Affordability Report

MEDIAN DWELLING PRICES

INTEREST RATES

MORTGAGE REPAYMENTS

WEEKLY EARNINGS

HOUSEHOLD INCOME

DWELLING PRICE MOVEMENT

A quarterly update on the affordability of housing

December 2019 Quarter

ARE FIRST HOME BUYERS REALLY A BAD RISK?

HIGHLIGHTS:

> Affordability deteriorated in the December 2019 quarter, for the first time since mid-2017.

> The return to house price growth was not offset by a fall in interest rates in this quarter.

> FHB participation rate remains high as investors and owner occupiers delay their return to the market.

> FHB's face an additional challenge to achieving home ownership as prudential restrictions imposed on banks are requiring a larger deposit.

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

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In the September 2019 quarter the HIA-Housing Affordability Index for capital cities reached the most favourable level since the late 1990s, but the strong recovery in home prices in Sydney and Melbourne during the latter stages of 2019 caused the index to fall by 1.7 per cent in the December 2019 quarter.

The recovery in home prices in Sydney and Melbourne provides evidence of the market's capacity to right itself after times of uncertainty. This has been a positive for housing market activity, and in turn should be a positive for broader economic growth.

The recovery in home prices may be a positive from a macroeconomic perspective but it is little consolation for those trying to purchase their first homes, particularly in Sydney and Melbourne. During the second half of 2019 the median home price grew considerably faster than earnings, and the reduction in interest rates did little to offset the impact of the price rises.

Despite showing a slight deterioration in affordability in the December 2019 quarter, the HIA-Housing Affordability Index continues to show that the relativity between income levels and the cost of mortgage repayments compares favourably against much of the last 20 years. Servicing a mortgage is not the constraint on home ownership that it has been in the past. The sticking point facing the current generation of aspiring home buyers is obtaining a mortgage in the first place – this relates to the lengthening of the time it takes to save a deposit, and then meeting the increasingly stringent requirements of lenders.

When home prices grow at rates considerably faster than household incomes it lengthens the time it takes for first home buyers to save the 20 per cent deposit lenders require to access finance without lenders mortgage insurance. First home buyers are very active in the housing market accounting for 27.5 per cent of homes financed, significantly higher than much of the last decade. It is a matter of time before those with deeper pockets and better access to finance return to the housing market.

Structural changes to the banking sector over the last decade are working against first home buyers. While first home buyers typically have income to meet loan serviceability requirements, they typically borrow a high proportion of the property value - and borrow closer to their capacity - means they are considered a higher risk. The structural changes in the banking sector are discouraging banks from lending those borrowing a low LVR, which includes most first home buyers. There is strong competition amongst banks to lend to those customers that are well capitalized and own their own home. When it comes to getting a home loan, first home buyers are at a disadvantage.

In the years since the Global Financial Crisis (GFC), Australia's financial market and banking regulators have sought to create an 'unquestionably strong' financial system. This decade of reforms have reduced risk in the system but they have come at a cost. This cost is borne by first time home buyers who are being forced out of the housing market.

Banks have been required to increase their capitalisation for loans with less than a 20 per cent deposit which makes them less willing to lend to first home buyers. This is in addition to tighter scrutiny of household budgets and the measure imposed to restrict interest only loans.

In 2009, lending to home buyers with a deposit of less than a 10 per cent of the property value exceeded 20 per cent of new lending. Now it accounts for just 7 per cent of new loans.

The problem is that this regulatory squeeze has forced the banking sector to eliminate much of the flexibility in the mortgage market that made home ownership accessible for households of variable credit quality, such as first home buyers. This is having the effect of forcing first home buyers to achieve a deposit of greater than 10 per cent at a time of record low interest rates.

Having an 'unquestionably strong' financial system is essential to the future of the building industry, but home ownership must remain an attainable goal for all Australian households.