Autumn 2023

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HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance

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International Union for Housing Finance

Housing Finance International

Housing Finance International is published four times a year by the International Union for Housing Finance (IUHF). The views expressed by authors are their own and do not necessarily represent those of the Editor or of the International Union.

ISSN: 2078-6328
Vol. XXXVIII No. 1

Contents:

➔ **Subscriptions:**
Individual Regular Annual Rate €135;
Individual Three-Year Discounted Rate €360.
Institutional Regular Annual Rate €155;
Institutional Three-Year Discounted Rate €420.

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The housing affordability crisis in Australia in a context of high interest rates

↳ By Alan Morris

1. Introduction

There is consensus that Australia has a housing crisis. Media stories on the present state of housing in Australia are regularly accompanied by the word crisis. Some recent examples include 'Vacancy tax could improve Australia's housing crisis but isn't the only solution, expert says' (Nichols & Smithurst, 2023); 'How to solve Australia's housing crisis' (Richards, 2023); 'Housing crisis: Australia faces 106,000 homes shortage by 2027' (Sharples, 2023). An article in the daily broadsheet, *The Sydney Morning Herald*, concluded,

> So serious are the [housing] problems that there are fears Australia could become a "Jane Austen world" where wealth will be determined by a parents' housing portfolio, and people are forced into choosing between buying a home and having children (Wright et al., 2023).

In mid-August 2023, the Prime Minister, Anthony Albanese, called a meeting of the national cabinet to discuss ways to resolve the housing crisis. The national cabinet is constituted by the prime minister and the premiers of all the states and territories[1]. An increase in supply was touted as the solution and there was agreement to set a target to build 1.2 million homes over the next five years.

The crisis has four primary features – high levels of mortgage stress, high levels of rental stress, a drop in home ownership and increase in long-term or even lifelong renting and an increase in homelessness and the number of households in marginal housing. Importantly, the crisis is a fundamental contributor to the already significant wealth and income divide (Morris, 2023). A key factor that has intensified the crisis has been the increase in interest rates from 0.1% in November 2020 to 4.1% in June 2023. The article scrutinises the role of the increase in interest rates. The four features identified are discussed in turn and the contribution of the crisis to the growing wealth and income divide is then examined.

2. Mortgage stress

The 2021 Census found that 35% of households (approximately 3.43 million households) are homeowners with a mortgage[2]. A recent study concluded that in mid-2023, 1.43 million (28.7%,) of mortgage holders were at risk of mortgage stress and that the number of households in mortgage stress had increased by 539,000 in the year to June 2023. At risk was defined as mortgage holders who were having to use 25% to 45% of their after-tax household income to pay the mortgage. The same study concluded that 19.6% of mortgage holders are 'extremely at risk' (Roy Morgan, 1990 to 2023). Households were classified as extremely at risk if the monthly payments on the interest only component of the repayment were over a certain proportion of household income.

The primary reasons for the considerable increase in mortgage stress have been the constant house price increases over the last three decades, the dramatic rise in house prices in 2021 and interest rates on loans since May 2022. The increase in the interest rate from 0.1% in May 2022 to 4.1% in June 2023 (the rate was still 4.1% in September 2023) has occurred in a context where over the last three decades increases in house prices have constantly outpaced inflation and wage increases. Pawson et al (2020) estimate that between 1990 and 2020, house prices trebled (adjusted for inflation) whereas real earnings increased by around 50%. This has meant that historically most first-time homeowners have had to take out substantial mortgages.

On the 3 November 2020, in response to the economic crisis precipitated by the pandemic, the Reserve Bank of Australia (RBA) reduced the cash rate to 0.1%. Throughout 2021, Philip Lowe, the then governor[3] of the RBA, insisted that interest rates would remain close to zero until at least 2024. For example, in March 2021, in response to speculation that interest rates may start to rise, he insisted that it was 'not an expectation that we share'. He went to state that '… that the cash rate is very likely to remain at its current level until at least 2024' (in Wright, 2021). The then governor's constant refrain that interest rates would remain close to zero for some time, had a profound impact on the housing market. Thousands of households decided to purchase a home, premised on the belief that interest rates will remain low for a number of years and that they would therefore be able to manage the mortgage repayments and not be dependent on the lightly regulated and thus insecure private rental market. Thus, despite the pandemic, demand for residential property soared and house prices rocketed. In the year ending December 2021, residential property prices increased by 23.7% in the eight capital cities. In Melbourne, prices rose by 20% and in Sydney by 26.7% (ABS, 2022b). The two cities account for around 40% of Australia's population. The median house price in Australia in March 2022 was $941,900. In Sydney it was $1,245,000 and in Melbourne, $930,000 (ABS, 2022c). The median weekly personal income across Australia in June 2021 was $789 and the median weekly household income was $1,770 (ABS, 2023). The main source of income was salaries or wages (56.4% of people aged 15 years and over), while 23.4% received most of their income from government benefits (ABS, 2023).

