WORKING PAPERS IN ECONOMICS

HOME PURCHASE ASSISTANCE

FOR LOW INCOME EARNERS

BY

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This paper provides an initial assessment of the Federal Government's initiatives in revamping the home purchase assistance available to first home buyers. It acknowledges that the current scheme is a considerable improvement on its predecessors in that it has overcome many of the objections levelled at earlier assistance schemes but goes onto argue that current housing policy towards assisting low income earners is still misdirected. An alternative approach which is more equitable is suggested.

This paper is intended to give an initial assessment of the First Home Owners Assistance Scheme (FHOS) introduced by the Federal Labor government to replace the Liberal government's Home Deposit Assistance scheme. This new scheme, aimed at improving the home purchase assistance available to lower income earners, was introduced in October, 1983 and provides upto $7000 to low and middle income earners who buy or build a first home intended as their principal place of residence. A maximum subsidy of $5000 over a period of five years is available to either sole or joint applicants with no children as long as total taxable income of all applicants is less than $24300 at the time of application; a sliding scale of benefits is available for those with incomes upto $27900. This maximum subsidy increases to $6500 for applicants with one dependent child and to $7000 for applicants with two or more dependent children. The intention of the subsidy is to assist first home buyers "by raising either the borrowing capacity or the deposit of those who otherwise might not qualify for a housing loan". Payment of the subsidy can be made in one of three ways: under option 1, the whole amount of the subsidy is paid over 60 monthly payments; under options 2 and 3 a lump sum (of either $1500 or $2500 respectively for applicants without or with dependents) can be paid immediately and the reduced subsidy paid over 5 years in 60 monthly payments.

The strengths of this scheme can be seen by comparing it with its predecessors; the Home Savings Grant (HSG) scheme and the Home Deposit Assistance (HDA) scheme. For both of these schemes assistance provided was related to savings capacity; on a dollar for dollar basis on savings over two years for the HDA, or on a dollar for three dollars saved over three years for the HSG when it was phased out. This led to the just criticism that the previous schemes were inequitable because they favoured those who had the greatest savings capacity. The current scheme, by removing the savings requirement, attempts to overcome this criticism. The maintenance of income ceilings introduced with the Home Deposit Assistance scheme is likewise an attempt in the current scheme to stave off similar criticisms regarding the regressive nature of the earlier grants by limiting it to defined low and middle income groups only. The 1973 Coombs Task Force criticism of the HSG scheme that it was not needs related was finally responded to in 1980 by the introduction of a dependents' allowance in the HSG and this, also has been maintained by both the HDA and now the FHOS. The final main source of complaint about earlier schemes was that they provided too little assistance too late. The infamous 9 month delay on the HSG and its subsequent labels as a curtains and carpet or soft-furnishings or white-goods grant all attest to the frustration felt by those in need of immediate support. By removing the delay in the payment of the lump sum the HDA scheme overcame the too late aspect of this criticism. By maintaining this and by providing a far more generous grant and restructuring the way in which the subsidy is to be paid the FHOS scheme apparently overcomes both the too little and too late aspects of the criticisms.

On a superficial assessment, therefore, there appears to be a lot for which the Federal Government should be congratulated. It has plugged away at the weaknesses of previous schemes until the package appears to be almost water tight. The complaints still heard about the current scheme suggest that there are one or two more difficulties to be overcome regarding the eligibility requirements of divorced couples or households who split up and the appropriateness of the current cut-off levels for eligibility on income grounds but there is every indication that the government is aware of these difficulties and will continue to refine the package until all the apparent problems are overcome.

The only real question which remains is whether this approach to assisting first home buyers is the most equitable way of helping low income earners overcome their housing difficulties. To determine whether this is the case it is instructive to examine the ways in which the scheme might operate more closely.

