



The Impact of Financial Circumstances on Tenure Choices in New Zealand

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Report to:
Centre for Housing Research Aotearoa New Zealand

FURTHERING OUR UNDERSTANDING OF TENURE TRANSITION

The Impact of Financial Circumstances on Tenure Choices in NZ

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1 Summary

This study was tasked with the aim of generating a set of related housing research projects (research programme) addressing the relationship between financial circumstances and tenure choices for those New Zealanders in the 18-40 year old cohort. In particular, the focus was on the requirements to enable an improvement in our understanding of tenure transition and choices and - in this context - the impact of (potential) policy interventions.

1.1 Issues in the research method

An important issue to be tackled early was to strike a balance between a desire for detail and a desire for simplicity. At either ends of the spectrum are situations which we believe would achieve little in attempting to improve the understanding of tenure transition. In particular,

- on the one hand, this study could easily slip into attempting “a comprehensive explanation of the dynamics of the housing market”.
- on the other hand, reverting to a simple analysis of the “costs (and benefits) of renting versus those of home ownership” risks a naïve interpretation of the many inter-related variables influencing tenure choices.

The first option would quickly become enmeshed in the detail, with difficulty in ‘seeing the wood for the trees’. The second option risks providing little additional information to that which is already known.

1.2 The three sets of influences

In disentangling this topic, we have focussed on the role of three broad sets of influences:

- financial circumstances: including current and expected income, savings, current wealth/indebtedness (including student loan obligations), access to finance/credit, employment and security thereof, housing assistance schemes, investment and lifetime wealth accumulation expectations.
- household formation: including demographic influences such as changing family formation behaviour, as well as the changing composition of households.

- preferences: including changing lifestyle, aspirations and the existence of a greater range of choices in the consumption basket.

1.3 The *conventional* NZ model and the complex world

Under the baseline model of tenure transition people progress from the parental home, via the rental market, to the final stage of home ownership. The baseline model, with home ownership as the top of the tenure ladder has exercised a strong influence on NZ's housing policy. In this context we observe:

- although the housing career¹ is portrayed as linear, in practice, it may move in a number of directions.
- the housing choices facing those in the 18-40 age group are becoming more challenging because of the myriad of factors now in the tenure choice-set.
- ostensibly, the conventional model of housing transition may be weakening as home ownership for many in the 18-40 age group:
 - * appears unattainable financially.
 - * becomes less important as family formation is delayed.
 - * is (relatively) less preferable given the widening range of other consumer items/goods/services entering the potential 'consumption basket'.

In our view in developing a housing research agenda it is important not to take assumptions from the housing careers of one generation into another. As has been highlighted in this report the context facing the current 18-40 year old group is very different to the context within which tenure choices were exercised by the same age group in previous decades.

Just as the concept of a long-term stable employment position ('career') has lost much of its relevance in today's dynamic (and global) labour market, and the nuclear family is only one model among many household structures, the conventional NZ model of tenure path (or housing career) appears to be becoming more diverse.

¹ Analogous to a 'career' in the labour market context - a la an individual moving up an occupation/profession job ladder. We take care in adopting such a term - as its implicit acceptance of the conventional housing model may unduly limit the scope of any analysis. This term, however, is useful to convey the framework of related but sequential, decision stages.

1.4 Improving our knowledge

We make three key observations about our current state of knowledge:

- information about housing tenure *options* and relative affordability is well developed, collated and available;
- information about the *transition* amongst these options is much less developed; and
- information about *pure preferences* is sparse.

Such information is necessary to recognise that transition choices do not occur in isolation to other choices faced by today's 18-40 year old. Noting the existence of these other choices and investigating their place in the decision process will enable a robust context to be assigned to the role of financial circumstances in tenure choices.

Arising from these observations we outline in section 6 five housing research topic areas:

1. testing the *conventional NZ* model.
2. testing the *relative* importance of the three influences (financial circumstances, household formation and preferences).
3. testing *when* tenure choices are made.
4. testing the *renting* option.
5. modelling - *microsimulation* techniques.

Overall the proposed research topics are intended to complement the broad direction set out in the *Building the Future: Towards a New Zealand Housing Strategy* by providing a sound empirical foundation that will ensure policy initiatives and interventions are related to the realities of the housing market. In this connection it is perhaps pertinent to note that one of the nine principles included in that discussion document was:

“Evidence-based: housing policy and interventions should be informed by solution-focused, evidence based research.”

Consequently, we also identify priority data (ref sub-section 6.8) requirements to enable robust research studies to be undertaken.

2 Introduction

This report examines the factors, in particular financial circumstances, influencing the tenure choices of the 18-to-40 year-old population cohort. The aim is to generate a set of housing research topics relevant to the issue of how financial, and other circumstances, influence tenure choice.

The 18-to-40 year-old age range is a period of young adulthood, transition and *coming of age* not only in terms of housing but also of other life events such as entering the labour market and household formation.

Those in the age group 18 to 40 will have been born between 1964 and 1986. Thus it will include that cohort described by social commentators as *Generation X*. Rather than apply a label it is important to recognise that those who are 40 are unlikely to share the same housing experience and context as those who are 18.

Through developing a research agenda in the area of tenure choice, policy makers will be better informed on the forces shaping the New Zealand housing market and the issues that households face in meeting their housing needs.

2.1 Methodology

Decisions on housing tenure reflect a complex and inter-related set of factors. The range of variables influencing tenure choice is broad and includes household status and financial circumstances, as well as preferences. Isolating and accurately assessing the impact of particular variables requires an economic modelling approach that is outside the scope of this report. In this report the approach used is to map out, and briefly comment, on the key variables that impact on tenure choice at pivotal points with a view to exploring their significance from a housing policy perspective.

This report does not purport to provide a general model of the NZ housing market but aims to identify research topics that would be of particular valuable in terms of their:

- contribution to improving understanding of tenure transition and choices
- relevance to (potential) policy implications or interventions

Information on tenure choice has been gathered through a review of relevant written material as well as through interviews and consultation with individuals involved in

housing research and policy development. This information has been used to inform and guide the findings in this report.

As was envisaged the original work plan for this project a range of New Zealand and international material relating to tenure choice has been explored through the course of this study. However, the scope of the literature review has necessarily been targeted and selective, rather than comprehensive. No short report can comprehensively cover all aspects of the material on tenure in a subject as diverse as housing. Material that is considered to be of particular value (whether in terms of its relevance to the New Zealand context and/or to central policy issues) is set out as a bibliography to this report.

2.2 The general housing context

In this section we outline the current general contextual environment facing the 18-40 year old group in terms of meeting their housing needs. The aim is to highlight a set of general environmental features that set the scene for a detailed examination of tenure issues.

Census data on tenure confirms a long-term trend towards declining home ownership rates. From being a country with one of the highest rates of home ownership (74% in 1991 - having progressively risen from about 65% in 1956) the proportion of dwellings that are now owner occupied has declined progressively to 68% in the 2001 census.

