

Australian Housing Bubble

Fact or Fiction

INSIGHTS

October 2010

Not a day seems to go by without another newspaper headline on whether the Australian housing market is heading for a crash or not. Property commentators remain as divided as ever as to where the housing market is headed.

Here's a selection of views:

"In my view, Australian house prices are expensive on every value metric, they are expensive relative to history and expensive relative to houses in comparable countries."

Gerard Minack, Morgan Stanley, August 2010 ¹

"Concerns of a housing bubble are often based on a superficial/incomplete analysis of the Australian market."

Commonwealth Bank, 9 September 2010²

"Australia's housing market's soft-landing has been broad-based."

Christopher Joye, Rismark International, 30 September 2010³

"Australia already faces a chronic housing shortage which is set to worsen over the next two years as demographic demand outstrips supply."

Goldman Sachs, September 2010⁴

In the past few months, two excellent reports have been produced that provide some interesting facts that commentators on both sides of the debate should consider.

The first report "Are We Banking on a Bubble" was released by the UBS banking team on 31 August 2010⁵. Those commentators pushing the bubble theory, often point to the fact Australia's real estate appears expensive by global standards. On face value that is probably correct but what such analysis doesn't do, is take into account the spatial distribution of the population and allow for the "coastal versus inland price differentials".

Approximately 83% of Australia's population lives within 50kms of the coast. UBS compared Australia's capital cities to other global capital cities and found "that Australia is not materially out of line with many other countries".

1. Living in a Bubble, Morgan Stanley, 17 August 2010

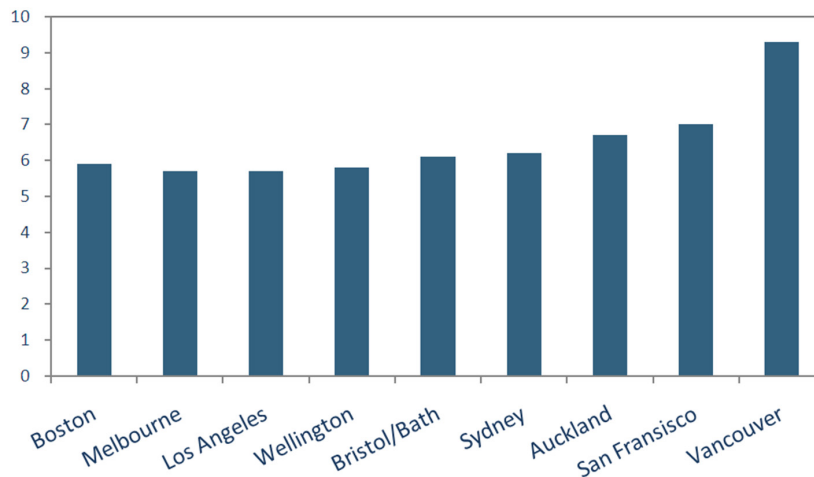
2. Australian Residential Housing, CBA, 9 September 2010

3. Seasonally Adjusted aussie Home Values Decline, RP Data, 30 September 2010

4. Acute Australian Housing Shortage Set To Worsen, Goldman Sachs, 16 September 2010

5. Are We Banking on a Bubble. UBS. 31 August 2010

Graph 1: House Prices of Global Cities: House Price to Income Ratio: 2010

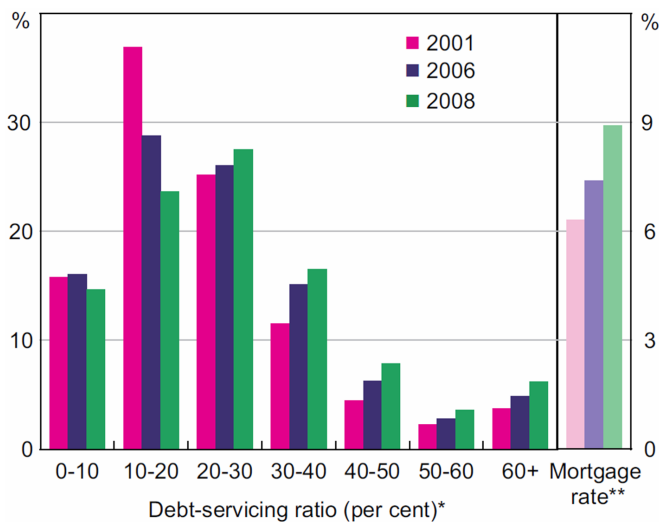


Source: Demographia, UBS estimates

The second report is by the RBA, who have over the past six months become regular commentators on the housing sector¹. In the RBA’s six monthly Financial Stability Review², they undertook a detailed analysis of the balance sheet of households.

