# Australian Dwelling Prices

August 2011

Australian dwelling prices have, generally speaking, demonstrated what could be most accurately described as a controlled moderation since the middle-part of 2010. For example, according to RP Data-Rismark (the most closely watched dwelling price series), the seasonally adjusted hedonic price series for capital city house values declined by 2.6 per cent year on year as of June 2011. Similarly, national 'rest of state' house values fell by 2.5 per cent year on year.

This recent example of a softening of dwelling prices in Australia is in stark contrast to the trend evident over the year to June 2010. According to RP Data-Rismark, capital city house values were up by 10.2 per cent year on year as of June 2010, while national rest of state house values were up by 5.2 per cent over the same period.

HIA has held the view for a considerable time now that the short term outlook is for a flat to modest downward trajectory in dwelling prices. The variance within this generalisation is, of course, enormous. At present, dwelling prices are rising, steady, falling, and dropping quite sharply, depending on the local geographical market and dwelling type being observed. Note also that, at the moment, the trading market for property is relatively thin, with the volume of transactions well down on recent years.

HIA holds the view that based on current fundamentals Australian dwelling values in aggregate are unlikely to decline any more than 5 per cent over the next twelve months. Despite the strong performance in housing starts over 2009/10, Australia still possesses an aggregate housing shortage, albeit not everywhere, despite ignorant and spurious claims to the contrary. Australia also maintains a healthy labour market, albeit one experiencing not inconsiderable underemployment.

There are a myriad of additional and inter-related factors operating in the Australian economy that provide support for dwelling prices avoiding a substantial correction, and we'll get to a few more shortly. Stoking household fears with scaremongering about imminent and substantial corrections to dwelling prices is, of course, not one such factor.

In the post GFC world, Australian households are a relatively nervous and cautious bunch. Global uncertainty persisted throughout the first half of 2011, which didn't help. At home, widespread expectation of further interest rate hikes amidst confusing commentary on the subject, and a fractious carbon tax debate, are but two factors that have severely dented consumer (and business) confidence (and activity). Most recently, debt woes on both sides of the Atlantic have highlighted political ineptitude and selfishness, hammered equity markets, reminded us of how quickly hysterical headlines about the end of the world can re-emerge, and further derailed confidence here at home.

Against this backdrop the downside risks for Australia's short term economic growth, which HIA has been warning of since late 2010, have increased.

This situation provides a fertile ground for proponents of a property crash to chase headlines with a renewed vigour.

The collapse of the housing market in the United States is often cited as one piece of irrefutable evidence that the Australian housing market will inevitably follow the same path. However, the discussion tends to ignore the important structural differences in our economies and financial systems.

A key difference between the Australian and the US markets is the structure of mortgage lending. Home loans in the US are “limited recourse” meaning a lender's

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capacity to claw back losses on a bad loan are limited to the value of the home and unlike Australia, lenders have no further claim against the borrower. This design provides the perverse incentive for borrowers in the US to default on the loan when the size of the loan becomes greater than the value of the property. The contribution that mortgage design made to the extremely high default rates in the US should not be underestimated. Losses as a consequence of this mortgage design would be unlikely to result in the cataclysmic scenario under prudent lending standards and adequately capitalised loans, but when combined with the extremely lax lending standards in the lead up to 2007, lenders left themselves exposed to a significant risk.

Australian mortgages are "full recourse", hence there is far greater incentive for home owners, in the event of diminished or negative equity, to maintain their mortgages throughout dwelling price fluctuations as lenders are unable to demand additional security or force a foreclosure so long as the repayments continue to be met. The Reserve Bank of Australia has, on a number of occasions, made reference to the fact that Australian lenders were not plagued by the same lax lending standards of many US lenders.

It is also important to note that the profile of housing tenure in Australia is quite different to other countries. Just over 70 per cent of Australian households are owner-occupiers, and only around half of the owner-occupier households have a mortgage. The average level of gearing of owner-occupiers with a mortgage is around 50 per cent, although within this cohort there will be some who have very low gearing levels while some will have high gearing levels. Those with higher gearing levels are typically those who have been in the market for the shortest time.

Home buyers are typically at the greatest risk of experiencing mortgage stress during the early years of home ownership due to the low level of equity and the fact that mortgage repayments typically consume a higher share of household income. In Australia we have in recent times seen a natural increase in levels of mortgage arrears, albeit by a very small amount off an extremely low base. Any suggestion that the rise we have seen is evidence of an imminent market-wide collapse is merely speculation.

Discussion of dwelling prices typically prompts very emotive responses and hence provides easy fodder for sensationalist headlines. Dwelling prices are likely to fall moderately over the next twelve months and the rapid price growth experienced over the last decade is unlikely to be repeated, but we are most certainly not standing on the precipice of an imminent crash. Those touting an imminent crash in home prices should take the time to reflect on Australia's inherently sound housing market fundamentals, well-functioning banking industry, shortage of housing stock, relatively healthy labour market, and above all the importance of avoiding exaggeration at a time of heightened fragility in economic confidence.

Should the current carnage on equity markets and widespread hysteria of the moment begin to tangibly damage economic activity, then Australia's very sound fundamentals will be tested and the risk to dwelling prices will increase. We would argue this is already occurring. Australia will stand the test, however, especially when you consider the fact that Australia does not exist in a policy vacuum - we have ample room to move on both monetary and fiscal policy. Indeed HIA is of the view that we should be tapping into this policy capacity now.

Household and business confidence will be battered further in the absence of immediate action. Exaggeration of the risks to property prices has been a persistent driver of poor sentiment, and if elevated now could hardly be deemed responsible commentary.