Consider, for example, what would happen if an institution was prepared to incorporate the subsidy fully into current repayment capacity. For a household on a single income of $275 p.w. (or approximately 80 per cent of average weekly earnings), repayment capacity is $298 p.m. and, without any subsidy, the maximum loan which could be financed would be $24700 (assuming a 25 year loan at an interest rate of 14 per cent and a monthly repayment capacity of 25 per cent of monthly income). If the maximum available interest subsidy in the first year of $1800 p.a. or $150 p.m. for a household with no children is added to the repayment capacity of this household, this capacity increases to $448 p.m. and the maximum loan which can be financed increased to approximately $40000. In the second year, however, the subsidy reduces to $1400 p.a. or $117 p.m. and hence the repayments which need to be met from household income increase to $331 p.m. - an increase of over 11 per cent on that available in year one. Thus, for there to be no increase in the burden of loan repayment, income needs to increase at a rate of over 11 per cent. For households with dependent children, the required rate of increase in income increases to 15 per cent for households with an income of $275 p.w.. For higher income households the required rate of increase is lower, being 9.5 per cent for households on AWE with no dependent children or 12 per cent for those with dependent children. In the not unreasonable expectation that the wages pause and the prices and incomes accord will have had or will have some effect on inflation and income growth, such rates of increase would seem unlikely. It should be pointed out, however, that if the rate of income growth and inflaton are lower then it it also unlikely that such high nominal interest rates will be sustained.

In fact, what has happened in N.S.W. is that, in the most favourable adaptations to the new scheme, a typical response from the permanent building societies has been to reassess an applicant's capacity to pay but not by simply adding on the subsidy available to current income. Several societies in NSW, for example, have based current capacity to pay for low, single income applicants on the basis of income 5 years hence on the assumption that income would grow at 6 per cent per annum rather than the more optimistic 11 per cent required if lower income groups are to gain maximum benefit from the subsidy. Dual income households are generally treated slightly less generously. (1) Savings banks, who are currently lending at interest rates 1-2 percentage points less than the building societies, have had little incentive to introduce schemes which significantly increase the borrowing capacity of potential applicants. At present they face an excess demand for their housing funds and, in the desire to maximise the number of loans made rather than the size of those loans, are only interested in taking the subsidy into account as a means of improving the security offered by those who would have been granted a loan in the absence of any subsidy. In general they take the subsidy available into account in such a way as to increase borrowing capacity of the applicant by no more than the amount of the grant taken up by the borrowers as an interest subsidy rather than a lump sum payment. Such a response is likely to be maintained until bank and building society lending rates are brought more closely into line both with each other and with market rates.

Table 1 indicates the impact of building society policy on the borrowing capacity of a single income earner with the available subsidy taken up under option 1. Whether or not there are dependent children makes no difference to the calculation of the maximum loan which can be paid; it merely affects the amount the applicant contributes to that repayment. Repayment capacity without the subsidy is calculated on the assumption that capacity is 25 per cent of monthly income and the maximum loan which can be serviced with this repayment capacity is calculated on the basis of a 14 per cent loan over 25 years. Any interest subsidy offered by the building society merely serves to reduce the amount which needs to be repaid in the first two years rather than affecting the calculation of repayment capacity. Equivalent information for dual income households is presented in Table 2. In this case capacity to pay is based on 20 per cent of combined income plus subsidy. Because the subsidy is taken directly into account for dual income applicants, the maximum loan available may vary with the number of dependent children. Table 2 is presented on the assumption that the maximum subsidy of $7000 is available and is taken up as option 1 which increases borrowing capacity by the greatest amount. If the maximum loan so calculated requires too great a rate of increase in household income, however, it is unlikely that the full amount will be granted. Instead each case will be judged on its individual merit, with it being likely that the loan will be scaled back to that serviceable with a 6 per cent rate of growth of income.(2)

From Table 1 it can be seen that a household with a single income of $275 p.w. (approximately 80 per cent of AWE) can obtain no more than a $34200 loan. If such a loan is taken out, and if income does grow at the assumed rate of 6 per cent per annum, then after 5 years repayments will still absorb 25 per cent of taxable income. If income grows less rapidly, the repayment burden will be greater.

