

HOUSING AFFORDABILITY

This article looks at housing affordability on a national basis, covering data available as at March 2009 and analysing each state and territory individually. Historical data back to 1986 is also included.

INTRODUCTION

QUESTION

Why is it that you can buy your dream home in one region of Australia for far less than in another region? Not just in different states but in different regional areas within states?

What drives market house prices? The answer is **many things**, but a few have considerable influence on the amount of money you have to pay for a house in the area you want to live. Some major factors are:

1. The state, city and suburb you want to live in
2. The services available in that area
3. The economic circumstances of that area
4. The availability of houses and units
5. The levels of employment, inflation, wages and income in that area
6. Interest Rates

Market prices are very much determined by what people can afford to pay.

Once you have determined where you want to live, you must determine if you can afford to live there. Points 1 - 4 above remain fairly constant over time, in a particular area. However points 5 and 6 are changeable dependent on the economy at the time, particularly interest rates, which have a major influence on the affordability of a home loan.

There are a number of Affordability Indexes. These indexes plot home loan affordability over time and readily explain when a certain market becomes overheated. The usual response to an overheated market is for house prices to retreat back to the level that purchasers can afford. This is explained in the information below which sets out how these three Affordability Indexes operate.

These indexes are:

1. **The Real Estate Institute of Australia (REIA) Home Loan Affordability Indicator**
2. **The Commonwealth Bank of Australia–Housing Industry Association (CBA–HIA) Housing Affordability Index**
3. **The BIS Shrapnel Home Loan Affordability Index.**

Each of these indexes measures affordability with respect to new loans only.

They look at the trend in home loan affordability over the past 22 years and show how interest rate movements have affected affordability over time.

Home Loan Affordability Indexes

1. **The REIA Home Loan Affordability Indicator** is a ratio of median family income to average new loan repayments. The REIA indicator divided by 10 shows the number of times that median family income exceeds average home loan repayments in a period. An **increase** in the REIA indicator represents improved affordability.

2. **The CBA-HIA Housing Affordability Index** measures accessibility to home ownership for an average first-home buyer. It is calculated as the ratio of average disposable income per household to the 'qualifying' income required to meet repayments on a 25-year loan, for 80 per cent of the median price of an average established dwelling purchased by a first-home buyer. The index divided by 100 shows the number of times that average household disposable income exceeds the minimum income needed to meet repayments on an average established dwelling. As with the REIA indicator, an **increase** in the CBA-HIA index represents improved affordability.

3. **The BIS Shrapnel Home Loan Affordability Index** shows the proportion of full-time male average earnings needed to meet the mortgage repayments on a 'typical' housing loan. A typical housing loan is assumed to be a 25-year loan for 75 per cent of the median house price. A **decrease** in the BIS Shrapnel indicator represents improved affordability.

Index Summary

The indexes are not an exact science but they are consistent over time and very useful in plotting home loan affordability over a long period. Some limitations exist. In particular, each is influenced by changes over time in median house prices that are not due to pure price movement. Therefore the indexes do not adjust for changes in affordability that are the result of price changes caused by improvements in the quality of the housing available and changes in the composition of houses eg size, quality and geographic location, between the periods examined.

Another limitation is their failure to account for changes in lending practices which reduced deposit constraints over a number of years and led to very high loan to valuation ratios to the point that borrowers could borrow the whole purchase price. Since the global credit issues arose lenders have retreated to the requirement for higher deposits again. Other things such as home equity loans that allow home owners to borrow against the family home for renovation, cars and holidays etc also causes distortion, which in turn has impacted on the various measures of affordability.

1986-2006

The trend in home loan affordability

Home loan affordability has fluctuated considerably over the past 20 years. Bearing in mind that a fall in the **REIA** indicator denotes a deterioration in affordability, new home loans, according to this indicator, were least affordable in 1989 when the indicator was 28. That situation, however, quickly reversed and by 1993, when the indicator reached a high 47, home loans were more affordable than at any other time in the past 20 years. After falling and then rising again, the trend since 1998 has been predominantly downward. By 2006 the indicator had fallen to 30, a level worse than during much of the 1980s, when interest rates were considerably higher than they were in 2006 as shown in Chart 1 and Table 1. The fall in the REIA indicator since 1998, despite lower interest rates, coincides with a time of rapid growth in house prices.

