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# **Submission to the Review of the First Home Owner Grant Act 2000**

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## **Recommendations**

### **Recommendation 1**

- a) That a formal analysis be conducted of the impact of the First Home Owners Grant scheme on housing prices, and**
- b) That the amount of Government funds committed to the First Home Owners Grant scheme, and the size of the grants, be considered subject to the outcomes of this analysis.**

### **Recommendation 2**

- a) That First Home Owner Grants be made available only to households earning below the median income, or**
- b) If the administrative costs of an income-based limit prove excessive, that First Home Owner Grants be made available only to dwellings below the median housing price in the area.**

### **Recommendation 3**

**That a safety net system be developed and implemented aimed at home purchasers who find themselves in financial difficulty.**

## About Shelter WA

Shelter WA is an independent, community based peak body that promotes affordable, accessible, appropriate and secure housing for people on low incomes. Since its establishment in 1979, Shelter WA has worked towards the elimination of homelessness and housing related poverty, focusing particularly on people who have low incomes or who are otherwise disadvantaged in the housing market.

The aim of Shelter WA is the realisation of a housing system that ensures:

- Every person has access to affordable, appropriate, safe and secure housing;
- Housing provision free from all forms of discrimination; and
- Housing that enhances people's health, dignity and life opportunities.

In order to coordinate and represent community sector views on housing related issues, Shelter WA regularly seeks input from housing consumers and community groups. In addition to meetings with community members and representatives, Shelter WA uses consultation and information forums and surveys as consultation mechanisms.

Shelter WA produces quarterly newsletters and information sheets, and prepares submissions, reviews, papers and reports on housing related matters. National Shelter, our national affiliate, regularly produces journals and research publications on housing. Both Shelter WA and National Shelter publications are a forum for the views of housing consumers, community groups and policy makers. Many of Shelter WA's publications are also available on the Internet at [www.shelterwa.org.au](http://www.shelterwa.org.au). In addition, Shelter WA is an active member of the Housing Advisory Committee (HAC) that advises the Minister for Housing and the Department of Housing and Works on housing policy and practice and chairs the Homeswest Operational Standing Committee.

## Context

High quality housing at an affordable price is a fundamental element of strong societies and healthy economies. Housing is central to people's quality of life, and is vital in ensuring positive outcomes in employment, education, health and social well-being. Shelter WA is deeply concerned that home ownership is becoming increasingly less affordable and more difficult to access, particularly for people on lower incomes.

Shelter WA believes that the current housing affordability and accessibility crisis is a direct result of the lack of policy direction on housing by the various levels of Government in Australia. A large amount of money is involved with intervening in the housing market through an array of policies, programs, taxes, subsidies, schemes and incentives. However, these initiatives are not grounded in a consistent policy framework, do not reinforce each other, and in some cases work against one another's aims. As a result, significant Government intervention in the housing market has delivered neither affordability nor accessibility to a large number of recent and prospective home purchasers.

In addition, Shelter WA believes that the various levels of Government have failed to recognise the close links between affordability in the rental sector and accessibility to home ownership. In view of these links, Shelter WA believes that any solution should tackle the housing system as a whole, including private rental, social housing and home ownership, rather than any measures exclusively on first home ownership.

After more than a decade of ad hoc measures, falling housing affordability is now a major issue across the country. The problems are mounting rapidly, and a clear policy direction at all Government levels is required before the structural problems become so large as to be irreparable.

### *The West Australian Housing System*

The housing system in Western Australia is changing. For many years, high rates of home ownership underpinned by high employment levels and an adequate income support system ensured that most Australians were well housed. In the last five to ten years, however, rising housing prices have put the Great Australian Dream of home ownership out of the reach of an increasing proportion of West Australians.

During this period, real household incomes have grown slowly at the bottom end,<sup>1</sup> and there is a severe shortage of houses that can be purchased affordably by low to middle income earners. Housing affordability problems have climbed the income ladder to affect the 'working poor' and middle income households, as housing prices have boomed in both Perth and regional areas of the State.

While housing price increases have provided a windfall to existing home owners, prices have now increased to the extent where families who are anything less than wealthy cannot afford to purchase their own home, let alone purchase housing that is adequate to their needs. Moreover, housing affordability appears to be lowest in areas with high employment opportunities, making it difficult for lower income households to move to where the jobs are.<sup>2</sup>

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<sup>1</sup> The median household income in Western Australia increased from \$829 in June 1997 to \$987 in June 2002, a nominal increase of 19.1%. Over the same period, the Perth CPI increased by 14.0%. Real Estate Institute of Australia, *Australian Property Market Indicators*, 2003

<sup>2</sup> For instance, see National Shelter, *Creating the Links between Housing, Employment and Income Support*, Adelaide, 2001, or Mike Berry and Jon Hall, *Policy Options for Stimulating Private Sector Investment in Affordable Housing Across Australia – Stage 1 Report: Outlining the Need for Action*, prepared for the Affordable Housing National Research Consortium by the Australian Housing and Urban Research Institute, September 2001.