Although less than in many OECD countries, house price inflation in NZ has been considerable in recent years. NZ's median house price reached \$240,000 in March 2004. House price inflation has shown significant regional differences with generally the main metropolitan areas and coastal property showing the biggest rises.

There has been a large expansion in the numbers participating in tertiary education. Since the early-1990s a user pays approach to funding has applied in tertiary education and, in aggregate, student debt has accumulated to around \$7 billion by early 2004.

There has been widespread availability of consumer credit on relatively low interest rates resulting in large aggregate increases in household indebtedness.

Supply and demand conditions in the residential property market have been affected by strong investment in residential property for rental rather than ownership purposes.

Globalisation and deregulation of the labour market has changed the nature of employment in many sectors - with long-term security of employment no longer prevalent. Despite the labour market strength in recent years there has been a trend towards self-employment and part time positions with more emphasis on mobility and flexibility even for those in permanent and full-time employment.

Housing expenditure decisions are being made in a context of increased competition from other demands on disposable income including the availability of a much broader range of consumer items such as travel and communication technologies. In addition, earlier NZ government funded schemes which used to assist first-home buyers have largely been abolished. While robust measures of inequality are difficult to construct, perceptions of growing disparities in income and wealth continue.

Furthermore, NZ is becoming more demographically diverse. This suggests that care needs to be applied when extrapolating the housing preferences of previous generations into the current 18-40 cohort.

3 The housing model

In the course of a lifetime individuals exercise tenure choice on a number of occasions commencing with the decision to leave the parental home. The specific pathways that are taken to meet housing needs will reflect individual circumstances. Nevertheless it is possible to distinguish broad patterns of tenure choice and transition for the purposes of housing policy analysis.

The pattern of tenure choice adopted over a lifetime can be seen as constituting a “housing career.” This concept is useful in that it allows an exploration of the underlying factors that influence tenure choice over an extended period.

This report uses a simplified model of the housing career as its baseline or reference model to explore the dynamics of tenure transition. The simplified model is based around the following broad tenure choices:

1. Leaving the parental household
2. Accessing the rental market - private or public
3. Home ownership

3.1 The *conventional* NZ model

Under the baseline model of tenure transition people progress from the parental home, via the rental market, to the final stage of home ownership. The baseline model, with home ownership as the top of the tenure ladder has exercised a strong influence on NZ’s housing policy. However, this has never been a universal model and, even when home ownership was at its peak, significant numbers of households did not achieve home ownership, either through choice or the constraints they faced.

Although the housing career is portrayed as linear, in practice, it may move in a number of directions. For example, individuals may return to the family home and homeowners may revert to renting. Rather than the housing career being likened to a ladder, for some households snakes and ladders may be a better analogy.

Within the broad pattern of tenure transition there are numerous possible permutations of renting or ownership. Individuals and households may take a number of paths and they may also retrace tenure steps in the light of changing circumstances.

In the NZ context, progression to home ownership has been considered as constituting in some respects an *ideal* or desirable tenure path – and more generally has been seen as a foundation element of the NZ lifestyle. The significance of the home ownership aspiration is one that NZ has shared with Australia, USA, UK and Canada.

This report attaches no value judgement to a particular tenure choice. In particular, we do not presume one type of tenure to be inherently superior or more desirable to another. For example, there is no implication that home ownership should be seen as the culmination of a housing career.

The focus of this report is on the housing career choices for the 18-40 year olds. The boundary point of 40 has been selected as a convenient cut off point to limit the scope of this report and has no intrinsic significance. Clearly, tenure choices continue to be made after 40 into middle age and beyond in response to a range of factors including retirement from employment, changing family size and lifestyle. Tenure choices prior to age 40 will be influenced by expectations and prospects for the post 40 year old period.

When applying the concept of a housing career it is important to acknowledge that discrete, and generally unpredictable, life events such as illness or permanent disability can significantly impact the course of a housing career and associated tenure choices. For purposes of clarity in this report we consider the general case only. In addition, this report does not cover the situation of those who may be termed the housing ‘marginalized’, that is those who are either homeless or require specialised housing and/or institutionalised support.

The theoretical outlines covered in the sub-sections 3.2 and 3.3 below are presented to assist in structuring thoughts and also to providing a robust foundation for the discussions in subsequent sections. In common with many theories, the theory is necessarily simplified and abstract. However, it is designed to force explicit identification of assumptions that are critical to any derived conclusions. In this manner such assumptions can then be open to scrutiny and be tested - as opposed to being (unknowingly) hidden.

3.2 Housing and other goods - theory

From a theoretical base, the trade-off between spending on housing and spending on other items in the consumption basket follows from the neo-classical theory of

consumer choice. The outcome of such a trade-off is determined as a result of the interaction between an individual's *preferences* (tastes) and their *budget constraint*.

Diagrammatically, this model of consumer choice is depicted in Figure 3.1. The axes of this diagram represent increasing quantities of each good (for simplicity, there are two goods - housing and other) to be consumed. This model can be interpreted as follows:

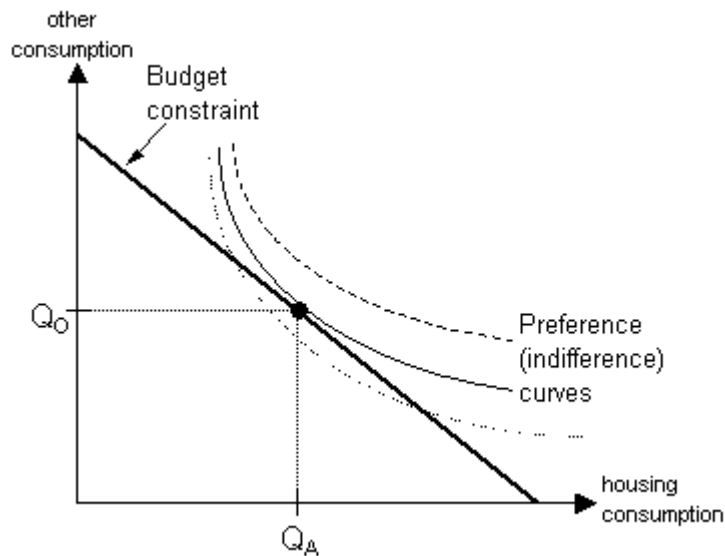
- an individual's (or household's) *preferences* reflect the desire to consume a combination of housing and other goods. Furthermore, this preferred combination varies as more housing is consumed, and the ratio at which housing is willingly *swapped* for other goods also varies.
 - * this ratio is reflected in the diagram as the slope of the preference curves shown. The preference curves themselves represent combinations of housing and other goods that jointly provide the individual with the same level of preference (or utility²). The higher the preference curve indicates a higher level of satisfaction (eg the dashed curve shown), while shifting along one curve represents different combinations of housing and other goods that provide the same level of satisfaction.
- an individual's (or household's) *budget constraint* is determined by the combination of available income as well as the prices of housing and of other goods.
 - * the triangle, that is bordered by the two axes and the solid straight line, depicted in Figure 3.1 illustrates the combinations of housing and other goods that are available to be chosen.
 - * the budget constraint will expand outwards as the income increases - thereby expanding the choice-set to encompass more possible combinations of housing and other goods.
 - * the budget constraint will also change where there is a change in the price of housing relative to the price of other goods. Such a change will alter the *slope* of the budget constraint. For example, a fall in the price of housing - relative to the price of other goods - would 'flatten' the budget

² Economic jargon - but, for argument's sake, interchangeable with 'satisfaction'.

constraint, bringing more 'housing-intensive' combinations into the available choice-set.

