Macro reforms for housing affordability

Restricting the number of investors in the housing market is possible if there is an increase in interest rates on investment loans. In 2017, this kind of regulation reduced house prices in Australia. Reintroducing this policy could, as interest rates fall, help make housing more affordable for owner-occupiers.

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21 May 2025

INTRODUCTION

The Reserve Bank cut rates in February and May 2025, and the market expects further rate reductions in the second half of the year. As these cuts would lower the cost of borrowing, they could lead to rapid increases in house prices.

Lower rates encourage investors into the housing market. Investors push up house prices and push out owner-occupiers, in particular first home buyers. Housing affordability was a major issue in the recent election campaign, and Labor promised an "ambitious housing agenda".[1]

Some of their policies have focused on increasing housing supply, such as building 100,000 dwellings for first-home buyers and infrastructure funding for roads, sewage

[1] O'Neil (2025) *The Albanese Labor Government is building more homes more quickly, and making them easier to buy*, https://ministers.treasury.gov.au/ministers/clare-oneil-2024/media-releases/albanese-labor-government-building-more-homes-more

and water connections to speed up housing construction. But they also have policies that will increase demand for housing, like their 5% deposit scheme and their help to buy scheme that will see the Government co-invest up to 40% of the price of the home. While increasing supply will, in the long run, make housing more affordable, increasing demand will push up prices.

One solution is for the Commonwealth to cut the capital gains tax (CGT) discount and restrict negative gearing. This would make it less attractive for investors to enter the market, even when interest rates fall. The lower demand from investors would reduce upward pressure on house prices.

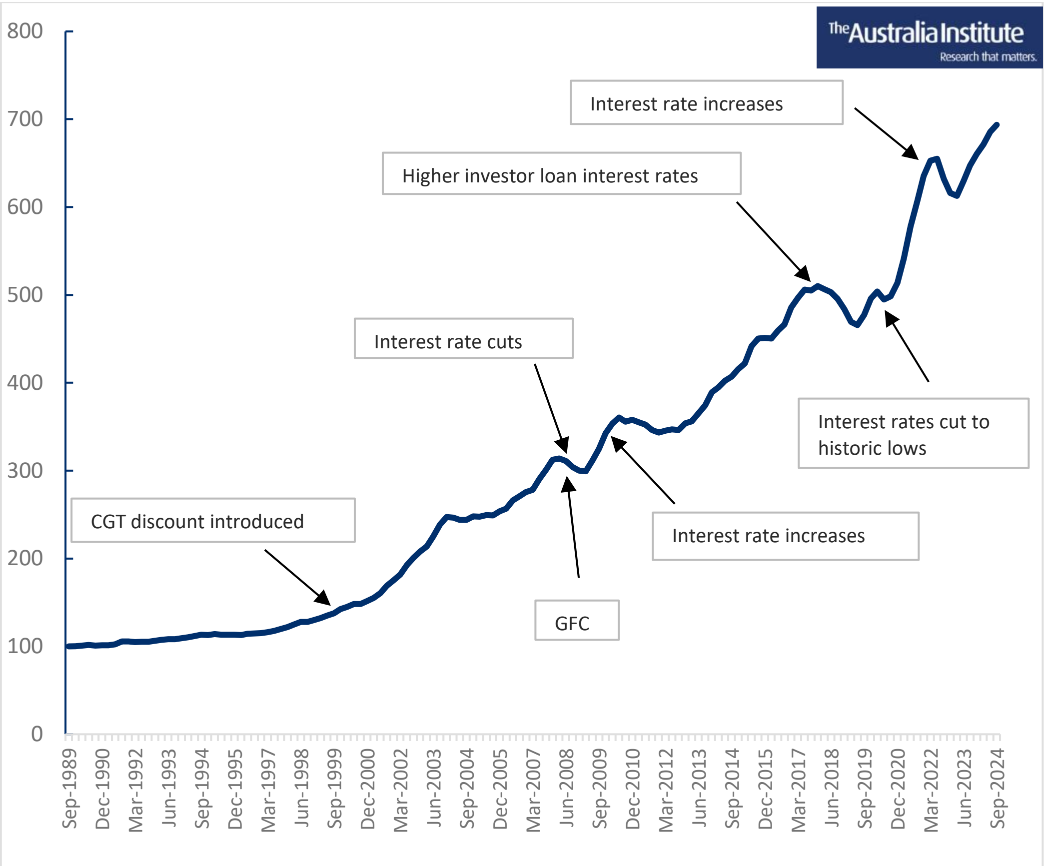
The Albanese government, however, has not indicated that it will make changes to negative gearing and the CGT discount. But there are other things that the Commonwealth could do to make sure that lower interest rates primarily benefit owner-occupiers, not investors.