Whilst recognising the current discrepancy between family incomes and the mortgage repayments required for home purchasing, some analysts have pointed to the cyclical nature of the housing market and argued against Government intervention. In the view of these analysts, housing prices are currently approaching the top of the cycle and will soon start falling relative to family incomes, thus restoring affordability and accessibility.

Shelter WA disagrees with this view. Whilst there have most certainly been short and medium term fluctuations in the housing market, the general pattern has been that housing price growth has outpaced income growth for more than two decades. As the Productivity Commission's Issues Paper on First Home Ownership noted, mortgage repayments have increased as a proportion of full ordinary-time male earnings over this period.<sup>3</sup> As a result, an increasing number of West Australian families have been forced to have both parents in the work force in order to be able to pay the higher mortgage repayments associated with higher housing prices.

However, the question regarding the nature of the current high level of housing prices relative to household incomes is irrelevant in one important respect. Whether cyclical or structural, the fact is that housing has become increasingly unaffordable for first home purchasers for a protracted period of time. These people are effectively locked out of home ownership at a stage in their lives when they have traditionally purchased their own house. This is a major change in the state's social fabric, whose consequences could be far reaching.

Prospective purchasers now face a difficult dilemma at a time in their lives when previous generations would have started building equity in their own home. People wishing to enter home ownership, say a couple starting a new family, have a choice between purchasing now and remaining in the rental market for the time being in order to save a deposit.

The first option, to purchase immediately, results in these purchasers acquiring housing that they cannot afford from their current income, is not appropriate to their needs in terms of location, size or state of maintenance, or both. Purchasers taking this option typically sacrifice some necessities of life – food, education, clothes, medication, a social life, etc – in order to be able to realise their dream of home ownership. They sacrifice what they hope is short term pain for a major long term gain: the opportunity to trade up to more appropriate home or refinance their mortgage once housing prices have risen and their equity has grown.

There is no doubt that in a time of rapidly rising housing prices this strategy has proven an effective way into home ownership for a large number of families. Nevertheless, in view of the longer term price cycles in the housing market this strategy could be viewed as gambling all of the family's life savings and most of its income on one asset, the family home.

As long as housing prices continue their current upward trend and interest rates remain low, this gamble will pay off. However, with a large number of recent purchasers at or beyond their capacity to pay their mortgage, this strategy becomes problematic if housing price growth slows down or stops altogether, or if interest rates rise before a purchaser has accumulated significant equity in its property.

The potential for interest rate rises is a perennial focus of debate in the media. Income constraints will mean already stressed purchasers will be unable to meet the higher debt servicing, and their still low equity will make them unable to refinance their loan. For many recent purchasers, any interest rate rises are therefore likely to lead to mortgage default and a shattered Australian Dream.

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<sup>3</sup> Productivity Commission, *Issues Paper: First Home Ownership*, September 2003, p.6

However, the case of slowing growth or falling prices in the housing market has been debated much less extensively. If this occurs, recent home purchasers will find their equity growing slowly or not at all, for what history suggests may be a period of anywhere between two and ten years. Until house prices start rising once again, or their income increases significantly, such purchasers may find themselves stuck in a house that is inappropriate to their needs or with a mortgage worth more than their house. If the downturn is longer rather than shorter, this could have a severe impact on the family's long term prospects in terms of employment, education and health.<sup>4</sup>

### *Private rental*

The private rental sector is usually ignored in the debate regarding falling levels of home ownership. This is surprising, because most prospective home purchasers reside in this sector for some period of time.<sup>5</sup> This implies that the extent to which affordable private rental is available is a key factor in determining the ability of prospective home purchasers to generate savings, and therefore the extent of their deposit.

The main factor that is of concern is that housing stress extends to the rental sector. Unfortunately, there is now ample evidence indicating that there is a grossly inadequate supply of affordable rental housing at the bottom end of the market.

For instance, the Australian Housing Survey of 1999 indicated that 57% of renters in the bottom two quintiles paid more than 30% of their income in rent.<sup>6</sup> *Housing Strategy WA* calculates on the basis of ABS data that that by 2001 this proportion had increased to 60%.<sup>7</sup> A report by National Shelter and ACOSS indicates that 330,360 or 35% of recipients of Commonwealth Rent Assistance (CRA) are in housing stress.<sup>8</sup> The same report indicates that 9% or 85,000 recipients spend more than 50% of their income on rent.