Given the depicted set of preferences and set of budget constrained choices, this individual will choose to consume Q_A units of housing consumption and Q_O units of other goods. This represents the combination housing and other goods of highest preference (satisfaction) that is available to the individual - ie. that is within its budget constraint.

Figure 3.1 Choosing between housing and other consumption



The key aspect of this theoretical model - in the context of this study - is to reinforce the argument that the choice between housing and other goods depends on the *interaction* of:

- preferences
- income available
- price of housing relative to price of other goods

If any one of these three influences alters then the chosen quantity of housing to be consumed (Q_A) will also change. Conversely, a change in the chosen quantity of housing to be consumed could arise from a change in one (or a number of combinations of all) of the three identified influences.

Note, however, that at this level, the issue of tenure is subsumed in the assumption that the individual (or household) is agnostic between ownership and renting. Indeed, pure theory would assert that the market mechanism would - in the absence of externalities and the presence of full information to all participants - make the costs of renting equivalent to that of ownership.

However, the two critical assumptions are (arguably) easily contravened in the world outside the textbook. The primary externality entering the housing market is the need for a minimum required quantity to be consumed by each individual (household). Without this minimum being consumed, external costs to society - for example, health, social exclusion, crime - would (again, arguably) accumulate. Such an externality is likely to tilt the returns to ownership versus that of renting away from the theoretical market-driven equality.

Similarly, full information is not available to all participants. For example, the presence of uncertainty clearly impacts on assessment of lifetime streams of mortgage compared to rental payments. This aspect could also shift the actual outcome away from the theoretical market-driven equality.

In summary, the neo-classical theory of consumer choice is helpful insofar as it potentially identifies the inter-related set of influences that impact at the high level choice between housing and other goods. It also provides the rationale for pursuing investigation of the rental versus ownership options in that the presence of market imperfections (eg externalities and uncertainty) can easily be identified³.

3.3 Housing tenure options - a simple model

In terms of housing alternatives Figure 3.2 presents a simplified model of the tenure choice set - still at the high level. Working through this model, even at its simplified version, clearly illustrates the complexity of the issue. As a starting point, we group the many influences that enter into the housing nexus into three broad categories:

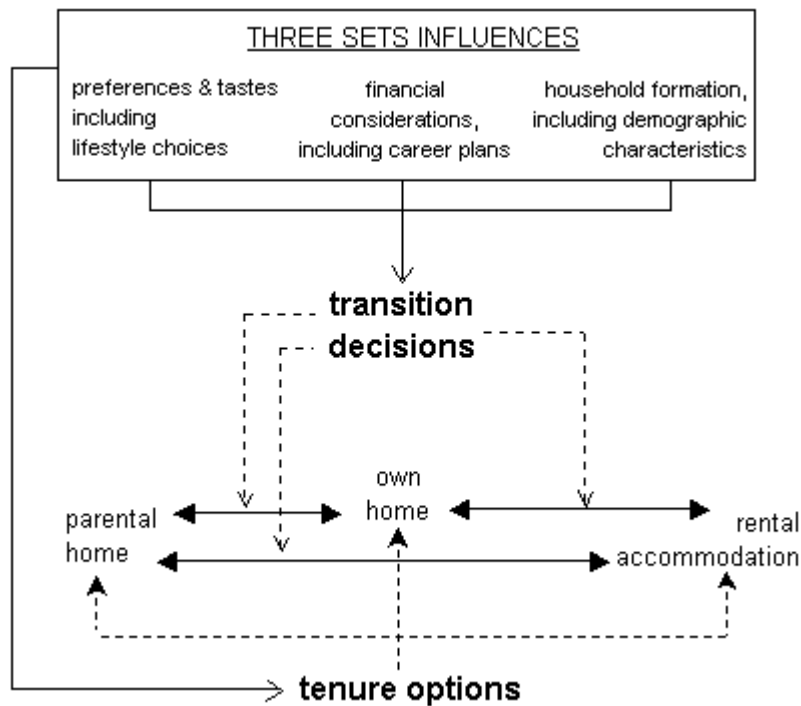
- i) financial and/or affordability - including current and expected income, savings, current wealth/indebtedness (including student loan

³ Another aspect in this theory that reduces its applicability to housing choice, is the 'bulky' nature of the commodity. In a technical sense, this feature can make the preference function discontinuous (ie. not a smooth line as drawn). In such a case the outcome can not be necessarily guaranteed as the 'optimal' preferred combination of goods.

obligations), access to finance/credit, employment and security thereof, housing assistance schemes, investment and lifetime wealth accumulation expectations.

- ii) demographic aspects - including changing household and family formation behaviour, as well as the changing composition of households.
- iii) preferences - including changing lifestyle, aspirations and the existence of a greater range of choices in the consumption basket.

Figure 3.2 Influences, options and transitions



These sets of influences can be viewed as combining (in varying degrees of relative importance) to impact on decisions to *transition* from one tenure form to another. In this simplified, high-level, structure we suggest three tenure options - namely, parental home, renting and own home.

Note, critically, that for the 18-40 year old cohort we believe:

- the transition decisions between these three options are in all possible directions.

- the three sets of influences also impact (again, with varying degrees of relative importance) on the actual housing options open to the individual or household.

In relation to the diagram there is little empirical data on the dynamics that underlie the pivotal points of tenure choice. For example, there is a paucity of information on when individuals leave the parental home and whether those patterns may be changing. Similarly, in NZ there is no comprehensive data on first homebuyers and what motivates their tenure choice.

In particular, information on the relative importance of each of the three sets of influences at various stages (pivotal points) remains to be quantified in a robust and rigorous manner. To obtain such robust and rigorous information requires a clear understanding of the consumer choice model. It is insufficient to ascertain whether a household would prefer to rent as opposed to own, without determining the other options they may also prefer (eg food, transportation, holidays). Thus, what may be thought to be a financial constraint on a rent versus ownership decision might well reflect a tighter constraint on other items in the household's consumption basket⁴.