Despite this dramatic increase in borrowing capacity from $24700 to $34200, however, some low income first home buyers still face considerable deposit gaps. Real Estate Institute of Australia figures for September (3), for example, show that the median house price in Sydney was $80300, median unit price was $62700 and that only 20 per cent of all dwelling sales were under $60000. The average contract price for NSW Building Society loans, however, for roughly the same period was $54400. (3) In the same period, the average price for a 2/3 bedroom cottage in Parramatta or Liverpool was $70000 - $75000- the cheapest average cost of 2/3 bedroom houses available anywhere in the Sydney metropolitan area was $50000 - $55000 in the outer-western region.(4) Whatever illustrative figures are chosen, it is probable that deposit gaps of $15000 - $25000 will still remain quite likely for lower income potential home purchasers in the Sydney region.

Earlier home purchase assistance schemes were criticised as being inequitable because they favoured those who had the greatest capacity to save. The current scheme has removed the explicit savings requirement attached to the subsidy but has left the far greater implicit requirement. Both past and current schemes have implicitly provided a subsidy to the lowest income groups only if they are able to exhibit a far greater savings rate than their higher income counterparts in order to overcome the greater deposit gap they face.

An alternative way of looking at whether the scheme which has been introduced is the most equitable way of helping low income earners is to consider the subsidy needed by a household on an income of less than AWE if it is to purchase a typical home in Sydney's outer west region. Calculations performed by Landcom in June this year indicate that for a single income household on $289 p.w. (approximately 80 per cent of AWE in NSW) with income growing at 10 per cent per annum to be able to buy a $55000 house on 10 per cent deposit, a subsidy of $15000 is needed over a period of 7 years. If projection A presented at the National Economic Summit is followed for income growth instead of the "optimistic scenario" of a 10 per cent annual increase in income then the subsidy required increases from $15000 over 7 years to $18000 over 9 years. These estimates are based on the assumption that the then current building society interest rate of 14.5 per cent is charged, that an interest subsidy of 1 per cent in the first and 0.5 per cent in the second year applies, that the repayment to income ratio is 25 per cent and that a 25 year loan of $49500 is available. On an income equal to AWE the subsidy required in the first case would be $7500 over 5 years and in the second nearly $10000 over 6 years. Data for other income levels is given in Table 3.

Thus the FHOS is apparently geared to households with incomes at or above average weekly earnings or to households with prospects of strong income growth. In 1978 in the Sydney metropolitan region, however, over 50 per cent of potential home buyers (viz. those who were still renting a home) had incomes less than A.W.E. and over 60 per cent of those who claimed that they rented because they could not afford to buy had incomes less than A.W.E. (5) Although there is no more recent data on the income distribution of renters, there is little reason to expect that this position of renters would have changed dramatically in the past 5 years. Again the conclusion is that the FHOS may not really help those most in need of assistance.

Under the specific building society criteria outlined in Table 1, the maximum loan a household on $275 p.w. can obtain is $34200. Thus, in order to be able to purchase a $55000 house such a household need to save a deposit of approximately $20000. Repayments on a loan of $34200 are $399 p.m., $150 of which is paid by the government if the household has no dependent children. Thus, the household is required to pay only $249 p.m. in order to service this loan. As well as these outgoings, the household will be required to pay out at least another 1 or 2 per cent of house value (say $80 per month in current prices) for rates, insurance and maintenance. Thus total housing outlays by this household in its first year would be approximately $75 - $80 p.w. assuming that it has been able to save the required deposit of $20000. Market rent for a 3BR house in the same geographical locality would be no more than $90 - $100 p.w. or, if the household could gain access to equivalent housing through the housing commission, approximately $85 p.w., with a subsidy of $13 p.w. being available since the market related rent exceeds 20 per cent of income.(6) Thus, if the household can save the required amount <u>and</u> can get a loan for the maximum amount serviceable on calculated repayment capacity, then total outlays for owner-occupied housing could be no more than, and may be less than, those required for a household renting an equivalent dwelling.