They could direct the Australian Prudential Regulation Authority (APRA) to instruct lenders to limit the number of home loans granted to investors. Restricting the number of investors in the market would mean that Reserve Bank interest-rate cuts do not lead to increased demand from investors, which has the adverse effect of pushing up house prices. When APRA had this kind of restriction in place in the 2010s it had the effect of reducing house prices. This type of policy, known as “macroprudential regulation”, would help make housing in Australia more affordable.

INTEREST RATES AND HOUSE PRICES SINCE THE GLOBAL FINANCIAL CRISIS

Over the last two decades, falling interest rates have helped house prices rise. When interest rates fall, property buyers can borrow more money. When more people with more money show up to an auction, house prices increase. The reverse is true when interest rates fall. Figure 1 shows how house prices have responded to interest rate changes over the last 35 years. The only time prices haven’t increased after an interest rate cut was after APRA’s 2017 introduction of restrictions on the number of investor loans.

Figure 1: House prices since 1989



Source: Bank of International Settlement (n.d.) *Selected residential property, all dwellings, whole country: Australia*, https://data.bis.org/topics/RPP/BIS,WS_DPP,1.0/M.AU.0.1.0.2.6.0

Figure 1 shows that, in September 2008, after the Reserve Bank lowered interest rates in response to the Global Financial Crisis (GFC), there was a brief drop in house prices. However, this was temporary, and prices rose 20% over the following two years from March 2009 to December 2010. From late 2009 to mid-2010, the Reserve Bank continued to increase rates. As a result, house prices fell 4% from late 2010 to the end of 2011.

From late 2011 to August 2016, the Reserve Bank cut interest rates, which led house prices to increase by 47% over the five-and-half-years from September 2012 till December 2017.

What happened next is proof that macroprudential regulations can help make housing more affordable. In the three years from 2017 to 2019, the Reserve Bank kept interest rates on hold, but house prices actually fell by 9% — this was the largest decrease since 1989. This reason for this fall was because, during this time, APRA used macroprudential measures to ensure that interest rates increased for investor loans and interest-only owner-occupier loans. The following section explains how these restrictions worked.

MACROPRUDENTIAL POLICIES

In the 2010s, APRA began to believe that demand for investor loans — which was high by historic standards — posed a risk to the stability of the Australian financial system. They were concerned that higher risk forms of lending were increasing too rapidly, and these loans were over-inflating the value of housing in Australia and creating a bubble.

To deal with this risk, in December 2014 APRA announced regulations which meant that lenders could not increase investor lending by more than 10% annually. They also required lenders to have a 2% buffer above the loan rate when calculating a borrower's capacity to repay the loan and increased supervisory intensity on higher risk forms of lending – this mostly impacted owner-occupiers who were taking out interest only loans.