[1] Australia has six states and two territories. The federal government has the power to override laws passed by a Territory government. This is extremely rare.

[2] The 2021 Census established that there were 10,852,208 private dwellings in Australia of which 31% were owned outright, 35% were owned with a mortgage and 30.6% were rented What is perplexing is that there were 1,043,776 unoccupied dwellings on Census night (ABS, 2021). With respect to rented properties around 4% were social housing and 27% were private rental. The population at this time was 25,422,788.

[3] Philip Lowe's seven-year tenure as governor of the Reserve Bank came to an end in September 2023. The primary reason for his contract not being renewed was most probably his statements that interest rates would remain at an exceedingly low level until at least 2024. Media articles constantly labelled him 'public enemy number 1'.

From May 2022, interest rates began to increase and in June 2023, after 12 consecutive increases, the rate peaked at 4.1%. The impact on mortgage repayments was dramatic. On a $600,000 mortgage, the monthly repayments rose from around $2,185 a month to $3,559 a month (Clun & Wright, 2023). In mid-2023, the average mortgage in Australia was $580,000, which was 20.9% higher than the average in February 2020, just prior to the pandemic (ABS, 2023). In NSW, Australia's most populous state, the average mortgage was around $720,000 (ABS, 2023b). The Australian Bureau of Statistics (ABS) revealed that in the 2022-2023 financial year, mortgage interest repayments totalled $82.8 billion, which was double the amount paid in the previous financial year. In the June quarter in 2023, repayments totalled $24.5 billion. In the same period in 2022, interest repayments totalled $11.9 billion (in Wright & Clun, 2023).

In November 2022, at a Senate[4] estimates hearing, the then governor of the RBA apologised to those thousands of people who made a decision to purchase a property premised on his repeated statements that interest rates would remain low:

> I'm sorry that people listened to what we'd said and acted on that, and now find themselves in a position they don't want to be in. At the time we thought it was the right thing to do (former RBA governor, Philip Lowe, in Wright, 2022).

The increase in interest rates did put a temporary halt to the spectacular increase in house prices. From May 2022 to February 2023, house prices dropped by around 9%, but then started rising again. In the June quarter in 2023, prices rose 5.3% in Sydney and nationally, in the capital cities, by 2.7% (Razaghi & Heagney-Bayliss, 2023). A recent report (September 2023) concluded that housing affordability in Australia is now at its lowest level since at least the mid-1990s. The report revealed that:

> … a "typical" or median-income household , earning just over $105,00 a year, could afford to make loan repayments on just 13% of homes sold in the past year … [and that] even high-income households, earning $200,000 a year – i.e. earning more than 80% of Australians – are facing strained affordability (Ryan & Moore, 2023, 8-9).

An increase in demand has certainly been a key factor accounting for the price rises. After a total halt to immigration during the pandemic, Australia has embarked on a substantial immigration push. The 2022-2023 migration program involved granting 195,000 new permanent visa grants and in 2023-2024 another 190,000 will be granted (Australian Government, 2023). The tightening of the rental market and resultant increase in rents and insecurity has inspired a portion of renters to look at buying despite the state of the market and high interest rates. Many of these first-time buyers would have parents who are outright homeowners and have some capital and are in a position to assist (Ong ViforJ et al., 2022). Older homeowners who have paid off their mortgage and are wanting to downsize is another factor pushing up demand. The increased demand is occurring in a context of limited supply; between April 2022 and May 2023 there was a 23.6% fall in new housing investment (CoreLogic, 2023). The high interest rates and high construction costs suggest that the growth of supply will continue to be subdued despite the recent meeting of the state premiers and the prime minister pledging to build at least 1.2 million homes over the next five years.

