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House prices reflect changing patterns

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HOUSE prices are a favoured topic of discussion among Australians.

The big issue, of course, is what's likely to happen to prices in coming years. These days, there's a wide choice of possible answers: up, flat, down a little or down a lot.

Related questions are: how do weaker house prices and higher rents affect decisions to buy or rent; will housing remain a drag on the economy; and what's the significance of the changing pattern of home ownership?

The median house price, as measured by RP Data, has fallen by 3.6 per cent in the past 12 months and 6 per cent from the peak in 2009-10.

The picture is very uneven by city, suburb and region, and generally housing with above-average prices has slumped proportionately more than lower-priced stock.

Various research groups will soon be releasing international comparisons of house prices for June 30, with many likely to conclude that Australian house prices are unsustainably high.

For example, British magazine The Economist, which looks at long-term trends in house prices relative to incomes and rents, is likely to claim that our homes are, on average, more than one-third overvalued.

These arbitrary measures of house price sustainability have many shortcomings: they don't take account of the impact of the structural fall in interest rates in the early 1990s, when inflation collapsed, the favoured tax treatment of housing in this country and our high level of urbanisation.

We should expect, nonetheless, to hear another round of shrill predictions of an imminent collapse in Australian house prices. In fact, however, that's unlikely.

Stocks of unsold homes are exceptionally low (indeed, in recent years annual net additions to the housing stock have been well below long-term demand).

As well, our banks have been more cautious in lending for housing than US or Spanish banks, and housing interest rates are at relatively comfortable levels. (In 1989, housing interest rates were 2.5 times higher than at present, but house prices did not collapse.)

In my view, the outlook is for a repeat of the experience of the 90s: an extended period in which the median house price wobbles between slight increases and mild deflation, with wide variations in house price moves state by state and with a small minority of households suffering badly from taking on too much debt.

It's good that the combination of soft house prices, lower interest rates and rising incomes is making housing more affordable.

At the same time, rents have been increasing more rapidly than inflation. The incentive for people to buy rather than rent has returned to about where it was in the early 90s and the opening years of this century.

But decisions on whether to buy or to rent always require careful thought. Yes, rents are likely to continue to outpace inflation, but buyers need to allow that the average mortgage of $270,000 taken out by first-home buyers is a big debt and that housing interest rates may well be at or close to their cycle lows.

Even with recent increases in rents, gross rental yields on investment properties average a relatively skinny 3 per cent nationwide and 3.5 per cent in Sydney.

Net yields on investment housing are well below returns available from term deposits, real estate investment trusts and bank shares. At current rental yields and diminished expectations for capital gains, investment housing does not have a lot of appeal.

Homeowners and investors are acting as though the next cyclical increase in house prices is years away. In turn, this is encouraging cautious and conservative financial behaviour.

Growth in household borrowings no longer outpaces income growth, saving is back in fashion and many households with mortgages are well ahead of required payments.

Understandably, these changes concern retailers large and small, but the strengthening in household balance sheets will be positive for investment markets and the economy in the medium and longer term.

Compared with five years ago, more of us rent (29.6 per cent of households now, compared with 28.1 per cent), more are owner-occupiers with mortgages (up from 34.1 per cent to 34.9 per cent of households), and a smaller proportion of households now own a house without a mortgage (down from 37.8 per cent to 35.5 per cent of households).

These changes reflect, in large part, the trend increase in home prices.

Some people have been priced out of home ownership, and others have had to take on bigger mortgages to buy their homes. Also, it was common a decade ago for people to borrow more as their houses increased in value to finance renovations and general spending.

Social changes are also contributing to the new pattern of home ownership.

More 20-something offspring now live with their parents than in earlier years (with their lower living costs funding lifestyle expenses rather than being saved for a deposit on a house).

All this makes it harder for the youngsters to become first-home owners and for middle-aged oldies to pay off their mortgages.

As a result, a growing number of Australians still have a mortgage to service when they retire, and that puts a big ouch into retirement plans.

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