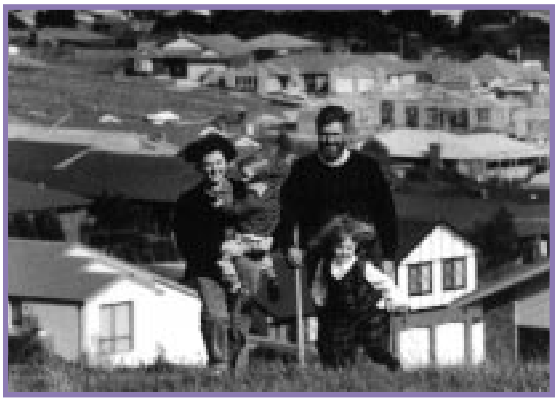
As Safe as Houses – or A House of Cards?

THE REAL COSTS AND BENEFITS OF HOME OWNERSHIP



A recent Treasury report calculates that housing makes up more than half of the nation's wealth and that the value of housing grew by more than $55 billion during 1994–95. There are regular calls that home ownership be further encouraged – by allowing first home purchasers to draw on their superannuation savings, or by enabling private renters to take their rent assistance as a lump sum for a deposit on a house. All of this rests on the widely accepted wisdom that home ownership is a good deal financially. But is it?

ANDREW BURBIDGE and IAN WINTER examine the financial costs and benefits of home ownership for families living in four areas of metropolitan Melbourne.

Home ownership in Australia is so widespread and has been at high levels for so long that it has become part of the national self-image. Having your own home is entwined with beliefs about family life – indeed, for many couples buying a home is a prerequisite for having children. Home ownership is assumed to provide security and a stable base for young families, as well as financial rewards and income security in retirement.

Assumptions about the financial benefits of home ownership form a major part of the broad public support for home ownership. Governments of various political colours at the federal, state and local levels have introduced a range of direct and indirect measures to encourage or support home ownership, including tax deductions and exemptions, social security and interest rate measures, rebates on rates and stamp duty, direct cash grants, and subsidised provision of infrastructure for new housing sites. The *Community and Nation* statement (Keating 1995) is a recent example of support for home ownership with its pledge to assist some renters to begin home purchase by allowing the rent subsidy to be taken as a lump sum for a deposit.

Given the revered status of home ownership in Australian popular culture, a quick evaluation would suggest that any measures which extend home ownership to more households must be a good thing. However, economic and social changes since the mid 1980s may mean that the benefits and risks of home ownership are now quite different. Assumptions about home ownership grounded in the 1960s and 70s may prove inaccurate in the changed economic environment of the 1990s – when interest rates are deregulated and much higher than previously, when job security is being undermined and casual employment increasing, and when high levels of unemployment can overturn financial plans.

In such uncertain times are there circumstances where home ownership brings financial loss rather than gain? If some families lose by becoming home owners, could measures to boost home ownership actually be increasing economic and social inequality? These are questions that have attracted much sociological and economic debate since the late 1960s (Winter 1994).

In this article data collected by the Australian Institute of Family Studies in its Australian Living Standards Study (ALSS – see pages 6–7) is used to examine first, the extent of financial advantages available to home owners and, second, which areas had the greatest gains and losses. In so doing we assess whether popular assumptions about the economic rewards of home ownership are accurate in the era ushered in by the deregulation of housing finance.

The extent and geography of capital gains and losses are important both analytically and in terms of policy development. An uneven geography of housing-related financial advantages (for example, house prices rising more rapidly in some areas than others) can increasingly preclude households from moving from one area to another and may reduce both residential and job mobility, trapping some families in declining areas and locking them out of the parts of cities where there is employment growth.

No attempt is made in this article to estimate the value to owner occupiers of the non-economic aspects of home ownership, such as security of tenure or social status, although it is acknowledged that such considerations are a rational part of a family's assessment of whether it is better for them to be owner-occupiers than renters. Our focus in this article is purely upon the financial apsects of home ownership.