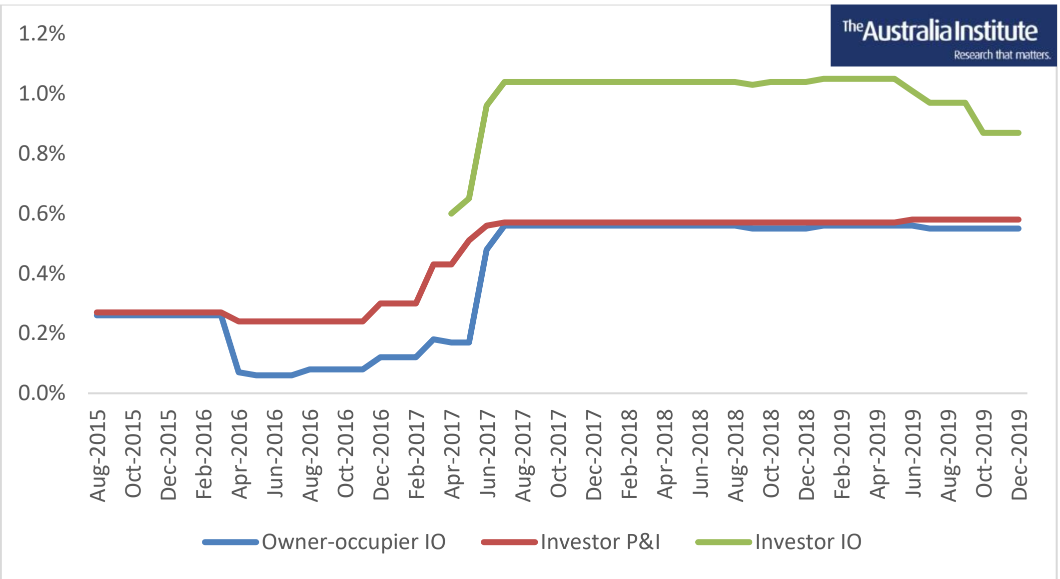
Initially, these policies worked as intended. As shown in Figure 3, the number of loans given to investors (and interest-only owner-occupiers) fells after the 2014 changes. However, by the end of 2016, the number of investor loans began to grow again. To counteract this, in April 2017 APRA introduced a stricter, 30% limit on the share of interest-only loans a lender could offer. As the Bank of International Settlement stated:

> The limit was introduced in an environment of high housing prices, high and rising household indebtedness, subdued household income growth, historically low interest rates, and strong competitive pressures. APRA took the view that in this environment, the shares of interest-only lending were too high: they were elevated by both historical and international standards.[2]

To meet this requirement, lenders increased the interest rates they charged on investor loans, which had the effect of reducing demand for this type of loan. This increased rates for both interest-only (IO) and principal and interest (P&I) investor loans. Lenders also increased interest rates on owner-occupier IO loans, which they considered to be a threat to their stability. Lenders charged an extra 50 basis points (0.5%) in interest on owner-occupier IO loans and investor P&I loans. An extra 100 basis points (1%) was charged on investor IO loans. This is shown in Figure 2.

[2] Bank of International Settlement (2023) *Macroprudential policies to mitigate housing market risks: Country case study Australia*, CGFS Paper, no. 69, https://www.bis.org/publ/cgfs69_au.pdf