A seminal study based on ABS data, Yates and Wulff found that the supply of affordable rental accommodation at the bottom end of the market declined significantly between 1986 and 1996. The study identified a shortage of 150,000 units of affordable rental dwellings.<sup>9</sup> Finally, more recent evidence suggests that this trend is continuing. In particular, rents in Perth have increased markedly over the last 18 months, with a 25% increase in rents over the year to December 2005.

The tight supply of affordable rental housing implies a low potential for many families in rental accommodation to save up the deposit required to access home ownership. In addition, during a period of strong house price growth, accessibility to home ownership can fall as the deposit required for, and costs associated with, entering home ownership increase at a rate beyond the savings capacity of many prospective home purchasers. In effect, the recent strong growth in housing prices has substantially increased the savings required to purchase a dwelling. This has reduced housing accessibility across the country, despite historically low interest rates.

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<sup>4</sup> The impact of housing on employment is discussed in National Shelter, *Creating the Links between Housing, Employment and Income Support*, Adelaide, 2001. In addition, a number of projects by the Australian Housing and Urban Research Institute are currently exploring the links between housing and 'non-housing outcomes'.

<sup>5</sup> See Paul Flatau, Patric Hendershott, Richard Watson and Gavin Wood, *What Drives Australian Housing Careers? An Examination of the Role of Labour Market, Social and Economic Determinants*, Australian Housing and Urban Research Institute, September 2004

<sup>6</sup> Australian Bureau of Statistics, *Australian Housing Survey 1999*, ABS Ref: 4182.5.48.001, 1999

<sup>7</sup> Department of Housing and Works, *Housing Strategy WA – Context Paper*, Draft 1 September 2003

<sup>8</sup> National Shelter & ACOSS, *Rent Assistance: does it deliver affordability?*, September 2003. Housing stress is defined as households in the bottom two income quintiles paying more than 30% of disposable household income in mortgage payments or rent.

<sup>9</sup> Maryann Wulff and Judith Yates, *Low Rent Housing in Australia 1986 to 1996*, Australian Housing Research Fund, March 2001

Prospective purchasers in this situation have no option but to keep renting until housing price growth slows down. Once growth has slowed sufficiently for these purchasers to be able to meet the financial entry requirements, they then face a choice between investing in a stagnant or falling housing market and remaining in the rental market for a further period to increase their deposit.

In either case, this group of prospective purchasers will be dependent on the rental market for accommodation for what can be, as discussed above, a protracted period of time. However, the above discussion is based on one important underlying assumption: that the rental market will be able to provide affordable accommodation, particularly to people in the bottom two income quintiles. If prospective first home buyers cannot afford the rent on their intended temporary residence in the rental sector, they will be unable to save a deposit for a home, and therefore unable to purchase a home at any stage in their lives.

## First Home Owners Grant: Shortcomings

The First Home Owners Grant was introduced in 2000 to offset the impact of the Goods and Services Tax on people purchasing their first home. However, since this time the emphasis of the scheme has shifted, and now it can be said that the FHOG is important principally as the only up front demand subsidy for home purchasers. In a period of rapidly rising house prices, the FHOG has effectively become a policy measure that aims to bridge the growing gap between household incomes and house prices. In this context, the scheme has been criticised on four counts.

Firstly, the scope of the First Home Owner Grant is somewhat limited compared to the tax concessions such as capital gains tax (CGT) exemptions, non-taxation of imputed rents, stamp duty concessions and land tax exemptions for the family home, as well as tax deductibility of costs associated with investment properties (negative gearing). As an indication, annual Government expenditure on the FHOG scheme has totalled less than \$1 billion, with each household able to apply for a \$7,000 grant. At the same time, the value of the tax concessions available to home purchasers alone have been estimated at between \$17 billion and \$21 billion per year, or \$4,200 per household per year.

Secondly, the FHOG has been widely criticised for its untargeted nature. All first home purchasers are currently eligible for the grant, regardless of their income, regardless of the price of the property, and regardless of whether they already own property overseas.

While figures on the income of FHOG recipients are not available, Shelter WA is concerned that a large proportion of FHOG monies appears to have been received by people who can by no means said to be in housing stress.<sup>10</sup> Shelter WA considers spending public funds under the FHOG on people on higher incomes as poor policy, particularly at a time when there is significant housing need among a growing section of the community.