Sections 4 and 5 provide further detail on the group of influences as they apply to some of these transition decisions. As a consequence, we also discuss the range of issues and information requirements that arise.

⁴ This is not to deny that financial constraints have an influence on what choices are made. This is precisely the foundation of the choice theory as depicted in Figure 3.1 and the associated commentary stressing that it is the *interaction* of the budget constraint and preferences that determine the choice that is made.

The point here is that such preferences have to be ascertained *separately* from financial considerations. That is, what are the pure preferences of the household? By definition there will be many combinations of these preferences that will be unattainable (as depicted in Figure 3.1, these lie outside or beyond the budget constraint). If such pure preferences are not separately ascertained, the impact of financial considerations will also not be able to be separately identified.

4 Deciding to move from the parental household

For those in the 18-to-40 year old cohort, the decision to remain or leave the parental home is the first significant tenure choice individuals make. It is, in many cases, the first step towards independent living. During the transition to independent living, however, there may be a period of churn. This aspect is explicitly noted in Figure 3.2 above by the two-way direction of the arrows. Accordingly, this step may be provisional or tentative with the possibility of returning to the family home if circumstances make this appropriate.

Overall, the decision to leave the family home is influenced by changing preferences and household status and is bounded by financial considerations that limit the range of available housing options. Again, this model mirrors the consumer choice structure described earlier (ref section 3.2 above) by emphasising the inter-relationships amongst the groups of influences. While individuals may not explicitly calculate the cost-benefit of the case for leaving in comparison with remaining, the decision will explicitly consider (or *factor-in*) a range of relevant considerations from each of our three identified groups of influences. Furthermore, there will be varying degrees of importance attached to each group - depending on the unique situation facing each individual.

4.1 Financial considerations

Some international studies have endeavoured to examine the relationship of the parental home leaving decision with household formation and labour supply choices. For example, a study in the USA based on the 1987 National Longitudinal Survey of Youth (which was filled out by respondents aged 22 to 29 years old) showed that young adults' decisions whether to live alone (single/married), or to cohabit with parents or other adults is influenced strongly by potential earnings and housing rental costs.

A move into independent living presumes the availability of an alternative type of accommodation that is affordable. An important consideration in this tenure choice is the price of living at home (often at a low or nil rent) relative to alternative accommodation. Generally, remaining in the parental home is a cheaper option - in a pure financial sense - than independent living.

Clearly, labour market opportunities are important in that their existence shifts out the budget constraint - thereby expanding the combination of goods (own housing,

rental, parental, other goods) available. Obtaining paid employment may facilitate a move; conversely, lack of employment may defer the transition. On the other hand, participation in study rather than the labour market may reduce the combination of goods available to choose from (ie contract the budget constraint).

However, it is important to note that employment and/or study status will also impact on the relative importance of financial considerations within the overall decision criteria. This is because of the potential relationship between lifestyle/preference factors and education/study status, as well as the likely relationship between household/family formation decisions and such status.

Some young adults (implicitly or explicitly) could take a human capital approach to their choices. From this perspective further education is seen as an investment and as a strategy for securing well paid future employment. In such a model, decisions as to housing options could well be subsumed by (or be of secondary importance to) other perceptions concerning lifecycle income.

It is pertinent to note here the issue of student debt. An individual's debt obligations are potentially a primary factor within the financial considerations sub-set of influences. Furthermore, this issue could also transcend the employment versus education status of the individual if lifecycle income is prominent amongst an individual's decision criteria.

Housing has certain fixed attributes - kitchen, bathroom and toilet, associated appliances and facilities. Therefore the economic costs of owner-occupancy are typically lower if they are spread across more people - eg. a family unit. Or, single-person households can combine with others to share such costs. Where this is an option, it has the effect of (potentially) relaxing the budget constraint facing the individual. For this reason, for many young New Zealanders their first tenure transition is to shared rental 'flatting'.

4.2 Preferences and tastes

A decision to leave the parental home is likely to encompass - at least, in part - a preference to live independently. Assuming that the move is not motivated by factors such as overcrowding or other distress, personal attitudes to independence and security will shape the move away from the family home.

However, if living at home is either free or highly subsidised this presents an opportunity to accumulate capital for a future move into the housing market or to achieve other life goals such as education, travel or acquiring consumer goods including individual means of transport. In comparison to earlier generations, the basket of goods from which to choose preferred combinations is (arguably) much wider. In terms of the textbook model, this has the impact of (all else remaining unchanged) increasing the rate at which substitution between housing and other goods could be preferred. In such a case, the wealth and/or income of parents becomes a factor in influencing the timing of the move from the parental home, as this has the impact of increasing the relative importance of preferences and tastes within the three sets of influences identified.

As noted above, in many cases educational status is a factor linked to the decision to remain in the parental home. Institutional accommodation provides an initial, and relatively riskless, move into independent living. For others, often the key aspect is the desire to cohabit with a partner in a separate dwelling. In general, wider lifestyle preferences all accumulate to impact - to more or lesser degree - on tenure options available as well as transition decisions.

4.3 Household formation

Household and family formation is another aspect with many and varied factors contributing to the set of influences acting upon tenure options and transition decisions. In the context of this study, the on-going changes in family formation and associated demographics are central to the understanding of the relative importance of this set of influences.

Not only are the well-documented declining rates of marriage and delayed family formation relevant. The differing composition of family arrangements - with generations spanning more than the traditional 20-25 years, as well as the older life expectancy of older generations - is also important to note. Not only may these potentially impact on expected lifetime income/wealth - in terms of inheritance expectations - but also these, in turn, can impact on whether and/or when to begin families. In turn, such decisions will also be influenced by competing preferences as the myriad of other goods (and experiences) compete for their share of the individual's preferred combination of goods to consume.

4.4 Potential issues for investigation

There is little data about trends in relation to leaving the parental home, for example in relation to:

- the average age at which people leave home for the first time and whether this is changing.
- is there any significant difference between the genders in this behaviour?
- whether there are significant ethnic or cultural factors that influence the decision to leave home.
- whether there are any significant barriers that inhibit young adults from leaving parental homes.

Generally there is a need to get a clearer focus, supported by empirical evidence, on motivation for the decision to leave the parental home. Ideally, this would take the form of a longitudinal analysis, measuring the changes in tenure arrangements every say, 2 years, that follows a group of young adults through leaving home and through the initial steps in the process of household formation.

5 Deciding between renting or home ownership

After leaving the parental home three options are available:

- to move into the rental market.
- to purchase a home.
- to return to the parental home.

This section of the report takes an exploratory look at the factors that drive housing choices between rental and home purchase through time.