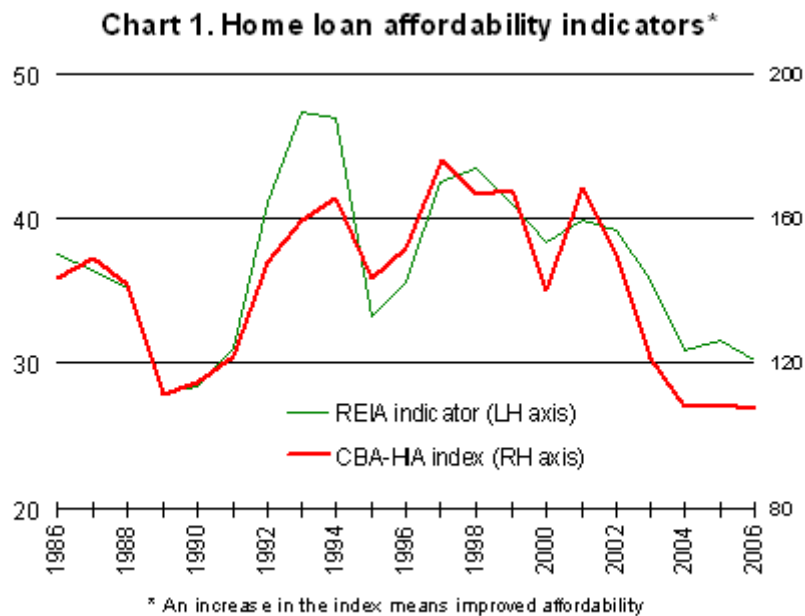


Table 1. Home loan affordability indicators - Aust*

A higher level indicates improved affordability

Year	CBA-HIA index			Australia
	REIA indicator	Capital cities	Other areas	
1986	37.5	142.7	146.4	143.3
1987	36.4	146.6	153.4	149.0
1988	35.2	133.3	166.7	142.3
1989	27.9	101.1	137.0	111.6
1990	28.4	106.0	134.6	114.9
1991	31.1	114.2	139.0	121.9
1992	41.2	139.9	163.4	147.6
1993	47.4	151.1	173.0	159.2
1994	46.9	156.9	182.8	165.9
1995	33.3	134.3	162.5	143.7
1996	35.7	142.1	173.7	151.8
1997	42.4	162.0	208.9	176.2
1998	43.5	152.6	205.1	167.0
1999	40.9	151.3	207.3	168.0
2000	38.3	124.2	179.2	140.6
2001	39.9	145.9	214.8	168.4
2002	39.2	128.4	193.9	150.6
2003	35.8	101.8	165.8	121.3
2004	30.9	98.5	125.3	108.1
2005	31.5	102.4	118.6	108.3
2006	30.1	101.9	118.4	107.8

* The BIS Shrapnel index is not available for all Australia

Sources: Real Estate Institute of Australia, *Home Loan Affordability Report*; Housing Industry Association - Commonwealth Bank, *Affordability Report*

The CBA-HIA index similarly shows that loan affordability was at a low in 1989 when the value of the index was 112. Affordability improved thereafter, with the index reaching a high of 176 in 1997. From 2001 the index has declined appreciably, its value falling to an all-time low of 108 in 2006. Over most of the last 20 years, there has been a significant gap in affordability between capital cities and 'other areas', with the former much worse than the latter. Interestingly, that gap has narrowed in the past few years, indicating that house prices have been increasing faster in regional Australia than in the capital cities.