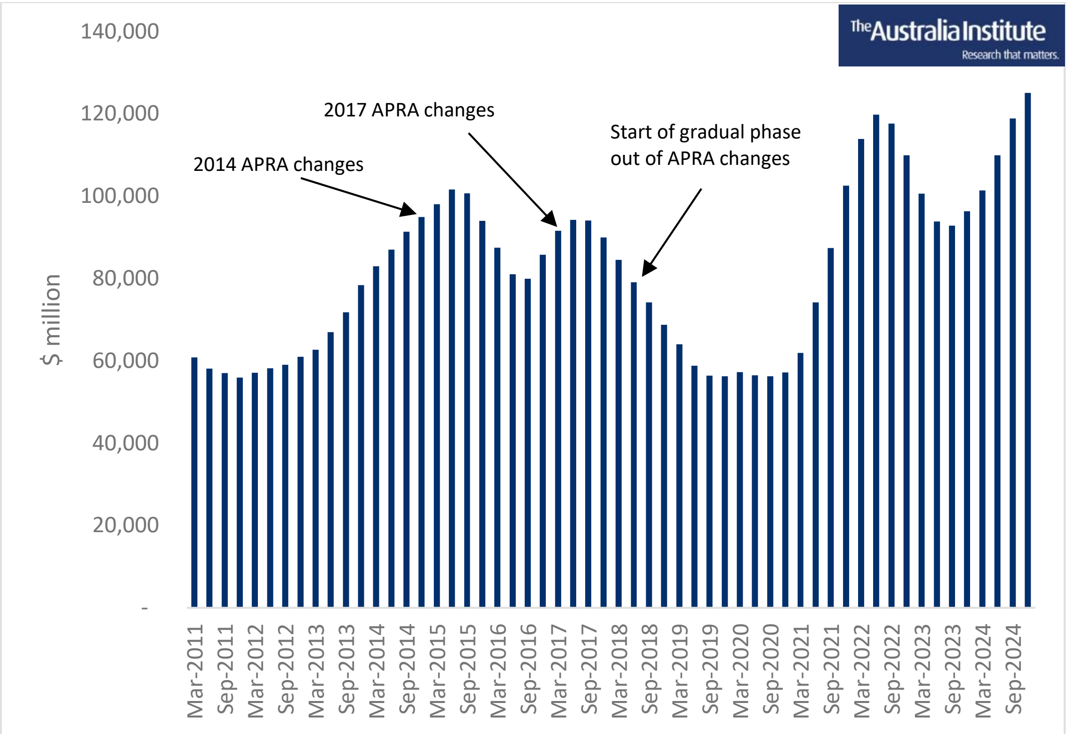
Figure 2: Advertised rate difference to owner-occupier P&I



Source: RBA (2025) Indicator Lending rates, https://www.rba.gov.au/statistics/tables/#interest-rates

The higher interest rates were effective at limiting investor loans. As Figure 3 shows, the number of loans given to investors fell over the two-year period from September 2017 to September 2019. This trend continued even after April 2018, when APRA began to phase out the changes because they no longer saw the number of investor loans as a threat to Australia's financial system.

Figure 3: Household investor loans for housing excluding refinancing, annualised (sum previous 12 months)



Source: Australian Bureau of Statistics (2024) *Lending indicators: December 2024, Table 13*, https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release

Investor loans remained flat until 2020, when interest rates fell to historic lows because of the COVID-19 pandemic. Over the next two years, house prices increased 32%. The growth in prices did not stop until mid-2022, when interest rates increased. As the Reserve Bank again moves into a cycle of cutting rates, macroprudential regulations would be an effective way of ensuring the benefits flow to people who need to buy a house to live in.

RECOMMENDATONS AND CONCLUSION

APRA has successfully used macroprudential policy to promote financial stability.[3] This paper proposes that the Commonwealth instruct APRA to expand this kind of regulation as a way of improving housing affordability. This would require APRA to monitor any rapid increase in investment loans, particularly during periods when interest rates are being reduced.

[3] APRA (2021) *Information Paper: Macroprudential Policy Framework*, p4, https://www.apra.gov.au/macroprudential-policy-framework

Macroprudential tools are the different policy levers that APRA can use to achieve its objectives. The tool that APRA could use to help with housing affordability is introducing lending limits to particular forms of borrowing.[4] This would require APRA to direct lenders to limit lending to domestic property investors.

The macroprudential policies that APRA introduced in 2017 increased the interest rate paid on investment loans. This restricted investors, which reduced demand for housing and, in turn, the price of housing.

With interest rates expected to be cut further over the rest of 2025, there is a real danger that investors will push up the price of housing at the expense of would-be owner-occupiers. After an election campaign dominated by concerns about housing affordability, would-be homeowners need policies to counteract this effect. We recommend that the Commonwealth add housing affordability to the objectives of macroprudential policies.

[4] APRA (2021) *Information Paper: Macroprudential Policy Framework*, p16, https://www.apra.gov.au/macroprudential-policy-framework