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Housing Affordability – LMHS AGM Version

OPPORTUNITIES FOR NEW APPROACHES TO HOUSING OWNERSHIP, TENURE AND FINANCE IN AUSTRALIA

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Introduction

I shall be talking about housing affordability – an all-too-familiar subject – about which a vast amount has been said and written, in your country as well as mine. Nonetheless, I suspect that at least some of what I have to say may not be so familiar and indeed may be somewhat provocative.

Nearly a million and a half Australian households are shelter poor: the squeeze between their incomes and their housing costs leaves them unable to meet their non-shelter needs -- for food, clothing, transportation, personal care, and so on -- at even a minimal level of adequacy.

A million and a half households: That's close to half of low-income households and almost a fifth of all households in this country. When a fifth of a nation are shelter poor, it is impossible to argue that this is a problem of the unfortunate few left behind by widespread economic growth and opportunity. A problem of this magnitude, I would argue, cannot be dealt with simply through tinkering with the existing mechanisms of housing provision. More money and reformed regulation are certainly necessary, but, I contend, are not sufficient to the challenges we face. There are deep structural sources to affordability problems. Just because

Australia has escaped the housing crisis engulfing the United States does not mean that some of these structural sources are not present here.

My purpose, though, is not to preach doom and gloom. Ever since I began working in this field I have tried to formulate policies, programs and strategies that I believe can deal with the causes as well as the manifestations of the housing problem. So, I shall share with you some progressive proposals regarding housing ownership, tenure and finance. While I do not underestimate the political difficulties in trying to realise some of these notions, they would not, in my view, constitute a revolutionary transformation of the existing housing system in Australia. Rather, they would open up opportunities and choices not currently available, and do so in ways that could begin to deal with the some of the deeper sources of the problem.

Structural Causes

The evidence I have seen suggests that the longer and deeper roots of the affordability problems in our two countries are not so different. Let me identify four:

1. Wide and widening inequality of income and wealth;
2. Overdependence on debt and the capital markets to finance housing;
3. Treating housing increasingly as a speculative commodity;
4. Public policies that exacerbate problems in these other areas.

I will not be able to discuss each of these in the limited time we have available, but will leave with you a paper which does so, should any of you be interested. Let me just share a few observations as a foundation for the proposals I will be making.

Combined with ever widening income inequality, and speculative increases in house prices, the dependency of housing on debt – and the dependence of consumption on debt, including housing-related borrowing – has been turned into addiction in the U.S, and apparently

in Australia as well, creating debt junkies at all levels of the system, and pushers emerging at all levels because of enormous and growing opportunities for profit. A major consequence has been that household debt has grown faster than the overall economy and hence faster than the ability to repay it. According to data published by the RBA, during the current decade alone, Australian households have increased their interest payments on housing-related debt about three times as fast as disposable income. As one Australian commentator recently put it: “While the USA may have had lower quality loans and lower lending standards, it appears Aussies have more debt, which is accelerating so fast it has left our US counterparts for dead.”

This debt addiction is coupled with treating housing increasingly as a speculative commodity. Nearly everyone has come to believe that they are entitled to make a killing in residential real estate, up and down the food chain – not just distant investors, intermediate mortgage packagers, and nearby speculators and mortgage brokers – but including far too many home purchasers and homeowners.

This attitude has been facilitated by an abundance of easy credit, as just mentioned, and the idealisation and over-promotion of speculative homeownership, based on a whole series of myths that have prevailed for most of the past century, if not longer, in Australia, the U.S., and Canada, viz:

- i. that you are always better off economically as a homeowner than a renter;
- ii. that homeownership assures you of free housing in your old age;
- iii. that homeownership is a sound and effective way to build assets/accumulate wealth;
- iv. that property values always go up, at least as long as you can keep undesirable activities and undesirable people out of your neighborhood;
- v. that homeowners are full citizens, but renters are not;
- vi. that the degree of societal development is correlated with the homeownership rate;

vii. the illusion of ownership through the reality of DEBT.

In what sense are these myths? I will not attempt to provide a comprehensive analysis of each of these elements that I call myths, but will highlight several of them having to do with housing affordability and wealth accumulation.

First of all, while it certainly is true that over the long term property values have risen and quite substantially in most of Australia, there has been enormous volatility in time and enormous variation in space, including periods and locations in which prices have fallen. This means that even though there have been many big winners, there have also been losers.

Second, even where house prices do rise steadily and substantially, home purchasers who sell within about the first five years of purchase will, on average, only break even and may actually have a net reduction in their wealth. How can this be? It depends upon the relationship between price increases, on the one hand, and mortgage interest payments, on the other, during the period of ownership. That is, rising property values do not necessarily lead to increasing wealth among home purchasers.

Third, in Australia about 85 percent of mortgage loans have adjustable interest rates – a far higher share than most other countries, exceeded only by the UK and Sweden (according to the RBA). Since rate adjustments can occur monthly, home purchasers' housing costs are quite volatile, indeed more so than they are for renters. This means that affordability can go up and down suddenly. For lower-income purchasers the result can be unpredictable challenges in meeting their non-shelter needs after paying for housing, as well as risk of mortgage arrearage, default and foreclosure.