Thirdly, a number of analysts have argued that the FHOG has been a contributing factor in to the increases in house prices that have occurred across Australia since the introduction of the scheme in 2000. However, a direct link between a program such as the FHOG and housing affordability has been difficult to prove, and to date there has been little research into the impact of this subsidy on housing prices.

Nevertheless, providing a grant such as the FHOG towards purchasing an established dwelling effectively boosts the demand for housing, putting upward pressure on house prices. This implies that the FHOG under its current policy parameters increases access to home purchasing for some recipients at the expense of reducing affordability for all prospective home buyers.<sup>11</sup>

Finally, the FHOG is a once-off payment that, regardless of any success it may have had in reducing the gap between savings and deposit, does nothing to alleviate housing stress associated with paying off larger and larger mortgages. In addition, neither the State nor the Commonwealth Government has devised any other policy response to this problem, despite recent growth in the size of mortgages compared to incomes.

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<sup>10</sup> Mike Berry, *Affordable Housing Project: Background Paper*, Brotherhood of St Laurence, December 2002

<sup>11</sup> The extent to which increased effective demand will result in price rises will depend on the relative price elasticities of the supply of and demand for housing. However, unless the supply of housing is perfectly elastic, any increase in effective demand will result in price rises.

### *Improving the FHOG*

Since its inception in 2000, the FHOG has changed in nature. It has outlived its original purpose as a compensation for the introduction of the GST. Instead, it has become a de facto policy response to falling housing affordability. However, the policy parameters of the scheme have not changed to reflect this change in purpose. As a result, the current policy parameters serve the scheme poorly in achieving its new purpose.

A key question that has bearing on all aspects of the debate regarding the FHOG is the potential inflationary nature of the scheme. So far, this question has remained unanswered. Shelter WA strongly believes that before any decisions can be made regarding the optimum size of the grants, a formal analysis should be conducted to establish to what extent the FHOG has contributed to the increase in house prices that has occurred since 2000.

#### **Recommendation 1**

- a) That a formal analysis be conducted of the impact of the First Home Owners Grant scheme on housing prices, and**
- b) That the amount of Government funds committed to the First Home Owners Grant scheme, and the size of the grants, be considered subject to the outcomes of this analysis.**

As argued above, the FHOG has a number of shortcomings in addition to its potential inflationary nature. Shelter WA believes that in order to address these shortcomings, it is essential that the scheme is targeted at the bottom end of the market. Targeting the grants to a subsection of prospective home purchasers would have an obvious advantage in concentrating assistance where it is most needed. In addition, targeting the grants would reduce any potential impact that the FHOG may have on house prices by limiting the number of prospective purchasers that have access to the scheme.

Shelter WA believes that targeting the FHOG would be best achieved by relating eligibility for the grant to household income rather than, as has been proposed, to house prices. Shelter WA is concerned that a FHOG scheme targeted to lower house prices could concentrate any inflationary impact that the FHOG may have at the bottom segment of the market, further reducing the supply of affordable housing. Shelter WA proposes using the median household income as a reasonable cut-off point, as it has the advantage of data being readily available.

Nevertheless, Shelter WA acknowledges that substantiating each applicant's income could prove administratively cumbersome and that the price of the house being purchased could serve as a reasonable proxy for the income of the applicant. Should the administrative costs associated with targeting eligibility for the FHOG directly to income prove excessively high, Shelter WA would accept using a cut-off based on the price of the house being purchased as a second-best option. In this case, the median house price for the area could be used as a cut-off point.

#### **Recommendation 2**

- a) That First Home Owner Grants be made available only to households earning below the median income, or**

- b) If the administrative costs of an income-based limit prove excessive, that First Home Owner Grants be made available only to dwellings below the median housing price in the area.**

As a policy response to reduced housing affordability, Shelter WA believes that the assistance provided by the FHOG should not cease at the time of purchase. In addition to an up front payment, increased mortgage to income ratios make it essential that the FHOG provides some form of assistance to home owners who find themselves in financial difficulty due to changing family or employment circumstances.

It should be noted that the Department of Housing and Works' home loan arm, Keystart, has put a safety net scheme in place to help any of its borrowers "whose financial situation deteriorates after their loan is approved and who, without help, might lose their home."<sup>12</sup> This scheme has been successful in preventing financial stress from escalating into mortgage foreclosure, and includes referral to an independent financial counsellor, increasing the loan, temporarily reducing payments and Keystart purchasing part of the equity in the dwelling.

### **Recommendation 3**

**That a safety net system be developed and implemented aimed at home purchasers who find themselves in financial difficulty.**

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<sup>12</sup> Keystart, *Safety Net: Let Keystart Help You*, <http://www.keystart.com.au/key/safety-net.htm>, accessed 16/2/06.