For many households, however, this highly subsidised form of saving is simply not an option. Low income single parent households, or households with a number of dependents simply may not have the discretionary income available to make the choice the government apparently has provided them with. In February 1983 the poverty line excluding housing costs for a couple with 2 children was $154.60 per week; for a couple with 4 children it was $205.00.(7). For a household on 80 per cent of average weekly earnings with 4 children this leaves $70 per week for rental costs and no margin for saving. Such households, because owner-occupation is inaccessible, are committed to housing costs which may represent 20 - 30 per cent of their income (or far more in many cases) either for life or until their economic or family circumstances change. Owner-occupiers, on the other hand, because of their ability to take advantage of the highly subsidised forms of saving, are faced with housing costs which fall significantly over their life-cyles (unless, of course, they continue to trade up to bigger and better houses to take increasing advantage of the tax shelter provided by investment in owner-occupied housing).

Whilst the government's first home ownership scheme is a considerable improvement upon its predecessors in providing access to home ownership to the marginal home buyer and goes a long way towards reducing the inequity of earlier schemes, it does not address the fundamental inequity which arises from the fact that not all households are marginal home buyers. Owner-occupation involves a considerable saving decision on the part of the household; in the examples used above, after 25 years the household owns an asset now worth $55000. Part of this saving has been subsidised by the government; most of it has come from the household and may have resulted from considerable hardship and sacrifice on the part of the household.

To ensure that homeownership is accessible to all households on all incomes, the government needs to ensure that it is accessible on the basis of repayment capacity alone and not on the basis of savings capacity. In many cases borrowing capacity is inadequate simply because of the front end loading imposed on repayments by the form of mortgage instrument used. If the government was prepared to take out a commercial loan at the going market rate of interest for the full amount needed by the household to meet the difference between house price and amount saved and then to simply reschedule the repayments for the applicant so that they did not exceed 20-30 per cent of income, access could be increased without there being any need to introduce a subsidy. If the repayments of 20-30 per cent of income made by the household do not repay the interest on the loan, the shortfall can simply be added to the back-end of the loan in much the same way as is done with standard graduated payment or low-start loans. If income increases over time, this increased debt can be reduced; until it is, the household continues to pay 20-30 per cent of income back in repayments. As equity is built up, the percentage of income going into repayments will decrease. If the household never manages to pay off its loan the effect of such a policy is the same as that achieved by increasing expenditure on public housing by the amount of the initial loan. Under the current public housing policy, tenants pay no more than 20 per cent of income back to service the loans provided for this housing. Under this revamped owner-occupation scheme, owner-occupiers would do the same.

Owner occupation has long been regarded as the great Australian Dream - the events of the past decade have shattered that dream for many but despite this the general thrust of government policy has not changed. Thanks to the need for some government stimulus in the economy, expenditure on public housing has at last been increased but public housing, with its guarantee that housing costs need not exceed 20 per cent of income, remains available only for some 5 per cent of the population and does not therefore yet provide an effective alternative to owner-occupation. In concentrating on ensuring that the FHOS scheme is equitable for would-be home-buyers the government has totally ignored the more fundamental question of whether it is equitable across all individuals or households. The average income of home owners in Australia is higher than that of their fellow renters; their average asset holdings are likewise higher. They belong to the privileged groups in society. Home owners are not taxed on the capital gains they derive from owner-occupied property, they are not taxed on the income derived from that property and yet they can, if they meet certain requirements, deduct some of the costs involved in owning that property from their income. The exemptions which to date have been assumed to be mandatory with the introduction of any assets test for pensions will add to these benefits. It is difficult to understand why the government persists in introducing or maintaining additional subsidies when all that may be required is some form of temporary assistance which could be repaid at a later date.

Footnotes:

1. One society did indicate a more favourable attitude towards single income, dual applicant households in that the maximum loan allowed was to be based on a repayment capacity of 27.5 per cent of single income plus the subsidy. For low income households where this formula resulted in a required rate of growth of income in excess of 10 per cent, the loan was made in the hope that either income would grow faster than expected or that the second applicant would join the work force. The society, however, did acknowledge that not many such applications had been received and that the majority of applicants, in fact, whether single or dual income, were applying for their subsidy after their loan had been approved, which implies that FHOS made no difference at all to the amount borrowed, although it may have had some effect on the willingness of the borrower to apply for a loan in the first place.

