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How property will stand up in the global crisis

James Dunn | November 05, 2008

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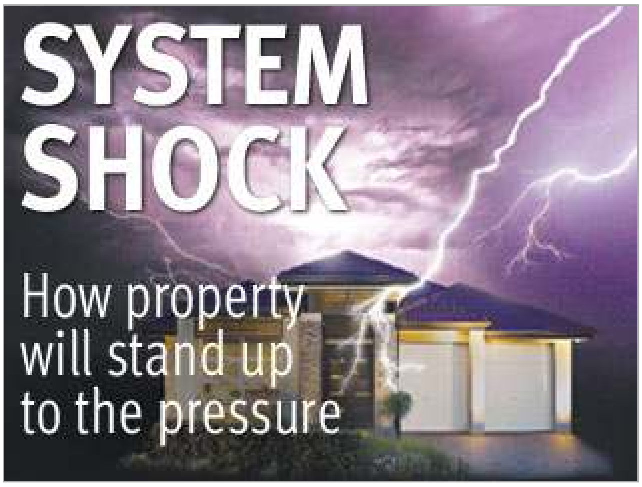
THERE have been many casualties of the global financial crisis, and one of them is the investment "truism" that "you can't go wrong in bricks and mortar".



Australian home owners and residential investors have good reason to look over their shoulders in fear after the bloodbath in the US.

As the Americans, British and Spanish have shown, you can go very wrong in bricks and mortar. As with any tradable commodity, if the market is oversupplied, prices will fall. That is Economics 101. And fall they have.

Whereas hardly anyone had heard of the S&P Case-Shiller Index a year ago, most of us who read the financial pages know that the index -- which measures house prices in the 20 largest US metropolitan markets -- has fallen by 16.6 per cent in the year to August. US house prices have fallen for 25 consecutive months.

In California, house prices have fallen by 41 per cent over the past 12 months. In Phoenix, prices are down by 30.7 per cent, while Las Vegas prices are down 30.6 per cent and Miami 28.1 per cent. It is no surprise that those four states were the main players in the sub-prime boom.

Like all markets, US residential property will recover. Moody's estimates that it will take until late 2009 for the market to be equally balanced between buyers and sellers.

Australian home owners and residential investors have good reason to look over their shoulders in fear after the bloodbath in the US and ask: could it happen here? After all, Australia has been an enthusiastic participant in the global housing boom. The Economist ranks Australia in the top five in a sample of 22 developed countries that have experienced the largest price growth in the past decade -- 173 per cent.

Investment bank Goldman Sachs JB Were says house price rises have well and truly outstripped growth in incomes.

The ratio of median house price to income has risen from three times a decade ago to five times, one of the highest among the Anglo-Saxon economies. "On that comparison, we're actually one of the dearest markets in the world," says Liam O'Hara, senior economist at Australian Property Monitors.

O'Hara accepts that residential property is overvalued here and has to face a correction but says US-style falls are unlikely.

The main reason, he says, is that whereas the US has a heavily oversupplied housing market, Australia's is still undersupplied. "Australia has been undersupplying housing demand for some time, and that's helping to maintain prices," he says. "If that undersupply weren't the case, I suspect that we'd be seeing some more major movements in the market."

The major factor in housing demand is population growth.

According to KPMG demographer Bernard Salt, Australia added 332,000 people to its population in calendar 2007, the largest addition to the national population in any year in our nation's history.

The Treasury estimates that to accommodate this rate of growth, 200,000 new dwellings a year are required in Australia.

But in the year to June 2008, Australian Bureau of Statistics (ABS) figures show that about 157,000 new dwellings began construction -- a 21 per cent shortfall.

Tim Lawless, national research director at property research firm RP Data, says low supply and strong population growth are "at odds with each other", and the result is a "remarkably resilient" market.

For the year to August 2008, Lawless says, national dwelling values grew by 1.7 per cent, despite a 1 per cent decline in the three months to August.

"These figures should put to rest claims that Australia's property market is heading for a crash."

The only capital city to record a material decline in property values over the year, Lawless says, was Perth, with a fall of 5.7 per cent. (Sydney also showed a fall, down 0.6 per cent.)

But Lawless says that even the Perth fall should be placed in context. Perth home owners have seen values increase by 13.9 per cent a year over the last five years.

O'Hara expects a 10 per cent "across the board" fall in dwelling prices.

"We think that's a reasonable indicative move for the property market in general.

"But even though the bias is downwards, it will flatten out quite a bit, and we certainly don't see a California-style 40 per cent slump in property values, because the supply situation doesn't warrant that."

Louis Christopher, head of property research at investment research firm Adviser Edge, is not a wholehearted believer in population growth as a buttress for the residential property market.

"I get a bit annoyed when I hear this. I think it is closing your eyes to economic reality," he says.

"The truth of the matter is that if we go into an economic downturn, the number of occupiers per dwelling will rise.

"Even if you have population growth, if people don't have jobs, they'll tend to group together more.

"In that case, young people will stay with their folks. They won't go out and rent or try and buy a home. Families will move in together. People will accept reality and lower their standard of living, and live together a bit more than they do now. So you can get a population increase, but if the number of occupiers per dwelling increases from two persons per household up to three or four persons per household, it won't matter. That's what the more optimistic analysts out there tend to gloss over."

The prospect of a recession is the "elephant in the room" for the residential property market, Christopher says. "That's the big caveat. If Australia goes into a sustained recession, all cards are off the table. There's plenty of evidence from the past that job losses really hurt housing. The classic example is southeast Queensland between 1994 and 2000.

"That was a period of exceptional population growth, but house prices went nowhere. The reason was that southeast Queensland had a relatively high unemployment rate. People were moving into the area, all right, but they couldn't get themselves a job, and they soon had to move out.

"Having a job is everything. That's what gives you the purchasing power to be able to go out and buy a property. If we did happen to see unemployment at 8-9 per cent, which is at the high end of median estimates, that would be very negative for the housing market nationwide."