Mortgage stress has resulted in an increase in distressed property listings in low-income suburbs. In Bringelly-Green Valley a low-income area in Sydney's outer west, the share of urgent listings more than tripled year-on-year to 7.3% in June 2023. In Fairfield, a Sydney suburb dominated by low-income households, 10.8% of all listing were distressed listings in June 2023, down from 11.5% in December 2022 (Burke, 2023).

A major concern is that many people who purchased over the recent period, purchased using a fixed rate housing loan. An RBA analysis determined that in the first couple of years of the pandemic the value of fixed rate housing loans peaked 'at almost 40% of outstanding housing credit in early 2022', which was twice the usual share from prior to 2020 (Lovicu et al., 2023). The fixed loans are usually for a period of three years. Once the fixed rate ends, the interest rate is readjusted. In the current context that will invariably mean that the new rate will be higher than the fixed rate. The RBA study concludes,

> One quarter of fixed-rate loans outstanding in early 2022 have now expired … Another 40 per cent of fixed-rate loans will expire… by the end of 2023 and a further 20 per cent by the end of 2024. This equates to 590,000 loan facilities in 2022, 800,000 in 2023 and 450,000 in 2024 (Lovicu et al., 2023).

The implications for these homeowners are concerning. The RBA study revealed that the loan repayments on fixed-rate loans that expired in 2022 increased by up to 50% and that two thirds increased by more than 30%. The same study estimates that the loan repayments of 90% of fixed rate loans that end in late 2023 will increase by at least 30% (Lovicu et al., 2023). There is little doubt that low-income households will be severely pressured by the increase in mortgage repayments. It is evident that the housing crisis is having a major impact on the quality of life of people affected. A common response is the taking on of second jobs. Approximately 958,600 people had a second job in June 2023, equivalent to 6.7% of employed people. In September 2020, 728,700 people, 5.7% of employed people had a second job (ABS, 2023d). A 49- year-old factory manager bought a home in Western Sydney in April 2022. Interviewed in June 2023, he summed up the impact of the interest rate hikes on his mortgage repayments and quality of life:

> Within the first six weeks of me buying a place, the mortgage went up. I started off paying off about $2000 a month, and now I'm paying more than $3000 … At the moment there is no fat, there's no money to go do anything, there's no money to go out, to fix anything that needs to be fixed. I'm toying with getting a second job as with the economy slowing down, I can't see wages changing (in Razaghi, 2023).

3. The crisis in the private rental market

The Covid-19 pandemic had unexpected impacts on the private rental market which now accounts for around 27% of all households, up from 18% in 1994. At the start of the pandemic, rents in metropolitan areas fell slightly, whereas rents in many regional areas surged (Pawson et al., 2021). The capacity to work from home led to thousands of individuals / households relocating to regional areas; in 2020, 233,100 people moved to regional areas. Greater Sydney saw the greatest movement, a net loss of 31,600 people and Melbourne had a net loss of 26,100 people (ABS, 2021). The private rental vacancy rate reached 4% in Sydney and 4.7% in Melbourne in May 2022 (AHURI, 2022).

Rents in many of the most sought- after regional areas rose dramatically; for example, rents in Crescent Head, a small town of about 2,500 people, 440 kilometres north of Sydney, rose 54.5% (Williams, 2022). In Byron Bay, 780 kilometres north of Sydney (population around 11,000), in the year to September 2021, rents increased by 32% eclipsing rents

[4] The Senate referred to, is the upper house of the federal government.

in Sydney (Sweeney, 2021). The increases have had a severe impact on the local population. Historically, regional areas have been havens for low-income households due to the lower cost of housing. In Byron Bay employed key workers have been forced out of the area. A local city councillor commented,

> The market is failing a large section of the community … It's not right that a large part of a community can be displaced by unprecedented market forces. The pandemic pales in comparison to the housing crisis in terms of the impact on our community. We can't retain staff on council, staff that is on $80,000 a year, because of the housing crisis. It's essential we create a mechanism to look after the working class (in Razaghi, 2022).

In some areas the situation was worsened by the substantial number of short-term rentals (STR), most notably Airbnb. Nation-wide, in September 2022, there were around 251,000 STRs, representing about 10% of the rental stock. In some popular holiday areas as much as 15% of the housing stock is taken up by STRs (Sas, 2022).