Many interrelated factors affect the relative costs and benefits of renting or home ownership and the financial capacity of households to make choices within these categories. These factors impose the parameters that determine whether or not a household enters into home ownership. The factors include interest rates, property values, the cost of renting, and the ability of a household to save a deposit and to meet ongoing repayments. The ability to buy a home will also be affected by labour market changes and the level of household connection to the workforce. For example, people in part time, casual or contract employment are generally less able to make long-term financial commitments or obtain a loan than those in more long term (i.e. permanent, full-time) employment. A range of social trends, such as delaying family formation and increased participation by young people in further education and training⁵, affects the timing of first home purchase. In addition, home ownership may not be consistent with changing lifestyle choices or situations.

We retain our simplified model which breaks down the myriad of influences into three broad categories - financial considerations, household formation and preferences.

Note that in this report we do not examine tenure choice between the private and the social rental market. There is a relatively small social housing sector in NZ (approximately 6% of the national housing stock is in this type of tenure) and generally such a housing option is only available in the larger urban areas. Access to the stock of social housing is through rationing with income and other criteria being

⁵ Growing urbanisation and, perhaps, moves to allow increasing urban density may also be worthy of note in this context.

applied. The availability of social housing is unlikely to be of importance in the initial decision to leave the parental home.

5.1 Financial considerations

5.1.1 Housing mortgage affordability

In NZ, the measure of housing affordability generally used in the long run Home Mortgage Affordability Series compiled quarterly by the Massey University Real Estate Analysis Unit (MUREAU) and published through the auspices of AMP. The series uses three variables; fixed mortgage interest rates, average wages and median house prices.

The data on housing mortgage affordability shows that while rents have been increasing more slowly than house prices, both rents and house prices have been increasing at a greater rate than average incomes since 1993.

Housing affordability has been falling in recent years because of the escalation of house prices that started in late 2001 but the affordability index is still more favourable than during the 1996-7 period because of interest rates and salary increases.

What is disconcerting for those in the 18-40 age group, in terms of home ownership, is the rise house prices relative to incomes.

Housing mortgage affordability is distinguished from affordable housing. Generally the measure of affordable housing is that a household should pay no more than 30% of monthly income for housing.

5.1.2 Income

Income plays a key role in the quality and quantum of housing resource that is sought. In general the income and wealth accumulation opportunities of the 18-40 year old group have been affected by:

- the greater numbers taking some form of tertiary education has meant delayed entry to the workforce.
- the user pays approach for tertiary education has left many young adults entering the workforce encumbered with debt.

- the housing assistance programmes that targeted earlier generations of first home buyers have not been available.
- the state of the housing market has not been favourable to first home buyers since house prices have risen at a rate that has exceeded the growth in incomes for those on low to middle incomes.
- competition from older-age cohorts entering the housing market as *investors* seeking capital growth and/or income opportunities adding to demand (and so price) pressures in the residential property market.

5.1.3 Savings and indebtedness

In Australia, a 2003 research study by the National Centre for Social and Economic Modelling (University of Canberra) in collaboration with the Financial Planning Association of Australia (FPA)⁶ established that only one third of 24-34 year olds in Australia was saving for a house. In comparison a further one third were saving for holidays. We are not aware of a similar study on savings intentions in NZ. Improved information on this aspect and its role in tenure choices and transitions, reinforced by the growing significance of student debt, is clearly necessary.

5.1.4 Access to finance and credit

To exercise a preference for home ownership implies that there are no insuperable income and deposit constraints. Access to credit is usually based on capital accumulation and income level.

In the past government policy has been directed at reducing the impact of such constraints by assisting prospective home owners overcome the deposit gap. Until recently direct government support for home ownership was confined to small scale programmes targeted at Maori and low-income rural families.

A mortgage insurance scheme offered through Kiwibank has recently been introduced. This is intended to assist those who can sustain a mortgage to actually access mortgage finance. The programme is designed as a pilot but has generated a high volume of interest. Whether this interest is indicative of an inability to access finance from other private institutional lenders, or whether it reflects a response from

⁶ Refer Kelly S. and Toohey M. (2003), www.fpa.asn.au.

those *with a perception* that mortgage finance from this source may be somewhat easier to access and/or cheaper than other sources, remains to be assessed.

The role played by the wealth and income of parents is unclear. There is little evidence available on the role of wealth transfers in facilitating home ownership. For example how many in the 18-40 age cohort use a jump-start through wealth transfers to purchase a home?

In a related vein, the impact of student debt is cloudy. Anecdotal evidence suggests that some individuals see their student debt as automatically eliminating them from mortgage applications - while many private lenders do not (officially) state this to be the case.

5.1.5 Labour markets

Household employment status is a key variable in either facilitating housing tenure opportunities or constraining them. For example, a stable employment record is sometimes perceived as a prerequisite for obtaining long-term housing finance. This perception could well be related to the conventional NZ model of a Kiwi's housing career.

However, with intermittent career changes and sporadic employment history now well accepted as part of the labour market scene, this perception may well be outdated. Nevertheless, an individual's calculation of expected lifetime income - dependent on their assessment of short and/or long-term employment prospects - is clearly central to the financial considerations subset of influences determining tenure choice.

5.1.6 Investment expectations

Analysing motivation and decision making in respect to the rent or buy tenure choice is complicated by the fact that home ownership has both a consumption and an investment dimension.

The transition to home ownership is the most significant financial decision the average household makes. Implicit in the decision to move to home ownership is a view of the long-term financial outcome of such a choice.

Individuals are forward looking and anticipate life transitions such as new employment opportunities and retirement. Many people have seen home ownership

as the major component of their lifetime wealth accumulation objective. While currently housing is enjoying a favourable view as a store of wealth its relative risk as an asset over the longer term may be changing for the 18-40 year old group.

Housing decisions involve more than consumption. In particular, home ownership has been seen as a form of saving, and even accumulating wealth for retirement. Given the relatively favourable tax regime enjoyed by residential property this asset class been a strongly favoured investment in NZ.

User costs of housing such as maintenance, rates and insurance can add significantly to the costs of home ownership. There is no data on how well informed people are as to the actual costs and benefits of particular tenure choices. Anecdotally it appears there may be considerable lack of understanding of the mechanics of house purchase as well as the longer terms implications of this tenure choice.

An interesting feature of the recent government mortgage insurance scheme is that it embodies pre- and post purchase support that ensures that buyers are aware of what home ownership involves.

5.1.7 Role of housing assistance schemes

Housing assistance affects the relative prices of housing options. The presence or absence of housing assistance schemes can have a significant impact in terms of overcoming constraints on tenure choice and creating housing options and opportunities.

In the past in NZ there have been a variety of schemes designed to assist first homebuyers. Many of these centred on the so-called deposit gap that constrained first homebuyers from entering the market.

It has been surmised that the historically high rates of home ownership in NZ may reflect earlier government schemes intended to encourage home ownership.