Table 2 (following page) provides a breakdown of affordability on a state/capital city basis. Each of the indexes shows that the least affordable home loans in 2006 were in Sydney, while the most affordable were either in Adelaide (REIA and BIS Shrapnel) or Hobart (CBA-HIA). All the indexes show that the biggest deterioration in home loan affordability in the period covered by the table occurred in Perth, with the least deterioration in Adelaide (where according to BIS Shrapnel affordability even improved over this period).

Table 2. Home loan affordability indicators - state or capital city

June	REIA indicator					
	<i>(a higher level indicates improved affordability)</i>					
	NSW	VIC	QLD	SA	WA	TAS
1986	34.4	37.8	39.6	33.3	48.7	44.1
1996	31.0	40.9	33.5	38.1	39.7	39.7
2006	27.0	31.9	29.7	33.2	32.6	31.7

June	CBA-HIA index					
	<i>(a higher level indicates improved affordability)</i>					
	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart
1986	136.9	132.2	160.8	142.1	182.4	197.1
1996	111.2	157.8	150.5	182.2	168.9	209.8
2006	86.3	106.0	109.2	133.0	104.7	145.8

June	BIS Shrapnel index					
	<i>(a lower level indicates improved affordability)</i>					
	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart
1986	49.0	44.4	32.1	41.0	28.6	34.9
1996	44.8	34.0	30.1	25.6	26.9	26.4
2006	58.1	44.9	40.8	35.9	45.1	36.1

Sources: Real Estate Institute of Australia, *Home Loan Affordability Report*; Housing Industry Association - Commonwealth Bank, *Affordability Report*; data supplied directly by BIS Shrapnel.

Summary 1986-2006

Home loan affordability fluctuated considerably over the period, with affordability at one of its worst points in 1989, a time when interest rates were at a record high. After experiencing further rises and falls, there has been an appreciable deterioration in affordability since 2001, a time when house prices have grown rapidly. It is significant that in 2006 the affordability indicator fell to a level comparable to that reached in 1989, despite the fact that interest rates in 2006 were very much lower than they were in 1989.

2008-2009

Home Loan Affordability has improved considerably during 2008 and 2009, due almost entirely to the reduction in home loan interest rates, following the RBA cash rate reduction to 3.00% as at June 2009. This was in response to the possibility of a recession in Australia, following similar downturns in other countries.

The REIA Home Loan Affordability Indicator

The March quarter 2009 has seen the level of first home buyer activity continue to climb with the availability of the First Home Owner's Grant Boost (FHOG Boost), improvements in affordability and the continued interest rate cuts.

At the end of the March quarter, there were 44,487 first home buyers in the Australian property market; this is compared to 36,098 in the December quarter 2008 and 30,373 in the March quarter 2008. First home buyers as a percentage also increased over the quarter to 26.8% of all housing finance commitments, compared with 22.9% in the December quarter 2008.

All states and territories recorded improvements in housing affordability, taking the level of affordability in Australia to the best it has been in nearly six years. The national proportion of family income required to meet loan payments decreased to 28.6% from 32.4% in the previous quarter, and 37.8% in the same quarter last year.

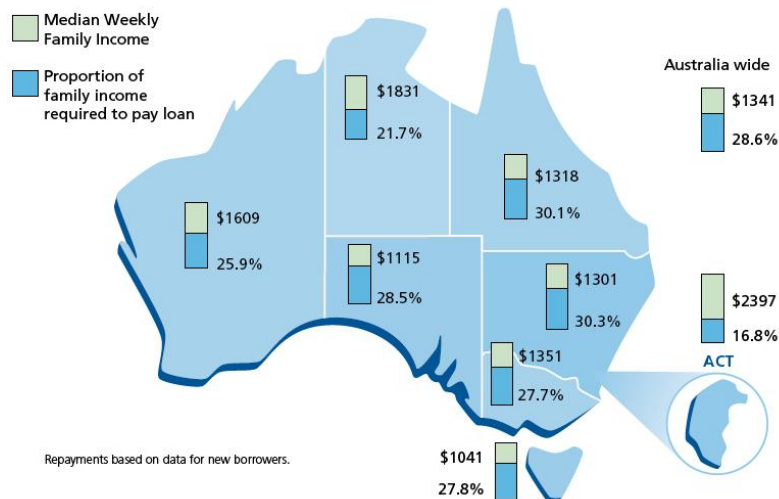
Despite significant improvements in housing affordability, during the December quarter New South Wales remained the least affordable state or territory in Australia in which to own a home.

