the FHOG and a shared equity scheme is the proportion of income units predicted to move from renting to home ownership. However, the nature of the home ownership outcome, at the consumer level, is not the same in each case. In a shared equity arrangement the level of equity held by the home owner is markedly (and purposefully) lower.

POLICY IMPLICATIONS

Whilst the FHOG is the main form of direct assistance for home ownership provided by the Australian Government, it is a relatively small part of the overall support provided which includes indirect assistance in the form of tax concessions, estimated by Yates to be worth \$21 billion per year.

If it is an aim of Australian housing policy to increase the rate of home ownership, the current FHOG may achieve this in the short run, but it is unlikely to achieve it in the long run. This is because the majority of those taking up the FHOG are not low-income long-term private renters.

A shared equity scheme is predicted to be more effective in achieving such a long-run policy aim. At present, though, it is unclear whether financial institutions and potential home buyers will be attracted to shared equity schemes. It is also unclear what impact shared equity schemes will have on house prices – will the availability of additional funds bid them up further?

The FHOG is currently available to all first home buyers, regardless of income level. The modelling predicts that fewer than 10% of FHOGs will go to those in the bottom 40% of the income distribution, yet these are likely to be the people in the greatest need of assistance. Depending upon the policy ambitions of the FHOG, the effectiveness of the programme in securing improved housing outcomes for lower-income Australians may need to be considered.

FURTHER INFORMATION

For more information about this project, see the final report of this project at:

www.ahuri.edu.au/attachments/80088_final_microsimulation.pdf

See also the following Research and Policy Bulletins:

Bulletin 28, A model of the Australian housing market, November 2003.

Bulletin 29, Increasing the supply of affordable private rental housing, November 2003.

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