2. The tables from which this information is derived were provided by Mary Donnelly of the Permanent Building Societies Association.

3. See Australian Financial Review, November 4, 1983

4. Data taken from R.E.I. sources published in the Sydney Morning Herald, November 15, 1983.

5. Housing Survey, 1978. ABS Cat No 8711.1, Tables 4 and 10.

6. Public rental figures given are applicable to 3BR houses in the Parramatta region and are based on information supplied by the Parramatta office of the Housing Commission.

7. Institute of Applied Economic and Social Research, June, 1983.

1: Impact of subsidy on borrowing capacity of single income household obtaining funds from a permanent building society

oss weekly income (annual income in brackets) $		No Subsidy		Maximum Subsidy, Option 1	
		loan[d] ($)	repayments ($)	loan ($)	repayments[e] ($)
275	(14300)	24700	298	34200	399
300	(15600)	27000	325	37300	435
325	(16900)	29200	352	40000	467
350[a]	(18200)	31500	379	42100	507
375	(19500)	33700	406	45200	545
400	(20800)	36000	433	48200	581
425	(22100)	38200	460	50000	602
450	(23400)	40500	487	50000	602
467[b]	(24300)	42000	506	50000	602
500	(26000)	45000	542	50000	602
535[c]	(27900)	[illegible]	[illegible]	50000	602

(a) male A.W.E., June 1983 = $247.30
for N.S.W., male A.W.E., June 1983 = $300.40

(b) maximum subsidy available upto this income

(c) no subsidy available after this income

(d) based on 14% loan for 25 years; repayment capacity = 25% weekly income x 52/12

(e) based on 25% of income in year 5, assuming 6% annual rate of growth of income

Source: Information provided by Mary Donnelly, Permanent Building Societies Association.

Table 2: Impact of subsidy on borrowing capacity of dual income household obtaining funds from a permanent building society

Gross weekly household income	Maximum Subsidy Option 1						
	loan [a]	monthly repayment [b]	monthly subsidy [c] $				
$	$	$	yr 1	yr 2	yr 3	yr 4	yr 5
275	36400 [d]	438	200	158	117	75	33
300	38200 [d]	[illegible]	200	158	117	75	33
325	40000	481	200	158	117	75	33
350	41800	503	200	158	117	75	33
375	43600	[illegible]	200	158	117	75	33
400	45400	[illegible]	200	158	117	75	33
425	47200	[illegible]	200	158	117	75	33
450	49000	570	200	158	117	75	33
466	[illegible]	[illegible]	200	158	117	75	33
500	[illegible]	[illegible]	[illegible]	79	58	37	16
535	50000	604	0	0	0	0	0

(a) loan based on 14% [illegible] for [illegible] years.

(b) repayment capacity based on [illegible] of household income plus subsidy.

(c) based on assumption of [illegible] dependent children.

(d) these loans would be re-assessed because of implications for required rate of growth of income to sustain repayment capacity.

Source: see Table 1

Table 3: Subsidy required for single income household obtaining funds from a permanent building society[a]

Gross weekly income (annual income in brackets) $		Income Growth: as for scenario A, National Economic Summit		Income Growth: 10 per cent per annum	
		Subsidy	No. of Years	Subsidy	No. of Years
244	(12700)	25973	10	22016	9
289	(15000)	18303	9	14965	7
332	(17300)	12640	7	9914	6
359	(18700)	9812	6	7460	5
393	(20400)	6803	5	4830	4
511	(26600)	370	2	273	

(a) Based on house & land package $55,000; 10% deposit; $49,500 loan from building society for 25 years; interest rate 13½% year 1, 14% year 2, 14½% thereafter. Repayment capacity 25% income.

Source: Simulations performed by Landcom, 1983

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