In Australia the First Home Owners Grant was introduced from 1 July 2000 enabling eligible applicants to a one off grant A\$7,000. By August 2003 the scheme had assisted 482,000 applicants. The Australian government has been sufficiently concerned at the position of first home buyers to hold a Commonwealth Inquiry into First Home Ownership conducted by the Productivity Commission which reported in 2004.

A significant step back into state assistance for first homebuyers has been taken. Housing Corporation of NZ's recent mortgage insurance scheme offered through Kiwibank is being evaluated throughout its implementation and its role may be expanded in the light of experience.

It is of interest to note that in Australia where the general housing context has marked similarities to NZ, state governments in Queensland, Victoria, NSW and ACT have all introduced additional measures over the past year designed to assist first home buyers.

It would be useful to know how significant the lack of public housing assistance programmes that support home ownership is for those in the 18-40 year old group. In addition an area to explore would be what sort of targeted assistance would materially improve the tenure options open to the 18-40 cohort who aspire to home ownership.

5.2 Household formation

Behind housing choices are a range of demographic determinants. Many of the changes that have been occurring in terms of household formation can be seen as impacting tenure choice and in particular the motivation to home ownership.

5.2.1 Marriage rates

Although there was an increase in the marriage rate in the year to December 2003, which saw the highest number of marriages since 1991, the overall trend is for people to marry later and marry less. The peak year for marriages was 1971 with 27,700 marriages. The decline in home ownership appears to be linked to a decline in the formal marriage rate.

Marriage rates per thousand have declined from around 30 per thousand in the early 1980s to around 15 per thousand in 2003.

There is now a significant proportion of NZ men and women who will never marry. Divorce and separation are also significant factors because household dissolution can have a negative impact on wealth. In 2003 the provisional number of orders for dissolution of marriages granted in the Family Court was around 10,000.

5.2.2 Family size and structure

The median age for mothers giving birth has been increasing and is now around 30.3 years - up from 24.9 years in the early 1970s. The birth rate in NZ has been falling since 1990. The numbers of children per household does vary widely however - with ethnicity being an important determinant here.

The fertility rate for the 30-34 year old age group (the group with the highest rate of fertility) is 117 per 1000, with the average number of children per women now at 1.98.

In summary household formation is being impacted by a combination of trends including, but not limited to:

- delayed marriage and childbirth at later ages.
- large numbers deciding to remain single.
- increases in people living alone.
- an increased propensity for informal living arrangements.
- significant rates of separation and divorce.
- growing numbers of single-parent households.

Note some of these changes are related to the others. Thus the above list does not represent a set of mutually exclusive trends. Rather, it represents a range of trends which potentially interact with each other and consequently compound or negate each other's influences.

5.3 Preferences and tastes

Preferences expressed in the form of lifestyle, values and aspirations are reflected in tenure choices.

While traditionally New Zealanders have expressed strong preferences for home ownership as a type of tenure policy makers cannot assume this preference will remain unchanged for the today's (or tomorrow's) 18-40 cohort. In our view a set of factors affecting tenure choice can be identified that are likely to have particular significance for those in the 18-40 year old group:

- Mobility: An important consideration in tenure choice may be how quickly a particular choice can be changed to reflect income or household circumstances. If there is increased mobility among the 18-40 year olds then the transactions costs associated with home ownership become more significant for this age group and would tend to favour rental tenure. Transaction costs tend to be higher for owner-occupiers compared to renters, encompassing search costs, legal, real estate and mortgage fees, as well as builders and valuation reports.
- Uncertainty: In exercising tenure choice individuals are faced with taking a view of their future. In particular, their decisions are likely to reflect predictions of their own circumstances and the broader state of the economy. In this connection, changes in the labour market have altered the nature of employment in many sectors. Long-term security of employment is no longer prevalent. A key consideration is the perception of uncertainty. The greater the investment and commitment associated with a tenure choice the more significant a role uncertainty is likely to play. Relative to renting, home ownership encompasses considerable longer-term commitment. This potentially raises the importance of uncertainty.
- Competition for discretionary dollar: Consumers face a greater array of options in the consumption 'basket' than ever. The possible uses of discretionary income are expanding at a greater rate than the growth of that income and thus housing expenditure faces more competition for discretionary spending.
- Security: Given the character of the private rental market, households concerned with long-term security and control may opt for homeownership given the character of the private rental market.

5.4 Potential issues for investigation

There is ample data surrounding household formation trends. There has also been - and continues to be - significant research and monitoring of affordability trends across New Zealand. However, little is known about pure preferences - not only in relation to home ownership versus rental, but also in relation to other goods. In particular:

- in many cases anecdotal data concludes renting is the only option as home ownership is not affordable. However, the context of the choices of other

goods in the consumer basket is not provided. An investigation that asks what are the (ranked) preferences of a group of 18-40 year olds amongst a basket of goods containing a selection of options should provide a useful insight into relative preferences of the current generation. For example the basket of goods to rank could comprise:

- * holiday abroad.
 - * repaying student debt.
 - * other consumer durables (eg TV, PC DVD ...).
 - * car.
 - * rental accommodation.
 - * own house.
 - * working holiday abroad.
 - * investment property.
 - * accumulating financial savings.
- such a questionnaire and/or focus group tool would need to ensure that all the options were suitably randomised and respondents were not prompted by external information. For example, a statement to the effect that “this survey would like to explore your attitude to home ownership” will implicitly signal a preference and invalidate any responses.
 - similarly, the supply of data concerning affordability would also invalidate the responses. This is in line with the consumer choice model depicted in Figure 3.1. Pure *preferences* need to be separated from *budget constraint* considerations in order to properly determine, subsequently, the preferred combination that is indeed within the individual’s budget constraint.
 - this tool would also be useful in identifying the relative importance of the three sets of influences. This would be achieved by ensuring the responses were accompanied by sufficient information to enable analysis across desired dimensions - eg. income, employment and study status, student debt obligations, geography (urban / rural), to capture the influence financial circumstances; age, gender, ethnicity, marriage and dependents’ status to capture household formation characteristics.

6 Priority questions for future research

All forms of housing assistance and interventions in the housing market make assumptions about the dynamics of the housing market. Such interventions should be informed by an understanding of the factors underlying tenure choice and how they are evolving. It is especially important that the understanding of those drivers reflects current realities rather than outmoded models of tenure transition.

Our initial view is that the housing choices facing those in the 18-40 age group are becoming more challenging because of the factors in tenure choice set out in this report. It appears that the general context in which housing tenure choices and decisions are being made is becoming more uncertain and that the patterns of tenure choice are becoming more diverse.

A primary aim of this report has been to generate a set of housing research topics relevant to the issue of how financial, and other circumstances, influence tenure choice. What is apparent is that there is relatively little data on the early stages of the housing careers of New Zealanders, and there is little robust information on the pure preferences of those in the 18-40 year old cohort.