The sample (1349 dwellings) is drawn from four of the ALSS local government areas – those in metropolitan Melbourne. These are inner suburban Melbourne (260 dwellings), middle suburban Box Hill (211), and outer suburban Berwick (403) and Werribee (475). For each of these dwellings, the ALSS data set provides information about the housing costs being met by the family occupying the dwelling in 1991.

This information, combined with that of the value of the dwelling and its land in 1986 and 1991, drawn from the Council valuation lists, forms a unique data set. In other words, the bringing together of the three elements (house price, land price, and the housing costs of the families in those houses) constitutes one of the most powerful data sets brought to bear on the 'data-starved' and thus vexing issue of the financial costs and benefits of home ownership.

Capital Gains and Housing Benefits

Capital gains are defined as the real change in each property's *land* value. This article argues that changes in the value of the house should not be treated as capital gains since they reflect the expenditure by owners on repairs, improvements, and alterations. Capital gains are calculated using the valuations of the individual residential sites of families interviewed in the ALSS survey. As valuations were only undertaken in 1986 and 1990, an annual estimate of real capital gains is calculated, using the Consumer Price Index (CPI) to adjust for inflation, by a simple averaging of the change during this four-year period. The other benefit of home ownership included in the calculations is the annual value of the rent saved by owner occupants.

On the costs side of the equation are interest on the mortgage (13 per cent was the prevailing rate in 1991), the opportunity cost on the owner's equity (calculated at the 1991 government bond rate of 11.5 per cent), local government rates, house repairs, maintenance and depreciation, dwelling insurance, and transfer costs. No tax is taken from the imputed rental income, as the government does not tax this. But the opportunity cost (the amount the home owner foregoes by living in the house instead of investing his/her money in an alternative investment) is reduced at the marginal tax rate of the higher income parent in the household. Net housing benefits, then, are total benefits, using the average annual capital gains between 1986 and 1990, minus total costs, using 1991 data only.

The analysis addresses the question: how many home owners would have been better off financially if, in 1991, they had sold their dwelling, rented one of the same standard and invested the net proceeds of the sale in long-term government bonds? The likelihood of large numbers of households actually being able to pursue such a course of action would, however, obviously be limited by the current size of the private rental sector – approximately a quarter of all households. Furthermore, private renting is a non-preferred tenure in Australia due to a lack of security and control, plus an associated social stigma (Winter 1994). The value of these non-economic aspects of housing tenure alternatives are not estimated in this article.

Table 1 Average net financial benefits ($1991) available to owner occupiers

Average net financial benefits ($ 1991)		Per cent of owner occupiers
> -$5000		3.5
-$5000 to - $1000		31.3
-$1000 to +$1000		28.6
+$1000 to +$5000		27.4
> +$5000		9.1
Total	(n= 1349)	100

Source: Australian Living Standards Study (ALSS) 1991–92, Australian Institute of Family Studies, Melbourne.

Given that interest rates in 1991 were particularly high, the calculations may be painting a pessimistic picture. On the other hand, the period 1986–1990 was one of a boom in house prices in Australia. Owner-occupiers who did not do well in this period of rapidly rising property values are likely to have been even worse off financially in the following period when the value of many properties slumped but interest rates remained relatively high.

Table 2 Average annual net benefits in four Melbourne areas, $1991

Melbourne	2528
Box Hill	1208
Berwick	-320
Werribee	-364

Source: Australian Living Standards Study (ALSS) 1991–92, Australian Institute of Family Studies, Melbourne.

As set out in Table 1, a majority (63 per cent) of owners had little or no annual net benefits from owner-occupancy in 1991, after account is taken of inflation and the cost of the equity tied up in their home. Compared with the rent and invest option, nearly 3.5 per cent of families lost more than $5000. Thirty-one per cent lost between $1000 and $5000, and 29 per cent roughly broke even ($-1000 to +1000). Those registering positive net benefits of $1000 to $5000 amount to 27 per cent, and those more than $5000 only 9 per cent.