From September 2020, rents also started surging in the metropolitan areas. Nationwide, the indexed median weekly rent increased from $461 in September 2020 to $595 in July 2023 and just under two thirds of suburbs recorded a rent increase of 10% or more (CoreLogic, 2023). Apartment rents in Sydney increased by 27.6% and house rents by 12.9% in the year to June 2023. In Sydney's inner south-west, rents increased by 36.4% (Burke et al., 2023). The increase coincided with the easing of Covid-19 restrictions. The key reasons for the increases were extremely low vacancy rates, high interest rates, a decline in the construction of new dwellings and minimal regulation of the private rental sector (PRS). STRs also contributed to the shortage as tourism once more took off.

In September 2022, it was estimated that the national vacancy rate was 0.9% (AHURI, 2022). At the start of the pandemic household size increased due primarily to young adults moving back to the parental home (Agarwal et al., 2023a). The increase in household size and the closure of international borders led to high vacancy rates and lower rents. However, once the pandemic eased, the manageable rents and the desire for more space encouraged people to move back into rental accommodation. The resultant decline in the average household size is estimated to have added an additional 120,000 households (Agarwal et al., 2023b). The reopening of the borders in early 2022 also contributed to a decline in vacancy rates. Returning Australians, international students and new immigrants contributed to the need for an estimated 96,000 additional properties (Agarwal et al., 2023b). The increase in the demand for private rental accommodation has occurred in a context where the supply of new housing has not kept up with the increase in the number of new households (AHURI, 2023). Between April 2022 and May 2023 there was a 23.6% fall in new housing investment (CoreLogic, 2023). The high interest rates and high construction costs suggest that the supply will not keep up with population growth.

The current low vacancy rates in the context of light regulation of the PRS, have given landlords an enormous amount of power. The light regulation means that once the lease (written agreement) ends, the landlord can increase the rent to whatever the market can bear (Morris et al., 2021). Tenants can challenge what they think is an unjust rent increase by appealing to Tribunals in their state. However, there no guarantee that the appeal will be successful and tenants fear that it could result in them being discriminated against in the future. There is also a concern that if they complain they will be given notice to vacate (Morris et al., 2021). Stories abound of long-established tenants being forced to vacate because of excessive rent increases (Tenants' Union of NSW, 2023).

The high interest rates have been used by landlords to justify excessive rent increases. A substantial proportion of Australia's approximately 2.3 million landlords have a mortgage on their investment property. Many are small investors with one property. For a proportion of landlords, the increase in interest rates has resulted in increases in mortgage repayments being greater than rent increases. For example, in Sydney, although rents increased by around $340 a month in the year to April 2023, mortgage repayments on a loan of $500,000, increased by $1113 a month. Nationally rents rose by around $227 a month, but mortgage repayments increased by $904 a month (Sweeney, 2023).

3.1. Rental stress

Estimates of the proportion of private renters in rental stress vary. However, what is evident is that a substantial proportion of private tenants are struggling to pay their rent and live a decent life. Already in 2017-2018, it was estimated that 44.4% of low-income renters living by themselves were in rental stress. Overall, it was estimated that 31.9% of low-income households at this time were in rental stress (AIHW, 2021). A study comparing how renters in 2020 viewed the affordability of their property to renters' perceptions in 2022, found that whereas in 2020 65% of renters said their rent was affordable, in 2022 only 55% had a similar sentiment (Beer & Baker, 2023).

A recent report (May 2023) estimated that nationally a median income household would require 30.8% of their income to service a new rent and a low-income household (bottom 40% of households by income) would require 51.6% of their income (CoreLogic and ANZ, 2023). Thus, almost all median income and low-income renters would be in rental stress, i.e., using more than 30% of their income to pay the rent.

A study by Business NSW drawing on NSW fair trade data concluded that in 82 of Sydney's residential postcodes, single tenants would need to be earning more than $100,000 annually to avoid rental stress. Tenants within five kilometres of Sydney's Central Business District would have to be earning at least $117,000 a year. Regional areas in NSW, especially those along the coast, also require that a tenant has a substantial income to avoid rental stress. Thus, in Newcastle on NSW's north coast, a two-hour drive from Sydney, a tenant living by themselves would need to be earning $95,333. In Wollongong on the south coast, a 90-minute drive from Sydney, a single tenant would require an annual income of $86,667 (Business NSW, 2023).