6.1 Integration with Housing Strategy and policy

In developing a set of research topics for further analysis we have been mindful of the NZ Government's recently released discussion paper *Building the Future: Towards a New Zealand Housing Strategy*. This document outlines a proposed framework for the New Zealand Housing Strategy stating:

“The vision for the strategy is that all New Zealanders have access to affordable, sustainable, good quality housing appropriate to their needs.”

In addition, the document identifies nine principles that guide and influence future housing policy and activity and a further six areas for action to be the key focus of the strategy.

In view of the importance of the document in providing a basis for the future direction of housing research and policy development, the research topics put forward in this report have been designed to align with the principles and areas of action. Accordingly, we have included comments under each proposed research

topic in order to clarify the linkage to the principles and action areas developed in the discussion document.

Overall the proposed research topics are intended to complement the broad direction set out in the *Building the Future: Towards a New Zealand Housing Strategy* by providing a sound empirical foundation that will ensure policy initiatives and interventions are related to the realities of the housing market. In this connection it is perhaps pertinent to note that one of the nine principles included in the discussion document is:

“Evidence-based: housing policy and interventions should be informed by solution-focused, evidence based research.”

6.2 Criteria for research priorities

Given the large range of possible issues to examine a method of filtering potential topics is required. In selecting candidate topics for research the following general criteria have been applied:

- the relevance of the topic in terms of the NZ Housing Strategy.
- the potential of the issue to inform and add to understanding of housing policy.
- the consensus view of the importance or significance of the issue among those involved with developing housing policy.
- whether the issue covers a gap identified in existing knowledge.
- the feasibility of applying research to the issue.
- the potential to draw on a range of pertinent overseas work to inform the topic.

6.3 Topic 1 : testing the conventional NZ model

The baseline model of housing transition culminating in home ownership appears to be becoming less dominant in the 18 – 40 age group for the combination of reasons covered in this report. Empirical evidence is required to confirm whether this hypothesis is the reality.

In terms of housing tenure it is important to distinguish temporary influences from longer-term trends. A research study is needed to determine whether current trends reflect a deferral of the traditional housing model by households or a more profound and permanent shift in housing tenure choice. Key questions are:

- is the apparent breakdown of the conventional NZ model a shift in timing (ie individual's delaying their progression up the ladder) or a long-term structural behavioural change?
- what influence potentially has the greatest impact to further change the structure of the conventional Kiwi housing career?
- do the 18-40 year old cohort view home ownership as an inherently preferred option to renting?

From a policy perspective this topic is a critical area for further investigation. In a period of change and uncertainty the risks of policy makers missing fundamental shifts in behaviour, expectations and aspirations are heightened. In such an environment policy is better placed to successfully achieve intended outcomes when the fundamental drivers and dynamics of behavioural changes are investigated, monitored and understood on an on-going basis.

The discussion document recognises this through one of its stated principles:

“Anticipating change: changing patterns of housing need should be anticipated and responded to.”

6.4 Topic 2 : testing the *relative importance* of the 3 influences

Distinguishing the relative impact of the factors in tenure choice presents considerable difficulties. Structured research is needed to establish which factors from the range of financial, household formation or changed preferences are most influential in shaping tenure choice. Key questions are:

- what are the *pure preferences* (ranked) of the 18-40 cohort when faced with a basket of consumer options?
- what predisposes those in the 18-40 age group to particular housing choices?
- how do those in that age cohort view the available tenure options?

- how well informed are those in the 18-40 age group on the costs and benefits of particular tenure choices especially the renting relative to home ownership?
- what tools could be developed to better inform people of the implications of the difference tenure choices?

From a policy perspective, this will generate information and insights into the actual housing decision process that households apply. The research will allow the consideration households apply to tenure choice and the relative importance they attach to the different factors to be distinguished. This information is related to the action area identified in the discussion document as:

“Developing and delivering innovative programmes to improve access to home ownership by lower-income households.”

A clearer picture of what actually facilitates and increases the housing options that are available and what constrains choices will result. In this way, the ability of policy to achieve intended outcomes will be increased.

6.5 Topic 3 : testing *when* tenure choices are made

There is little data on when tenure choices are being made and what underlies them. Longitudinal surveys follow individuals in a cohort and allow the impact of household formation events and financial circumstances to be tracked over time.

While they involve significant cost, consideration should be given to undertaking a longitudinal survey of how an age cohort’s tenure decision making is affected over time as a result of family formation and other changes.

Such a survey would generate insights and information on when tenure transition occurs and what drives choices, such as leaving the parental home, and how those drivers may be evolving.

Key questions:

- what is the average age at which people leave home for the first time and is this changing?
- what is the average age of the first-home buyer?

* other economic/demographic characteristics of the first-home buyer.

This research can be seen to support the following action areas:

“Developing and delivering innovative programmes to improve access to home ownership by lower-income households.”

“Building capacity and capability in the housing sector to better respond to diverse housing needs.”

Implicit in these action areas is the ability to follow the dynamics of households as they seek to meet their housing needs over time - as well as identifying what factors drive their choices. In addition, as NZ society becomes more diverse it is increasingly important that robust data be used to inform the policy process- thereby also limiting the need to adopt assumptions.

6.6 Topic 4 : testing *renting* options

Faced with declining home ownership rates the efficiency of the rental housing market assumes greater importance in terms of NZ’s overall housing market because more New Zealanders will be relying on it to meet their housing needs.

This has implications for the future focus of housing research and the relative priority attached to renting as opposed to research into home ownership issues. Of interest here also is the participation of the 18-40 cohort on *both* sides of the rental market - ie. tenant and property investor. There is a case for a study to widen our knowledge of the availability of renting options, the participation of the 18-40 age group in the rental market and the preferences of these participants. Furthermore, the interaction of this participation in the light of their longer-term housing aspirations (if any) would shed light on the shape of the overall housing career that is now evolving.

The rental market has received relatively less research attention and its growing size and significance suggests an increasing need for research here. In a similar vein, policy specifically directed at the private rental sector is likely to be of increasing importance. The Housing Strategy discussion document acknowledges the following action area:

Improving the capability of the private rental sector to provide secure, decent housing to all tenants.

6.7 Topic 5 : modelling - *microsimulation* techniques

To explore wider ownership/rental implications of housing policy and/or behavioural changes consideration should be given to the construction of a microsimulation model of housing tenure choices⁷. This modelling technique mimics the decisions of individuals (households) at appropriate stages of career and depicts the outcome.

Given some age- (and other characteristic) -specific probabilities at the numerous decision points within the career cycle, the sets of influences that determine tenure choice can be constructed and quantified. Amongst the age-specific probabilities that need to be input⁸ (or can be assumed) are:

- probability in study.
- probability in employment.
- probability of marriage.
- probability of children.
- probability of purchasing own house.

The advantage of this type of model construct is that it enables sensitivity tests to be performed. For example, changes in the outcome (ie. the numbers in the population renting and the numbers residing in their own house) can be simulated for different assumptions as to the various probabilities. These assumptions can be assigned to policy induced, demographic and/or social behavioural changes.