Not only are the proportions of families registering positive financial benefits from home ownership fairly small, but also the amounts they are gaining are very low. This is a different picture from the one that fuels dinner table conversations in which owners compare what they paid for their property with what they think it is worth now.

In purely financial terms, those home owners registering negative annual net benefits experienced costs that exceeded the annual economic benefits of imputed rental value and capital gains. With interest rates in 1991 of 13 per cent, these families would have been financially better off renting a dwelling and investing the equity tied up in their dwelling, if they could equal or better the opportunity cost interest rate of 11.5 per cent (the government bond rate).

While there are other methods of calculating the costs and benefits of home ownership (Duncan 1990), the finding that a majority of owner-occupiers had negative benefits highlights the (generally ignored) conclusion that, whatever the psychological and social benefits, in periods of high interest rates and fluctuating property values there is no guarantee that home ownership always provides financial benefits to all owner-occupier families. Such a finding raises questions about the validity of policy that unswervingly encourages all to attempt to access home ownership.

Locational Differences in Housing Benefits and Losses

There are, then, no guarantees of financial benefits from home ownership. Yet, as real estate agents are wont to cite, the three keys to successful house purchase are: 'number one, location; number two, location; and number three, location'.

Is this popular adage correct? Are the financial benefits to home owners greater in some areas than others? Can the positive financial aspects of home ownership be captured by buying housing in an inner suburb such as Melbourne, rather than an outer suburb such as Berwick, or vice versa?

If we examine average annual housing benefits for each local government area included in the study, it is clear that this was indeed the case (Table 2). The inner suburban local government area of Melbourne, on average, displays total housing benefits of just over $2500 compared with a figure of minus $364 in the outer suburban area of Werribee. The move into home ownership appears more rewarding financially in areas closer to the city centre. Yet, even within these areas there are wide variations in how families are faring.

A disaggregation of the averages in Table 2 reveals substantial proportions of families registering net losses from home ownership, while other families register sizeable net benefits.

Table 3 shows that, while Melbourne, once again, is the local government area in which financial benefits from home ownership are more likely to be registered (in that over one-third of home owners reaped net benefits of more than $5000 and over two-thirds registered benefits of more than $1000), at least 18 per cent of families made net losses. Box Hill is the next area where home owners have a reasonable likelihood of registering net benefits. Here 45 per cent of home owners registered benefits of more than $1000, although more than one-third registered net losses greater than $1000. In the outer suburban areas of Berwick and Werribee, less than one-third of home owners registered benefits of more than $1000. In fact, in these outer suburban areas more families are registering clear losses than gains.

Table 4, based on Council valuations, shows that on average Box Hill and Melbourne families had much higher value land than the Berwick and Werribee families. It follows that even if the percentage increase in land values is the same in the outer and inner suburbs, the size of the net benefits will be higher in the high land value areas. Thus, part of the explanation for the differences between areas in levels of net housing benefits rests with variations in the land to house price ratio and the emphasis our calculations place on increasing land rather than house prices.

Table 3 Grouped annual housing benefits in four Melbourne areas, $1991

($1991)	Melbourne	Box Hill	Berwick	Werribee
> -$5000	6.6	5.7	2.0	2.7
-$5000 to -$1000	11.5	30.2	35.9	36.0
-$1000 to +$1000	15.6	18.9	32.7	34.0
+$1000 to +$5000	32.0	29.2	26.6	25.7
> +$5000	34.4	16.0	2.8	1.7
Total	100	100	100	100

Source: Australian Living Standards Study (ALSS) 1991–92, Australian Institute of Family Studies, Melbourne.