Family Income %

Proportion of family income required to meet average loan repayments:

Chart 1

Proportion of family income required to meet loan repayments, March 2009



Proportion of family income required to meet average loan repayments – Australia

Proportion of family income required to meet:			
	Mar qtr 2009	Dec qtr 2008	Mar qtr 2008
Home Loan repayments	28.6%	32.4%	37.8%
Rent payments	25.1%	25.3%	24.7%

Table 1: Proportion of family income needed to meet loan repayments

Table 1: Proportion of family income needed to meet loan repayments			
	Mar qtr 2009	Dec qtr 2008	Mar qtr 2008
NSW	30.3%	34.3%	39.3%
VIC	27.7%	32.1%	37.1%
QLD	30.1%	33.2%	40.5%
SA	28.5%	31.9%	36.8%
WA	25.9%	27.9%	34.1%
TAS	27.8%	30.6%	35.3%
NT	21.7%	24.6%	23.0%
ACT	16.8%	18.6%	22.4%
AUS	28.6%	32.4%	37.8%

First Home Buyers

First home buyer participation in the market increased during the March quarter 2009 to 26.8% of all housing finance commitments compared with 22.9% in the previous quarter. This compares favourably with the average of 20.0% over the 26 year period since July 1991.

There were 44,487 first home buyers in Australia in the March quarter 2009, a considerable increase of 23.2% from the previous quarter, when there were 36,098 first home buyers. This is a 46.5% increase in the number of first home buyers when compared to the March quarter 2008, when there were 30,373 first home buyers.

Decreases in interest rates have been a driving factor in improving affordability, decreasing the average monthly loan repayment.

Government incentives aimed at increasing the number of first home owners in the market also appear to be working given the increase in numbers and proportion from December to March and an even larger increase between March quarter 2008 and March quarter 2009.

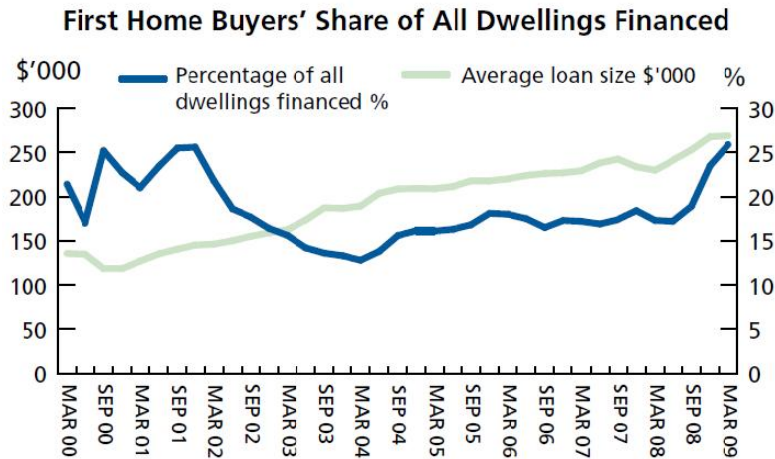
The government will extend the FHOG Boost until December 2009, however, it will only continue at the full rate until 30 September 2009. From October until December this year the FHOG Boost will be reduced from \$14,000 to \$10,500 for established homes and from \$21,000 to \$14,000 for newly constructed homes.

In the March quarter 2009, the average loan size to first home buyers increased once again, to \$269,000, a smaller increase than what was seen in the previous quarter,

however, this figure still remains higher than the average loan size across all owner occupiers, excluding those who refinanced, at \$266,174.

The First Home Buyers share of all dwellings financed and the average size of their loans from the March quarter 2000 to the March quarter 2009 are shown in Chart 2.