Finally, fewer Australian (and American) homeowners are entering old age with low and stable housing costs in homes fully-owned debt-free.

Is it not the role of government, in part at least, to counter some of these tendencies toward greater inequality, insecurity and instability? Unfortunately, there are a number of ways in which public policies – certainly in the U.S. and apparently in some similar ways in Australia as well – have at best failed to ameliorate these tendencies and at worst contributed to and exacerbated the structural weaknesses, flaws and problems. There are at least five areas of public policy that are relevant, but I will focus on just one of these, in which some similarities of concept and consequence between the U.S. and Australia can be identified: tax expenditures for housing.

Tax subsidies consist of preferential tax treatment of certain activities and/or groups. They do not appear explicitly in government budgets, and are not subject to the annual appropriations processes. But because they are fiscally equivalent to collecting the foregone taxes and allocating to the particular purposes and groups, they are also called "tax expenditures." They are huge in magnitude and have enormous consequences.

In both Australia and the U.S., tax expenditures for housing far exceed direct spending on social housing and housing subsidies for lower-income households. These tax subsidies flow overwhelmingly to homeowners. And they are highly regressive, with high income homeowners receiving far greater benefits than those of lower income.

In Australia, tax expenditures for housing amounted to about \$53 billion in 2005-6, based on government data recently analyzed by Judith Yates. This is more than 10 times as much as is spent on social housing and rent assistance. In the U.S. the ratio is also immense, about 6 to one.

In Australia, about 85 percent of these benefits flow to owner-occupiers, and most of the rest to investors in rental property, very similar to the U.S. Australian owner-occupiers receive an annual home ownership tax subsidy of more than \$8,000 a year on average. The benefit rises, though, with income. For owner-occupiers in the top 20 percent of the income distribution the

amounts to over \$14,000 a year; these are households with an average income of about \$160,000 a year in both Australia and the U.S. Indeed, about two-thirds of home owner tax subsidies flow to the top 20 percent of the income distribution in both countries.

No wonder these tax benefits have been labeled the “mansion subsidy.” More importantly, they distort the housing market, creating perverse incentives for housing speculation and increasing prices, as well as exacerbating inequality and depriving governments of substantial amounts of revenue. Indeed, in the U.S. even conservative economists have been recognising the destructive consequences of these tax policies.

Where to from Here?

The overarching conclusions my analysis are two:

- * Shelter poverty is extensive and increasing. It cannot be explained away as the problem of an unfortunate few. Rather, its causes are to be found in our systems of housing provision as well as our mechanisms of income determination.

- * The ideology and mythology of mortgaged homeownership are being left further and further behind by both economic reality and social morality. While home ownership certainly continues to provide real benefits to many, it has become inaccessible to many others, a source of economic and emotional insecurity to others who are nominally home owners, and a significant contributor to social polarisation and economic instability.

It is apparent that a comprehensive program of reform is needed, but I make no attempt to be so ambitious and presumptuous. Rather, I shall focus on aspects of housing ownership and tenure and on some related aspects of housing finance.

I have a plan for greatly increasing the amount of debt-free, non-speculative housing, which includes public housing, non-profit rental housing, and, my particular focus:

A. A Debt-Free Alternative to Mortgage Homeownership

It consists of three ingredients:

- * a modified mutual housing association form of ownership;
- * a form of tenure I call “resident-saver”;
- * capital grant financing.

Let me first say a little about the Mutual Housing Association. An MHA is a non-profit cooperative corporation, made up of residents, prospective residents and other community members. It assures resident ownership and control, balanced against community interest, as well as an infrastructure of expertise and support beyond the residents themselves. An MHA can be set up independently, or by an existing community housing provider as a subsidiary or sister organisation. An MHA can undertake housing development itself, or a community housing provider can develop the housing and convey title to the MHA upon completion.

MHAs finances housing to the greatest extent possible through capital grants rather than mortgage debt. The goal is to have no mortgage debt and hence no mortgage charges incurred by the housing and imposed on the residents. This means that the housing operates on a “cost rent” basis. That is, the residents have payments that cover the costs of utilities, local property taxes (rates), management, insurance, maintenance and repairs, and reserves for capital improvements and replacements.

Now to the tenure model. What makes the occupants “resident-savers” rather than social renters? First of all, residents would be expected to make an initial deposit or down payment, which is recoverable with interest upon moving out, but which is not a marketable property

interest. The goal in MHAs has been for residents to put up five percent of the total cost, with capital grants covering the rest.

Second, all residents would be required to make *mandatory* payments over and above operating expenses and capital reserves. *This is the crucial and distinctive feature of my model.* Such payments would be in lieu of mortgage payments, and would be required for a period up to the term of a conventional mortgage. *These funds would be placed into individual investment accounts to accumulate as a savings alternative to equity in conventional homeownership.*

That is, such payments by residents would be “forced savings,” somewhat like mandatory superannuation investments. Similar to superannuation contributions, residents could have a choice of investment vehicles, ranging from term deposits at banks and money market accounts to socially-oriented mutual funds. Unlike super fund investments, though, residents would be permitted to make withdrawals throughout their life span, thereby providing liquidity. However, withdrawals would be subject to some restrictions on the rate and amount in order to maintain the “forced savings” aspect corresponding to conventional home ownership.

