A quarterly update on the affordability of housing

December 2020 Quarter

REGIONAL AREAS EXPERIENCE A SHARPER DETERIORATION IN HOUSING

HIGHLIGHTS:

- The housing affordability index deteriorated during the December 2020 quarter.
- Regional areas experienced a sharper decline than the capital cities. This is the sharpest decline in affordability since the December 2009 quarter.
- Demographic changes and low interest rates are fuelling housing demand.
- Despite the decline, housing remains considerably more affordable than the average over the past 20 years.

The HIA Affordability index measures the extent to which average weekly earnings can repay and service a mortgage for a median-priced dwelling. The index is calculated based on prevailing mortgage interest rates, average weekly earnings and median home prices. The concept of affordability essentially explores the proportion of earnings absorbed by servicing costs on a 25 year mortgage with a 90 per cent Loan-to-Valuation-Ratio at inception. An index reading of 100 indicates the threshold for 'affordable' market whereby mortgage repayments account for exactly 30 per cent of average earnings under current market conditions. An index level above 100 indicates an affordable market and index level below 100 indicates an unaffordable market. When the index level is rising affordability is considered to be improving while a decline in the index indicates a deterioration in affordability

Housing in Australia became less affordable in the December 2020 quarter as house prices rose and average earnings declined. The HIA Affordability Index fell by 2.5 per cent to 87.0 in the three months to December compared with the previous quarter. This means that more than 1.1 average incomes are required to service the typical mortgage repayments.

Regional areas experienced a larger deterioration in affordability than the capital cities. The regional affordability index fell by 3.7 per cent in the quarter to return to the level it was in December 2019. This is the sharpest decline in affordability in regional areas since the December 2009 quarter.

With the onset of COVID-19, a number of factors shifted consumer preferences towards detached housing (with more living spaces) rather than higher density living. The newfound capability to work from home has enabled homebuyers to look at locations that previously would have been considered too far from their workplace.

School leavers have also remained in regional areas, rather than being attracted to the east coast capitals for employment and education. This has added to the increase in population and economic activity in many regional areas.

Preliminary migration data also shows more Australians departed capital cities to lower density locations in each of the first three quarters of 2020 than at any other time since records began in 2001. This suggests that many Australians took 2020 as the opportunity to retire, or at least advance their retirement plans. Melbourne has been the most affected by this demographic change.

Adding to this list of factors, it is typical for ex-pat Australians to return home in times of economic shock and 2020 is no exception. The inflow of returning workers has been constrained, but unlike previous shocks, in this cycle they are seeking a detached home rather than an inner city apartment.

The impact of a slowing in overseas migration will not impact demand for detached homes in 2021.

This change in demographic demand combined with low interest rates, is fuelling housing demand in both the established and new home markets. The issue has been exacerbated by a low number of homes listed for sales in the December quarter, an issue that has continued into 2021. Further evidence of this trend can be observed in rental price pressures in recent months.

It is likely that much of the shift in population that occurred in 2020 will be permanent sea changers, tree changes and retirees used 2020 as an opportunity to pursue their dreams. In addition, many of the two years of school leavers that have remained in the regions will also have established households and remain in the regions even when employment returns to capital cities.

However, when overseas migration and economic activity return to capital cities they will once again draw students and workers to urban areas. At the same time, the addition of a record volume of new detached home construction will reach completion in 2021 and 2022. These two factors will ease the pressure on regional housing affordability.