Chart 2



Source: ABS Catalogue No. 5609.0

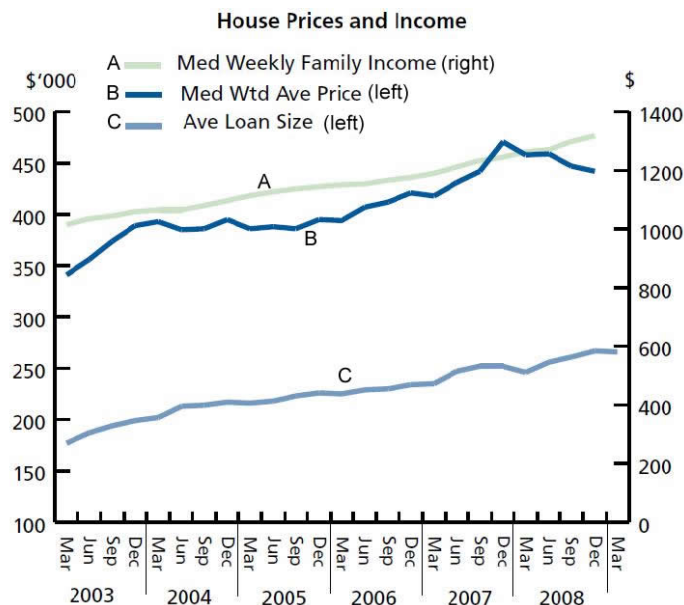
Factors Determining Home Loan Affordability

A range of factors determine home loan affordability, including the following:

- The amount to be borrowed reflects the price of the property being purchased and the borrower’s equity situation.
- The size of loan, interest rates and the period of the loan determine the average loan repayment.
- The ability to repay the mortgage depends upon the family income.

Chart 3 shows the relationship between the Australian weighted average median house price, median weekly family income and average loan size.

Chart 3



Median House Prices

Median house prices have shown varying results with only three of the eight capital cities experiencing decreases over the quarter.

In the March quarter 2008 there were two capital cities with a median house price above \$450,000, a year later this figure has jumped to four with Sydney still recording the highest median house price. Melbourne saw the most significant increase in the median house price over the quarter.

Median Family Income

The national median weekly family income increased by 1.8% over the March quarter, to reach \$1,341 (or \$5,811 per month).

The median weekly family income increased from the previous year by 6.3%, while continuing cuts in interest rates ensured that the average monthly home loan repayment decreased by 19.7% over the year to \$1,662.

The proportion of family income required to meet loan payments decreased nationally from 32.4% in the December quarter 2008 to 28.6% in March quarter 2009.

Average Loan (All Borrowers)

The national average new home loan (excluding refinancing) of \$266,174 in the March quarter 2009 was 0.4% lower than the average loan in the December quarter 2008, and 7.92% higher than in the March quarter 2008.

Interest Rates

The Reserve Bank elected to reduce the official interest rate by 1.00 percentage points in the March quarter 2009 in response to the continued deterioration of the global economy. The cash rate stood at 3.25% at the end of the March quarter, the lowest rate since 1964. It has subsequently reduced to 3.00%.

This decrease in official interest rates has been reflected in a decrease in standard variable rates charged by banks.

The average variable interest rates were:

Banks – 5.79%, a 1.01% decrease from the December quarter 2008.

Permanent Building Societies – 5.60%, a 1.15% decrease from the December quarter 2008.

Other Lenders – 5.64%, a 1.13% decrease from the December quarter 2008

Home Loan Affordability Indicator

As discussed earlier, The Home Loan Affordability Indicator (HLAI) is the ratio of median family income to average loan repayments. An increasing value reflects improving affordability of housing loans.

Chart 4 shows how the Affordability Indicator is arrived at.

Chart 4

The Home Loan Affordability Indicator is the ratio of median weekly family income to average weekly loan repayments.

$$\left\{ \frac{\text{Median weekly family income}}{\text{Average weekly loan repayment}} \right\} \times 10$$

While a fall in the Home Loan Affordability Indicator suggests deterioration in affordability and vice versa, this change may not be reflected in all of the components that comprise the Indicator.