The following four graphs from the RBA’s Review caught my attention and support their view that *“household financial circumstances are in aggregate, relatively strong”* and *“signs of financial stress in the household sector remains fairly limited, with the improvement in the labour market further underpinning household’s debt serving capacity despite higher interest rates.”*

Graph 2: Owner-occupier Debt-servicing Ratios: 2001, 2006 and 2008



Source: HILDA Release 8.0; RBA

* Principal and interest repayments on owner-occupier mortgage debt only; per cent of indebted owner-occupier households.

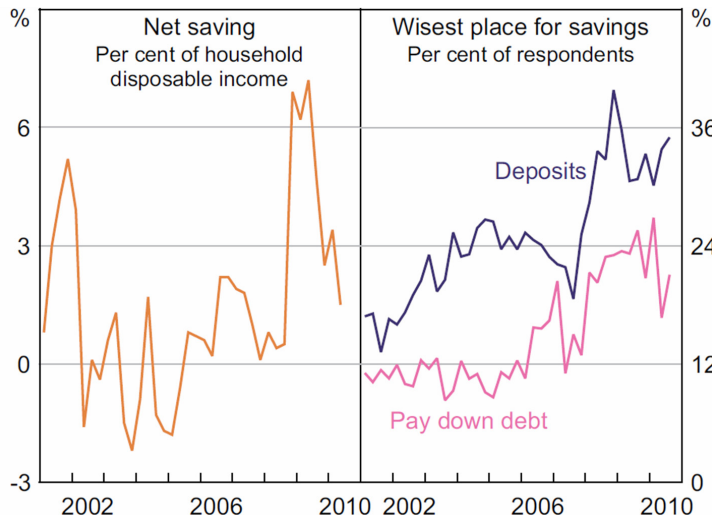
** Average interest rate on variable housing loans; as at September

The first of the RBA’s graphs (Graph 2) looks at owner-occupier debt servicing ratios. Using data from the Household, Income and Labour Dynamics in Australia (HILDA) survey, the RBA found that more than *“two thirds of households with owner-occupier debt faced repayments smaller than 30 per cent of their disposable income in 2008 (when interest rates were higher than they are now)”*. The HILDA survey also found that in recent years more than half of owner-occupiers have been ahead of schedule on the repayments on their property loans.

6. Asset Prices, Credit Growth, Monetary and Other policies: An Australian Case Study, RBA, 22 September 2010
 Housing Turnover and First-home Buyers, RBA Bulletin, June Quarter 2010
 Recent Developments in the Housing Market and its Financing, RBA, 18 May 2010
 The State of the Mortgage Market, RBA, 30 March 2010

7. Financial Stability Review, RBA, September 2010

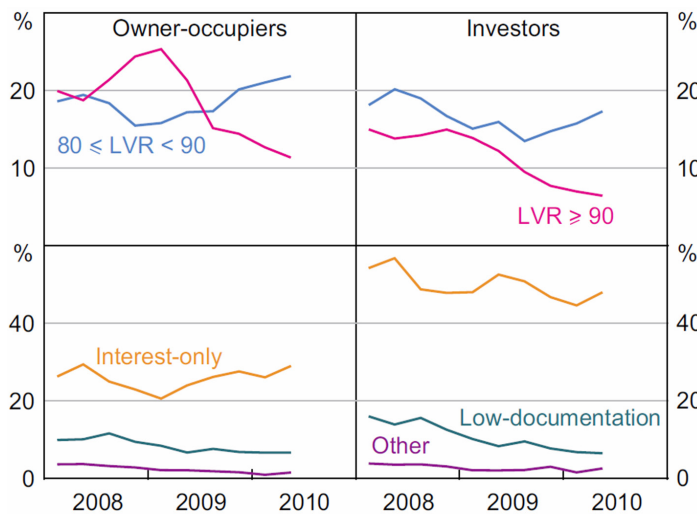
Graph 3: Household Saving Indicators: 2001-2010



