Global Crisis Fact Sheet 5

Housing

Secure, affordable housing is a basic human right. Under capitalism housing, or more specifically land, is also a major focus of speculation. There are three key drivers of this speculation: individuals (rather than institutions) speculating in housing; larger scale land speculation; and financial deregulation which drove house price inflation by making it easier to get bigger and bigger loans.

In the last decade or so, speculation in real estate has created artificially high prices or ‘bubbles’ in housing markets around the world. Since 2007, some of these bubbles have burst spectacularly, leading to sharp falls in house prices in the US, UK, and the Baltic States, among other countries. Opinions differ as to whether the Australian housing market could suffer a similar collapse but there are good reasons to expect some continuing fall in house prices. A major crash would require Australian governments to intervene to prevent large scale foreclosures and to keep people in their homes in the short term. In the longer term, the regulation of the housing sector needs serious reform.

Housing and the Global Crisis

The immediate trigger of the global crisis was the massive growth of high risk or “sub-prime” mortgage loans in the US housing market, which began after interest rates fell in 2001-2.

Falling real wages and casualisation of low paid work in the US increased the numbers of working poor, often depending on more than one part time job without earning a living wage. Millions of low income Americans, often from Afro-American and Hispanic communities, had no access to affordable housing as governments cut public housing programs.

Lending to people who cannot afford to repay is known as predatory lending, and had been illegal in some US states. But these laws were repealed in the name of deregulation.

US banks offered mortgages to low income people at initial low interest rates. But hidden in the fine print was a shift to higher interest rates that they could not afford. The banks knew that many people would not be able to continue payments, but they gambled that rising house prices would cover the cost of defaults.

The banks then converted the risky loans into securities, which were promoted and sold as investments with acceptable risks but high interest returns. Ratings agencies like Moody’s and Standard & Poor’s rated these securities as good investments.

The deregulation of global financial markets meant these securities could be sold to other banks, local government and pension funds all over the world, including Australia, creating contaminated time bombs in the global banking system.

By 2007, the highest risk sub-prime mortgages were 14% of the total US mortgage market, with a further 10% of the market classified as risky. As the higher interest rates kicked in over 2007-8, millions defaulted, flooding the US market with millions of houses for sale, leading to sharp falls in house prices. Families were left homeless as their houses were sold.

US house prices have fallen 30% from their peak and continue to fall at an accelerating rate. Housing bubbles around the world have also burst, with prices in 2008 falling by between 10% and 40% in the UK, Ireland, the Baltic States and Spain.

Australia

There have been significant falls in Australian house prices but we have not as yet experienced the catastrophic collapse seen elsewhere. According to Australian Bureau of Statistics figures, Australian house prices fell 6.7% in the year ended March 2009. This is the biggest annual fall since the data series began 23 years ago, with the largest falls in Perth and Sydney. The ABS reported a 2.2% drop in the weighted average for capital city house prices in the March quarter of 2009. There are good reasons for expecting house prices in Australia to fall significantly.

Economists are divided on how far prices have to fall. A recent JP Morgan report predicted that house prices would drop 14% by the end of 2010. University of Western Sydney economist Steve Keen predicts falls of more than 40% from the peak of the housing boom. He argues that the rapid rise in

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house prices was driven by an exponential growth in household debt that is not sustainable. Australian house prices peaked at 9 times average weekly earnings, compared to peaks of 7 times average earnings for the US and the UK. Australia's household debt to GDP ratio peaked at around 165%, nearly 7 times the ratio of the 1960s. As unemployment increases during the recession, prices could fall sharply as increasing numbers of homeowners default on their loans.

Other economists have predicted more modest falls, arguing that Australia does not have the same oversupply problems that have made the crash so severe in the US. They also point to less reckless lending by Australian banks, continuing population growth boosting demand, and lower interest rates reducing the burden of those with mortgages. In addition, if there is continuing demand for new land, constraints on land supply can push up prices (if these are not regulated as they are in some other countries).

Whatever the precise figure ends up being, with unemployment predicted to rise sharply over the next 12 months, it would be reasonable to anticipate signficant further house price falls in the short to medium-term. This is a real challenge, since we need real prices to fall to improve housing affordability, but want to avoid people paying off loans that are far more than their homes are worth.

Fair Housing Policies for Australia

Responding to a Crash

If Australia does experience a major housing crash Australian governments must be prepared to intervene to reduce home foreclosures and keep Australians in their homes.

In a recent statement to the US House of Representatives, the American economist James K Galbraith advocated two policy alternatives for dealing with the US housing crash that may be applicable in the event of a similar crash in Australia. They were:

- A comprehensive moratorium on new foreclosures, and then to turn over the entire portfolio of troubled mortgages to an entity like the depression-era Home Loan Corporation for assessment and renegotiation on a case-by-case-basis
- Allow ordinary foreclosure process to work. But, after foreclosure, owner-occupied properties would be bought at the lower of the appraisal price or mortgage balance by a new federal entity, and the previous owner allowed to stay in the house for a fair market rent, with the option of repurchasing the home at a fair appraisal at a value later on.

Reducing Speculation, Better Access to Secure, Affordable Housing

- a uniform land tax that removed the exemption on owner-occupied dwellings, to reduce speculation in land and raise revenue than can be used to fund the expansion of social housing
- a further way to reduce land speculation is to introduce a 'betterment tax' that taxes the windfall gains as scarce new land is re-zoned as residential
- policies that increase the size of the rental component of the housing sector from 30% to 40% and the social housing component from 5% to 15%
- promotion of Community Land Trusts as alternative forms of land tenure that discourage speculation. CLTs are non-profit organisations in the USA that hold title to land for the purposes of long-term affordable housing (ownership and rental) and community benefit. While housing primarily low-to-middle income households, in 2008 the CLT sector experienced a foreclosure rate of 0.5% amongst its homeowners, compared to a national average of 3.3% across all income levels. The success has attracted a lot of US federal and state interest, support and funding. The UK recently adopted the model, and CLTs are generating increased interest in Australia.

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