Table 3 shows the HLAI for Australia and each of the states and territories for the March quarter 2009, compared with the preceding quarter and the March quarter 2008.

Table 3: Home Loan Affordability Indicators			
	Mar qtr 2009	Dec qtr 2008	Mar qtr 2008
NSW	33.0	29.1	25.4
VIC	36.1	31.1	27.0
QLD	33.2	30.1	24.7
SA	35.1	31.3	27.2
WA	38.6	35.8	29.3
TAS	36.0	32.7	28.3
NT	46.0	40.7	43.5
ACT	59.4	53.7	44.7
AUS	35.0	30.9	26.4

A long-term series of the quarterly movements in the Home Loan Affordability Indicator from December 1988 is shown in Chart 5.

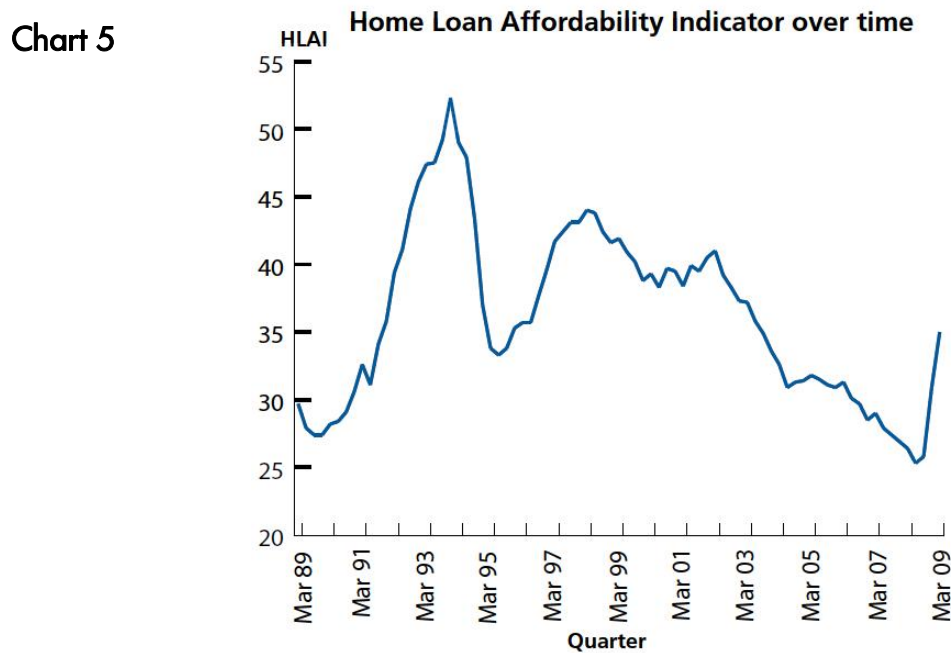


Table 4 gives a snapshot of the past 9 months affordability, clearly showing increased affordability for home purchases.

Table 4

AUSTRALIA	Mar 2009	Dec 2008	Sep 2008
Home Loan Affordability Indicator (HLAI)	35.0	30.9	26.4
Average HLAJ since March quarter 1980	39.5	39.5	39.8
Proportion of family income devoted to meeting average loan repayments	28.6%	32.4%	37.8%

Summary 2008-2009

A major correction to home loan affordability has occurred during this period. The main contributor to this has been the reduction in home loan interest rates from rates of around 9% to current levels below 6%. This reduction in rate, coupled with generally steady property prices and income levels, along with the FHOG Boost of \$7000 sees home affordability in March 2009 at its most advantageous level since 2003.

Sources of Information:

1. The Real Estate Institute of Australia (REIA) Home Loan Affordability Indicator
2. The Commonwealth Bank of Australia–Housing Industry Association (CBA–HIA) Housing Affordability Index
3. The BIS Shrapnel Home Loan Affordability Index.
4. Parliament of Australia Research Note no. 8 2006–07 Home loan affordability—measurement and trends