# The Great Housing Scandal —3

The dramatic growth rates achieved by permanent building societies since the early 1960s are traceable to several factors, the most significant of which include attractive deposit rates, limited Reserve Bank interference with lending policy, and the inability of savings banks to keep pace with higher loan limits necessitated by rapidly rising land prices.

## The problems of the highly geared home buyer

Their growth, predictably, has been particularly marked in N.S.W., where soaring land prices and consequent demand for higher maximum loan limits have left the private savings banks, with maximum loan limits of around $8,500, completely out of line with market demand.

Both the Commercial Savings Bank of Australia Ltd and the Bank of Adelaide Savings Bank Ltd have an upper limit of $8,500 on housing loans, with a qualification that "higher loans will be considered in some circumstances."

Other private savings banks, although having no official ceiling on loans, give preference to loans of $9,000 or less.

Government Banks have similar restrictions (although moves are now afoot to have them lifted) with the Commonwealth Savings Bank, the Commonwealth Trading Bank, and the State Savings Bank of South Australia limiting loans to $9,000.

The State Savings Bank of Victoria yesterday abolished its previously applicable limit of $12,000, but the Rural Bank, which professes to have no fixed limit on housing loans is still trying to work within the $10,000 bracket.

But this is not the end of lending restrictions imposed by the banks. Although it is difficult to generalise, one common restriction includes age limits on houses financed to around 10 years for brick, five years for weatherboard, and two years for fibro houses.

This, together with a general attitude of inflexibility regarding the inclusion of a wife's income even for a relatively short period and a reluctance to extend housing loan facilities to single women, has meant that the permanent building societies are gaining larger market shares at the banks' expense.

Building societies, although lending at higher rates — between 7½ and 8¼ per cent a year reducible compared with the banks' rates of 6¼ to 8¼ per cent a year reducible — offer maximum loan limits of between $20,000 and $30,000, with several societies having no fixed limits on loans whatsoever.

Many of the larger building societies are also now prepared to consider the wife's income, at least during the initial period of the loan, in determining loan sizes, and will lend to single women where there is adequate evidence of continued steady income.

These sorts of features have been largely responsible for a growth of 739.5 per cent in lending by permanent building societies in the period between 1964-65 and the first three quarters of the 1971-72 financial year.

In actual figures, lending by permanent building societies increased from $33.4 million in 1964-65 to $297.1 million.

New lending for housing by trading banks, on the other hand, increased by only 35 per cent between 1963-64 and 1970-71, from $138.9 million to $187.6-million.

As shown in the accompanying table, the rate of lending for housing by Savings Banks continues to evidence strong growth rates — 125 per cent in the period between 1964-65 and 1971-72 — although not as strong as the banks would like.

The banks claim, and quite rightly, that the low limits on their maximum loans have been caused by Federal Government restrictions limiting the availability of low-cost finance.

They point out that, whilst they must keep 60 per cent of their assets in official securities, societies are controlled to the extent of only 10 per cent. This puts them at a serious disadvantage.

The whole matter, of course, is in the lap of the Federal Government, which has the power to release more bank money for housing loan purposes.

Home lending by the life offices is particularly sluggish.

**Third of four articles by ANNE LAMPE on the housing crisis.**

A quick comparison of selected assets held in Australia by life insurance companies reveals that, while fixed assets between June, 1966, and December, 1971, increased by 161.9 per cent from $354.2 million to $927.8 million, and investment in shares increased by 122.7 per cent from $453.9-million to $1,010.8 million over the same period, housing loans increased by only 27.4 per cent, from $355.6 million to $453.1-million.

The life offices' standard reply when confronted with figures such as the foregoing, which clearly indicate a reluctance to lend for housing, is that mortgages do not offer any prospect of a capital gain and that such loans involve a high administrative cost.

These two factors combined, they argue, work against the interests of the general policyholder body.

However, in view of the fact that the loans are far from being gratuities at a rate of between 7½ to 9½ per cent a year reducible (the majority being between 8-9½ per cent a year charged on the larger loans) the argument that the investment return is substantially eroded by high administrative costs, taking into account that the offices receive substantial income tax concessions on investment returns, is not really a plausible one.

It could be argued that, with their massive overhead of clerical staffs and equipment, the life offices have the resources to blend mortgage loan administration, on a larger scale than at present, with the rest of the premium collection activities without incurring too much additional cost.

They can't very well fall back on the risk argument, for most companies insist that the loan is covered by a life assurance policy while the ready availability of mortgage insurance covers the lender against default by the borrower at no extra cost to the former.

The life offices may well claim, — and quite justifiably, too — that they are already contributing to housing the nation through their holdings of government and semi-government securities. They are virtually required to hold 30 per cent of assets in official securities, including 20 per cent in Commonwealth securities.

They indisputably do, but only in return for a very attractive dual incentive — taxation concessions on investment returns and taxation concessions on individuals' life assurance premiums and superannuation contributions.

So they are not, in fact, giving anything away for nothing.

It is no secret that most of the larger life offices regard themselves as being too important to deal with small fiddly investments such as mortgages, when they have bigger opportunities to display their investment strength — namely in the share and property markets.