I have done a series of calculations comparing the wealth accumulation rates for such hypothetical resident-savers with the wealth accumulation rates for home ownership. Based on investment assumptions that are conservative for resident-savers and relatively favourable toward conventional ownership, I have found that in general and on average a resident-saver would do at least as well as a conventional owner over any time span up to 25 years.

In sum, what does the resident-saver model offers residents?

- control over their homes comparable to conventional homeownership;
- greater security of tenure because there's no risk of mortgage foreclosure;
- asset development comparable in magnitude, on average, to conventional homeownership;
- but superior in terms of security (vulnerability), stability (volatility) and liquidity.

I am proposing a model of housing tenure that would open up housing choices and benefits not now available through the current alternatives of private rental, social rental, and conventional homeownership. To be sure, for the lowest income renters this model would not be affordable. But for moderate-income renters who have no realistic prospects of achieving conventional homeownership – and for those renters who might someday afford but do not necessarily want to bear the risks and other burdens of conventional home ownership – the advantages are obvious.

[Furthermore, the Resident-Saver/MMHA model is superior to so-called “shared-equity” homeownership. The Resident-Saver/MMHA model preserves affordability without limiting wealth accumulation, because it separates the social benefits of home ownership from the economic. Since asset development is separated from homeownership, residents may not sell their homes for a profit, thereby maintaining affordability for future generations.]

Finally, to the matter of financing. To reduce the burden of mortgage payments and dependency of housing on the volatile and costly capital markets, I have long proposed that non-speculative housing of all types – including both social rental housing and the proposed resident-saver/mutual housing alternative to home ownership – should be financed to the greatest extent possible by public capital grants.

In Australia a considerable portion of funding for social housing has been provided through capital grants, including currently through the Nation Building economic stimulus program. However, in Victoria at least, capital grants cover only 75 percent of capital costs for community housing providers; they must turn to conventional lenders for 25 percent of their capital funding.

In the U.S., the federal Section 202 program provides 100 percent capital grants to non-profit providers of housing for low-income elderly and disabled. In terms of financing it thus

offers an interesting comparison and example for community housing providers in Australia. Funding has, however, been subject to the annual appropriations process and severely limited for a number of years.

In addition, over the past two decades there has emerged in the U.S. a very different approach to generating capital funding that I hope might be considered here in Australia: Housing Trust Funds (HTFs). HTFs are special-purpose entities created by governments to receive dedicated revenue streams to support below-market housing. There are currently over 600 HTFs in the U.S., receiving and spending over \$1.6 billion a year. At the local level, HTFs receive funds primarily from impact fees paid by commercial developers. At the state level, funds come primarily from real estate transfer taxes, similar to the stamp duty.

In the middle of 2008 a *National* Housing Trust Fund (NHTF) was finally enacted, after a very long grassroots campaign. Currently, legislation is pending in the U.S. Congress for an initial capitalisation of \$1 billion, with funds to come from some element of the financial bailout program. While a good start, this is a relatively modest sum in relation to the scale of need and not a dedicated, on-going source of revenue.

I have instead proposed that the NHTF be capitalized through two other potential sources, sources that might also be appropriate to consider for a potential NHTF in Australia:

1. Reform of the housing tax expenditures, as already mentioned. If just 10 percent of the lost revenue were captured, it could provide over AU\$5b a year in dedicated revenue for an Australian Housing Trust Fund, more than is currently spent for social housing and rent assistance.

2. A tax of a few tenths of a percent on all capital market financial transactions, including stocks, bonds, mortgage-backed securities, derivatives, etc. While I do not know what the volume of such transactions is in Australia, based on a rough scaling of estimates for what

such a tax would raise in the U.S. (over US\$150b a year), I suspect such a tax could generate AU\$5-10b a year for an Australian Housing Trust Fund.

3. In addition, Prof. Terry Burke has suggested a modest “death duty” or estate tax: he has made a rough estimate that a 5% tax could raise about \$5b a year.

Not only would such revenue sources generate substantial ongoing dedicated capital grant funding for housing,; they would also be

- progressively redistributive;
- not subject to the whims of the annual appropriation process;
- not add to government budget deficits.

Conclusion

Despite its intimate and extensive significance, housing is not assured to all as a right. Rather, most of us must purchase housing as a commodity in the marketplace, with incomes obtained, for the most part, from participation in another marketplace, the labor market. “Affordability” is the measure of this often desperate, and sometimes unsuccessful, quest to secure the housing we need with the resources we have or can obtain. Affordability expresses the linkage between the well-being of individual families and communities, on the one hand, and the national and global mechanisms of housing finance and income determination, on the other.

Housing lies at the core of the dilemmas and challenges facing our families, our communities, our nations and our planet. The resolution of these dilemmas is to be found not through the celebration of selfish individualism, but rather through the rediscovery of social responsibility and the transformation of our economic institutions.