The annual 'rental affordability snapshot' carried out by the NGO, Anglicare, found that of the 45,895 properties listed for rent on the 17 March 2023, only 0.8% were affordable for a person earning a full-time minimum wage; 0.4% were affordable for a person on the Age Pension; 0.1% were available for a person on the Disability Support Pension and only 4 (0%) properties were affordable for a person reliant on JobSeeker (the unemployment benefit) and only 1.5% were affordable for a nurse (Anglicare, 2023). A property was deemed affordable if less than 30% of household income was required to pay the rent.

3.2. Is build-to-rent a possible solution?

Build-to-rent (BTR) has been touted as an important potential contribution to resolving Australia's housing crisis. The executive director of the Property Council in NSW claimed that the favourable tax regime for BTR (the federal government halved the Managed Investment Trust withholding tax for BTR to 15%) could result in 150,000 new apartments over the next 10 years and that BTR 'has the potential to drastically improve the supply of quality rental properties and when supply goes up, rents go down because there are more options on the market' (in Taylor, 2023). An article in *The Sydney Morning Herald* in July 2023 argued it 'a new model of developing apartments in inner-city suburbs [and] promises a potent solution to the escalating housing crisis' (Miles & Cummins, 2023). However, the notion that BTR could be a 'solution' appears to be hopelessly exaggerated. In mid-2023, BTR accounted for just 0.2% of Australia's housing market. If plans are approved, the sector will add about 27,000 to 30,000 units in the next five years. This will represent less than 5% of the federal government's push that 1.2 million new homes be built over the next five years.

A major limitation of the BTR model is that the rents charged mean that a low-income household in a BTR property would have to use a considerable proportion of their income to pay the rent. The rents in BTR complexes are at least 20% above the median weekly rent. In Sydney's largest BTR project, a one-bedroom apartment in August 2023 cost $650 to $670 a week. The median rent of a one-bedroom apartment in the area at that time was $550 a week (Taylor, 2023).

4. A drop in home ownership and an increase in lifelong renting

Over the last four decades the constant outstripping of wage increase by increases in residential property prices has resulted in home ownership rates for younger Australians dropping dramatically. Thus whereas 61% of 25- to 34-year-olds were homeowners in 1981, in 2021 just over 43% were. The 35- to 44-year-old cohort has experienced a similar decline; in 1981, 75% of 35- to 44-year-olds were homeowners, in 2021, 61% were (Ong Viforj, 2023). One projection is that if current trends continue home ownership rates for over 65 households will drop from around 80% at present to 65% by 2056 (Woods, 2023).

Since 2021, the surge in residential property prices and interest rates have ensured that home ownership has become an even more unlikely prospect for even 'average households'. Raising a deposit has become an enormous task. Whereas in the early 1990s it would take approximately seven years for the 'average Australian' to raise the deposit for a 'typical dwelling', it is now taking 12 years (Woods, 2023). Besides struggling to raise the deposit, young people are struggling to access bank loans and increasingly are turning to the high-risk non-banking sector. The interest rate on loans by non-banks is generally higher - about 100 basis points in 2022 (Hudson et al., 2023). Non-bank lending has grown rapidly since 2015 – 'growth has averaged almost 15% on a six-month annualised basis – more than twice the rate recorded by banks' (Hudson et al., 2023). Despite the rapid growth, the sector fortunately remains small, accounting for about 5% of all credit.

The decline in home ownership means that the proportion of households dependent on the lightly regulated PRS for an extended period or even lifelong will increase. Already in 2011, one in three renters were long-term renters, i.e., ten years or more (Stone et al., 2013). In the present period it is evident that an increasing proportion of low-income households are permanently locked out of home ownership and social housing is rarely an option (Morris et al., 2023; Pawson, 2021).