On the other hand, their argument relating to the absence of capital gains on mortgages stands up well and, to this end, the establishment of a mortgage market — where mortgages as a security are traded between buyer and seller and where yields vary with changes in mortgage interest rates over time — would go a long way toward turning mortgages into a more attractive investment.

The loans that are available, though, are generous. In terms of maximums, only the Colonial Mutual Life Assurance Society Ltd has a general applicable upper limit of $12,000; the rest have either $20,000 as the limit, or, as is generally the case, no fixed limit at all.

Finance companies, because of their fairly high rates of interest, are usually lenders of last resort for housing — where one goes when one has exhausted all other avenues of obtaining housing finance, or to obtain a second mortgage.

In analysing the factors contributing to the high cost of housing, the high interest rate figures prominently at every level, and any move in the direction of lower rates would certainly go a significant distance toward effecting a reduction in the cost of the final product.

Real estate activities at the speculator, developer, and homebuyer level are extremely highly geared, with up to 80 per cent of required funds for purchase and development of raw land, and up to 95 per cent of funds for the purchase of a completed land-home package consisting of borrowed funds.

In view of the long-term nature of these investments, the rate of interest payable on borrowed funds makes a significant impact on the total cost, and, over the past decade or so, interest rates have been extremely high.

Interest rates on borrowings of the individual homebuyer are usually between 7½ and 9½ per cent, but borrowings for land acquisition and development activities are usually at bridging finance rates — 12 to 13 per cent a year.

Over a long term, then, even a small reduction in the rate of interest can manifest itself in a significant drop in the final cost of housing.

But talking about reducing interest rates for housing and effecting that change, in view of its intricate inter-relationship with so many other economic variables, are two entirely different things.

As the lending institutions point out, the only way their lending rates can be reduced is if their borrowing rates from the public are reduced, and with present levels of inflation the public would not accept lower rates of interest on their savings.

This harks back to who is ultimately responsible for the presently high rate of inflation — the Federal Government — and what measures are being implemented to combat the problem.

There are those who argue that if the Federal Government reduced the long-term bond rate, this would have an effect of pulling the general level of interest rates down.

However, the rate of interest is very much related to supply and demand for money, and a lower bond rate may just have the effect of making public securities less attractive as an investment without affecting significantly the rest of the market.

There are, of course, alternatives, such as government subsidies to lenders of housing finance, so that the homebuyer effectively borrows money at 1 or 2 per cent less than the lender is in fact charging.

This is Mr Whitlam's proposal of subsidising, to the extent of 2 per cent a year, all borrowings for new homes during the first 10 years of purchase.

However, the politically ugly question of the cost of this to the taxpayer eventually emerges, and no costs have yet been worked out.

It could also be quite reasonably argued that this type of measure, like all subsidies, favours only one section of the community — in this case homebuyers — and results in a misallocation of resources by giving housing preference over other areas of economic activity, such as mining or steel production, which economists might argue are much more productive.

One home finance innovation which has attempted to get around this problem of high-cost housing finance is the growing crop of mutual home loans funds.

These funds, which lend money at between 2½ and 5 per cent a year to homebuyers, reduce considerably the direct cost of the loan, but only because they do not pay any interest on "savings" (They are in fact options coverted into shares) of borrowers while they are waiting for their loans — and the maximum waiting period actuarially can be up to 12 years.

In other words, although the direct cost of housing loans are reduced by these funds, other indirect or opportunity costs — interest forgone on savings and inflation of land and housing prices during the waiting period — must also be taken into account.

And in view of the inelasticity of housing supply and the high price elasticity of demand, any reduction in lending rates would merely shift the demand curve for housing upward, resulting in higher costs because of demand pressures.

In the longer term, of course, as the supply of housing adjusts to the new level of demand, costs would level out.

Then there is the question of who benefits most from such a subsidy.

If the subsidy is extended to all homebuyers, then those buying more expensive homes and borrowing higher amounts would stand to gain proportionately more than those buying less expensive homes and borrowing less.

If a substantial proportion of the subsidy is going to go to those buying expensive homes, who, it could be argued don't really need the subsidy, then there is a good argument for spending the money more effectively by directing it into the provision of low-income rental housing so that those who most need it obtain the most benefit from it.

**SOURCES OF HOUSING FINANCE—NEW AND ESTABLISHED DWELLINGS — AUSTRALIA 1964-65 TO 1971-72**

| | SAVINGS BANKS | TRADING BANKS | BUILDING SOCIETIES |
|---|---|---|---|
| | $ mill | $ mill | $ mill |
| 1964-65 | 298.1 | 137.9 | 33.4 |
| 1965-66 | 324.3 | 139.2 | 36.9 |
| 1966-67 | 364.0 | 185.9 | 55.0 |
| 1967-68 | 417.0 | 201.1 | 85.0 |
| 1968-69 | 458.6 | 194.0 | 130.0 |
| 1969-70 | 458.6 | 185.2 | 185.7 |
| 1970-71 | 558.2 | 187.6 | 223.7 |
| 1971-72 | 671.0 | *105.6 | 297.1 |

* 6 months from July 1, 1971, to December 31, 1971.

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