Source: HILDA Release 8.0; RBA

The second of the RBA’s graphs (Graph 3) highlights household savings indicators. Australians have taken a more conservative approach to their finances as a result of the GFC. The net savings of Australians increased during 2008 and 2009 to levels well above that recorded for most of the past decade. The savings rate has fallen in recent months as consumer confidence improved driven by the rebound in Australian economic prospects and falling unemployment. Also it’s not surprising with the attractive bank interest rates on savings that deposits remain a preferred place for savings while concerns about rising interest rates are encouraging the paying down of debt.

Graph 4: Banks’ Housing Loan Characteristics: 2008-2010

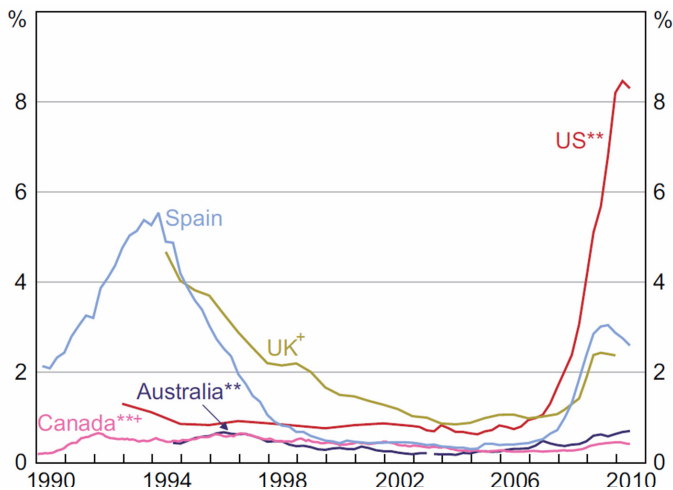


Source: ABS; Melbourne Institute and Westpac

The third RBA graph (Graph 4) looks at the bank housing loan characteristics. The key take-outs of this graph are:

- ◆ Low documentation and other loans (loans approved outside normal policies and other non-standard loans) have fallen in the past two years from 8% to around 7% and 0.8% to 0.3% of all loans respectively. One of the saving graces of the Australian housing market was the fact that unlike the US and other countries, Australia’s underwriting of mortgages was significantly better. In the US, sub-prime/low doc mortgages accounted for more than 25% of all loans in the lead-up to the GFC.
- ◆ Loan to value ratios of >90% have fallen for both owner-occupiers and investors to around 11% and 7% of all new loans in the June quarter. The spike in LVR’s above 90% to around 26% of all owner-occupier loans in early 2009 was driven by the surge in first home buyers. The RBA point out “the entry of such a large group of new home-buyers was an usual development, but although housing interest rates have increased by around 150 basis points...liaison and available data suggests little evidence to date of worse loan performance ...than earlier co-horts of first-home buyers displayed”.

Graph 5: Non-performing Housing Loans: 1990-2010



Source: ABS; Melbourne Institute and Westpac

The fourth RBA graph (Graph 5) highlights the arrears rates on loans. Perhaps the best, and most direct, indicator of households' capacity to support the increase in debt is the arrears rates on loans. The current arrears rate is very low at around 0.7 per cent. This is one of the lowest rates among developed economies and well below that of the US where non-performing housing loans represent more than 8% of all loans.

There are signs that the Australia's housing market is cooling. Three key indicators of the health of the housing sector were all down in August. The latest RP Data-Rismark house price index showed national house prices dipped by 0.2% in August, the HIA – Jeld Wen Home Sales Report found the number of new homes sold in August fell by 2.6% and were 11% lower than a year ago and according to ABS, total building approvals fell 4.7% in August to be down 12% over the three months to August 2010.

No doubt the debate on whether a bubble is occurring or not will continue over the coming months. Hopefully, the above graphs will contribute to a more informed debate.

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