A house or a home? Finding value in Australian residential property

Anthony Street
Real house price index

Real house price growth in Australia
Is it a bubble?

• “If we think about property prices .... you wonder how they are going to be afforded because these prices are getting quite high” Glenn Stevens, RBA, (on Sunrise March 2010)
Is it a bubble?

• “The price of housing typically trades about 3.5 times family income and in bubble it goes to 6 or 7.5. [Australia is] 7.5 times. . . which suggests you are twice the size that you should be” Jeremy Grantham, GMO, June 2010

Source: The Australian
Is it a bubble?

• “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
Is it a bubble?

• “The relationship between house prices and incomes in Australia is uncomfortably high versus the rest of the world .... By any normal set of measures, house prices in Australia are high” David Murray, Future Fund Chairman, March 2011

Source: The Australian
Is it a bubble?

• “Taking into account geographic differences, the ratio of house prices to income in Australia is not that much different to most other comparable countries” CBA, September 2010
Is it a bubble?

• “Australian housing affordability is not as stretched as some measures suggest .... House prices and affordability issues reflect a structural imbalance between supply and demand” Westpac, October 2010
Is it a bubble?

• “…the major reason for [Australia’s higher house price to income ratio over the past 10 years] has been a structural (read permanent) reduction in interest rates”

ANZ, May 2010
Is it a bubble?

• “... the [house price to income] ratio ... is higher than it used to be, but it’s actually not exceptional by a global standard”

Glenn Stevens, RBA, March 2011
Interpreting the RBA

ABS House Price Index

Mar10: 18% growth
Interpreting the RBA

ABS House Price Index

Mar10: 18% growth

Mar11: Flat growth
What is the house price to income ratio?

- Median dwelling price to average income ratio

=> 4 to 4.5x
What is the house price to income ratio?

- Median capital city house price to median income ratio

=> 6 to 7x

Source: calculated using ABS data
What is the house price to income ratio?

• CBA’s view

(from Australian Residential Housing investor presentation, Sept 2010)

<table>
<thead>
<tr>
<th></th>
<th>House price to income</th>
<th>Demographia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sydney</td>
<td>6.2</td>
<td>9.1</td>
</tr>
<tr>
<td>Melbourne</td>
<td>5.7</td>
<td>8.0</td>
</tr>
<tr>
<td>Brisbane</td>
<td>4.7</td>
<td>6.7</td>
</tr>
<tr>
<td>San Francisco</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>5.7</td>
<td>5.7</td>
</tr>
<tr>
<td>New York</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Vancouver</td>
<td>9.3</td>
<td>9.3</td>
</tr>
<tr>
<td>Bristol-Bath</td>
<td>6.1</td>
<td>6.1</td>
</tr>
<tr>
<td>Auckland</td>
<td>6.7</td>
<td>6.7</td>
</tr>
<tr>
<td>Wellington</td>
<td>5.8</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: Demographia, UBS
What is the house price to income ratio?

• CBA’s view

<table>
<thead>
<tr>
<th>House price to income</th>
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</thead>
<tbody>
<tr>
<td>Australia</td>
<td>4.3</td>
</tr>
<tr>
<td>Canada</td>
<td>4.1</td>
</tr>
<tr>
<td>UK</td>
<td>5.6</td>
</tr>
<tr>
<td>US</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: RP Data/CBA/ABS; UBS
Supply: every picture paints a story
IMF takes the same approach
Rental growth modest compared to price growth

Annual growth in residential rents

Source: ABS
Mortgage affordability

Mortgage repayments as % of household income
Dwelling size

Increased dwelling size accounts for small component of house price increases

Source: ABS
Households have used increasing levels of debt to fund house purchases.

Source: RBA
Unemployment and interest rates

Australian house prices compared to unemployment and mortgage rates

“When you have ... a strong, ideally nearly perfect economy and generous money – you are nearly certain to have a bubble form”

Jeremy Grantham
Residential property as an investment

• “Did you know that eight out of ten millionaires made their fortunes in real estate? ... actively investing in real estate projects is the best way to build wealth and help secure your financial future” Property developer
Residential property as an investment

• “Why you should invest in property .... Greater leverage on your money - banks lend up to 95% on property and only 60% on shares” Investment property consultants and finance brokers
Residential property as an investment

• “Housing Shortage Leaves High Demand for Rentals Invest Now!”

Real Estate University
Residential property as an investment

“If ... the resources story unwinds ... the RBA is likely to reduce interest rates ... The housing market is therefore a powerful hedge against Australia’s resources boom running off the rails.”  Rismark, Feb 2011
Residential investment returns

- Current gross rental yields 4.1% (houses) to 4.9% (apartments)
- Net yield 2-3%
- Investors (even ungeared) are betting on continued 5%pa+ house price growth
Rental growth furphy

• If price growth falls to 3%pa, rent growth of 13%pa needed for geared taxpayer to break even after 10 years
Actual investor experience

- 83% of wage earners with an investment property reported an income loss (over 600,000 taxpayers)
- 91% of these investors used gearing

Source: ATO 2007/08 tax statistics
## Rental income gains by occupation

<table>
<thead>
<tr>
<th>Occupation</th>
<th>% reporting rental gains</th>
<th>% using gearing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investment income recipients</td>
<td>74%</td>
<td>(42%)</td>
</tr>
<tr>
<td>2. Superannuation funds</td>
<td>67%</td>
<td>(50%)</td>
</tr>
<tr>
<td>3. Property operators</td>
<td>57%</td>
<td>(59%)</td>
</tr>
<tr>
<td>5. Financial asset investing</td>
<td>56%</td>
<td>(60%)</td>
</tr>
<tr>
<td>6. Sheep, cattle and grain farming</td>
<td>53%</td>
<td>(55%)</td>
</tr>
<tr>
<td>7. Dairy farming</td>
<td>53%</td>
<td>(56%)</td>
</tr>
<tr>
<td>14. Mushroom and vegetable growing</td>
<td>48%</td>
<td>(67%)</td>
</tr>
<tr>
<td>27. Gambling activities</td>
<td>37%</td>
<td>(76%)</td>
</tr>
<tr>
<td>192. Salary &amp; wage earners</td>
<td>17%</td>
<td>(91%)</td>
</tr>
</tbody>
</table>

Source: ATO 2007/08 tax statistics
Owner-occupiers: a house or a home?

• 70% of dwellings owned by owner-occupiers

• Decision to buy not solely financial: “economics of happiness”

• Leads to an inefficient market from a purely investment perspective
The US experience

Australian and US house prices since Dec '89

- Australian house prices
- US house prices
Strong labour market supporting Australian house prices
Summary

• Interest rates and unemployment are key to Australian residential market

• These cyclical factors will far outweigh any structural issues, such as undersupply
... one final quote

From Oct 2006 at peak of US housing market:
“The U.S. housing market largely reflects a strong U.S. economy ... the U.S. housing market has never declined.”

Ben Bernanke, Chairman US Federal Reserve