While any microsimulation structure would be ‘data hungry’, it is important to recognise quantitative data remains the lifeblood of most informative research. This therefore is an appropriate time to note some priority data required to be gathered to enable a more clearer understanding of housing tenure choices in New Zealand.

This research topic has been proposed because of its potential to contribute to a wide range of housing policy issues. It would give researchers the opportunity to model

⁷ McDonald P (2003) outlines a similar approach to address the question of whether “... observed housing tenure trends might be explained by deferral of home ownership rather than by lifetime non-achievement”.

⁸ Some of these *probabilities* can be derived from Census data for appropriate sub-groupings of the population. However, the key data relating to the characteristics of those entering home ownership for the first time remains to be collated. Section 6.8 refers.

policy interventions and their impacts, as there is limited scope to pre-test policy in the housing market itself.

Despite its initial cost, once developed and maintained, appropriate micro-simulation and modelling could assist policy makers with a wide range of housing questions.

6.8 Priority data

Census data does provide aggregate data on types of tenure but is of very limited value in illuminating the dynamics of tenure choice. For this reason the following information would be particularly valuable in the context of understanding tenure choice:

- at what age (on average) do people leave the family home?
 - * what is the trend on leaving the family home?
- what is the first tenure choice after leaving home?
- what proportion of house sales are to those buying or building their first home?
 - * how has that series been trending?
- key data on the first-home buyer:
 - * what is the average age of the first-home buyer?
 - * household composition - single, couple, couple with family, other?
 - * income distribution.
- financial arrangements and data relating to first-home buyers:
 - * proportion of new mortgage advances that are to first-home buyers.
 - * proportion of disposable income being committed to service housing loan.
 - * proportion of annual income being committed to repay housing loan.
- what types of houses (size, rural/urban, price range) are first home buyers purchasing?

7 Conclusion

As was going to be the case for a study designed to outline a set of research projects, this report raises more questions than it answers. The suggested priority topics for further research have been selected because of their potential to contribute to a national housing research agenda as well as a wider understanding of the tenure choices being (and about to be) made.

In our view in developing a housing research agenda it is important not to take assumptions from the housing careers of one generation into another. As has been highlighted in this report the context facing the current 18-40 year old group is very different to the context within which tenure choices were exercised by the same age group in previous decades.

Just as the concept of a long-term stable employment position has lost much of its relevance in today's dynamic (and global) labour market, and the nuclear family is only one model among many household structures, the conventional New Zealand model of tenure path (or housing career) appears to be becoming more diverse.

Three key observations have arisen:

- information about housing tenure *options* and relative affordability is well developed, collated and available;
- information about the *transition* amongst these options is much less developed; and
- information about *pure preferences* is sparse.

Such information is necessary to recognise that transition choices do not occur in isolation to other choices faced by today's 18-40 year old. Noting the existence of these other choices and investigating their place in the decision process will enable a robust context to be assigned to role of financial circumstances in tenure choices.

In a period of change and uncertainty the risks of policy makers missing fundamental shifts in behaviour, expectations and aspirations are heightened. In such an environment policy is better placed to successfully achieve intended outcomes when the fundamental drivers and dynamics of behavioural changes are investigated, monitored and understood on an on-going basis. The areas of housing research we suggest in this report are important from theoretical, empirical and practical

standpoints to understand the changing dynamics of tenure transition and so assist the policy debate and decision makers being better placed to indeed achieve their intended outcomes.

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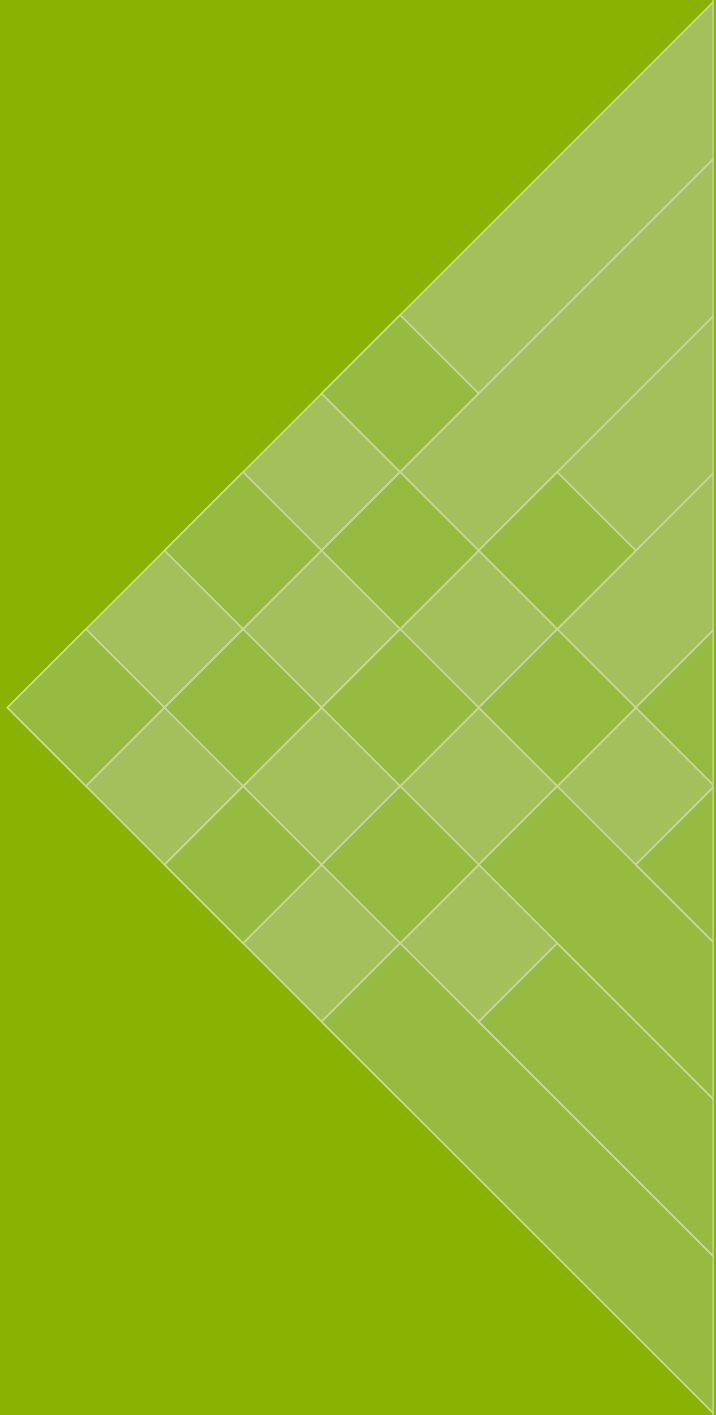
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