Table 4 also illustrates a gradient of land values that declines as one moves away from the city centre towards the urban fringe. Interestingly, though, the ratio of land to dwelling price is highest in Box Hill. This may be due to the fact that the blocks of land are larger in Box Hill than Melbourne, and/or that the housing is of a lower quality. For instance, timber dwellings are more prominent in middle suburban Box Hill (36.5 per cent) than inner Melbourne (13.6 per cent), much of which is characterised by Victorian era brick dwellings. As Table 4 shows, the overall property value was higher on average in Box Hill than in outer suburban Berwick and Werribee. Yet the value of dwellings in these outer suburbs was higher than the older, often smaller dwellings in Box Hill. Therefore, location and land to dwelling price ratios comprise a major part of the explanation for these differences in average net benefits.

Table 4 Mean land, house and property valuations* in four Melbourne areas, $1991

($1991)	Land	Dwelling	Property	Ratio	N
Melbourne	124,870	77,340	202,210	1.6:1	141
Box Hill	116,990	46,200	163,190	2.5:1	306
Berwick	55,210	72,020	127,230	0.8:1	280
Werribee	46,970	69,900	116,870	0.7:1	317

*Council valuations at June 1990, updated by CPI

Source: Local Government Areas: valuation lists.

Conclusion

Three key points follow from this analysis. The first is that there appear to be substantial differences between areas in the average levels of net financial benefits associated with home ownership. The smaller average net benefits accruing to families in fringe suburbs challenge the notion that home ownership provides similar benefits to all owner-occupiers. Those who choose to buy in fringe suburbs may be paying a high economic price in the longer term in terms of family asset accumulation and the cost of moving to other areas. However, there has been relatively little research on the causes of capital gains, so families buying in areas of low capital gains may not be aware of the economic differences between areas and thus have little basis to assess whether other benefits offset the negatives of buying in these areas.

The evidence of differences between areas in capital gains and housing benefits point to the need to identify the causes of these differences, as well as recognising the importance of home ownership for asset accumulation for families.

Second, home purchase in an era of deregulated interest rates and fluctuating market values can result in costs for buyers and owners which exceed financial benefits. The data used in this analysis for the calculation of total housing benefits comes from a period which may not reflect long-term trends, and should therefore be extrapolated with caution. However, the analysis suggests that if real interest rates remain high, relative to capital gains and rents, high rates of new home purchase on the urban fringe are not in the financial interests of many of the families involved (compared with them buying closer in or renting), or an efficient allocation of Australia's resources. Given the limited time frame of the analysis (1986–90) and the possibility of very different financial rewards applying in other periods, the timing of entries to and exits from home ownership clearly are crucial.

When account is taken of the broad range of costs and benefits of home ownership, many owner-occupiers had housing costs greater than their housing benefits. The capital gains and the rental value of their home were less than the cost of interest, rates, repairs and interest foregone. These owners, most of them living in the outer suburbs, would have been better off financially if they had invested their equity and rented a dwelling of similar standard to their own. It is in this context that policies seeking to assist families into home ownership should be questioned.

Third, as previously stated, this analysis has focused on the circumstances in which families with access to credit would have been better off financially if, in 1991, they had sold their dwelling, rented one of the same standard and invested the net proceeds of the sale in long-term government bonds. However, it should be remembered that families without access to credit have neither option available. The finding of substantial differences among owner-occupiers as to whether and how much it adds to their wealth highlights the complexity of the links between tenure and social inequality – there are major divisions among owner-occupiers as well as between owners, private renters and public housing tenants.

These findings raise questions about the validity in the post-regulation era of many of the old assumptions about home ownership. In this paper we have questioned the notion that house prices rise consistently above general inflation rates and by a sufficient amount to benefit all owners, and we have questioned that ownership is financially better than renting no matter what the mortgage interest rate.

Home buyers are probably now much more like other purchasers of assets on the open market – there is an element of risk of financial loss, particularly if interest costs are high or (perhaps because of job relocation, unemployment or family breakdown) if they are obliged to sell on depressed markets.

References

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