5. Increasing homelessness and marginally housed

On Census night (10 August 2021), it was estimated that 122,494 people were homeless, equivalent to 48 people per 10,000, or just under one in 200 people (ABS, 2023c). The housing crisis is pushing an ever-increasing number of people into homelessness. The peak body, Homelessness Australia, reported that between December 2022 and March 2023, the number of people seeking 'homelessness assistance' increased by 7.5%, an extra 6,658 people (Homelessness Australia, 2023a). In one month, March 2023, 95,767 people sought assistance. Kate Colvin, the CEO of Homelessness Australia, described the situation as '… the worst housing crisis in living memory'. What is particularly concerning is her conclusion that 'The bulk of increased demand comes from women and children, many of whom are fleeing violence …' (Homelessness Australia, 2023b). Three in four people using homelessness services in March 2023 were women or children. Women under 44 were the biggest group 'needing support'. The increase in demand resulted in 71,962 people being turned away from homelessness support in 2021-22. These people contacted a homelessness service, but the service was not able to provide the support required (Homelessness Australia, 2023a).

Homelessness Australia links the surge in homelessness to the rental crisis: 'Relentless rent increases and record low vacancy rates are driving more Australians into homelessness and services are unable to keep up with demand' (Homelessness Australia, 2023a). An annual report on homelessness reached a similar view, concluding 'Recent rental housing market trends have likely contributed to ongoing homelessness growth … [with] latest figures (June 2022) show[ing] annual private rent inflation running at 1.5 times the rate of consumer price rises more generally … (Pawson et al., 2023).

6. The increasing divide

Housing has become a key factor accentuating inequality in Australia (see Morris, 2023). In his statement in August 2023 justifying keeping interest rates on hold, the former governor of the RBA referred to the massive divide in Australia between those that have assets and a reasonable income and those households struggling.: 'Many households are experiencing a painful squeeze on their finances, while some are benefiting from rising housing prices, substantial savings buffers and higher interest income' (RBA, 2023). The latter group are in a position to help their children access home ownership. A recent study drawing on the longitudinal study, Household, Income and Labour Dynamics in Australia (HILDA) revealed that young adults in in middle class neighbourhoods who received parental assistance had 3.4 times more chance of entering home ownership than those who did not receive assistance (Ong ViforJ et al., 2022). The study also indicated that in-kind support (rent free accommodation in the parental home) can play an important role in enhancing the chances of accessing home ownership. 'The odds of transitioning into home ownership are nearly three times as high for those living rent-free in dwellings provided by family or friends than those living in private rental accommodation' (Ong ViforJ et al., 2022, 11).

Another indicator of the substantial divide is that in 2022, despite the phenomenal price increases, around 25.6% of residential properties and vacant residential land in Australia's eastern states (NSW, Victoria and Queensland) were bought for cash. Dwellings constituted 85% of cash sales in NSW, 80% in Victoria and 80% in Queensland. The amount of property bought without a mortgage totalled $122.5 billion in 2022, up from $83.6 billion recorded in 2020 and down slightly from 2021 when cash purchases of residential property totalled $124.8 billion. In NSW the median value of dwellings purchased with cash in 2022 was $900,000, up from $700,000 in 2020 (PEXA, 2023).

7. Conclusion

There is consensus that housing stress can be a major contributor to poor mental and physical health (Morris, 2018). In 2023, Lifeline in Australia answered 500 more calls each day than they did in 2019. Between May and June 2023, the number of calls averaged around 3,000 calls a day. Around 50,000 calls involved stress related to financial concerns. A lifeline volunteer commented that the housing crisis was a primary contributor to the increase in people seeking support:

> People are calling who have had to move away from their family and support networks because they can't get a rental property, or they can't afford one, and it feels anecdotally that there are more people calling with those kinds of issues, before it really was a small part of the population (in Banks, 2023).

Not only is the impact being felt by individuals and families. A recent report estimated that the lack of affordable housing in Sydney is costing the local economy in excess of $10 billion annually. The loss of talent was viewed as a major concern – the report costed it at $1.5 billion. It estimated that the housing crisis could potentially lead to fewer patents and fewer well-funded start-ups over each of the next five years and estimated that these losses could total $2.9 billion annually (Committee for Sydney, 2023, 25). In addition, the report's authors concluded that extra labour costs due to housing unaffordability could total $3.2 billion, inefficient commutes $1.1 billion and withheld spending due to high rents could total $2.5 billion.

It is evident that the present housing crisis in the context of high interest rates has created a perfect storm for individuals, households and the economy. Unfortunately, the problem is now so deep and the vested interests so powerful that the possibility of meaningful government intervention to dissipate the crisis is remote.

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