



**TCFS** TERRY CROSS  
FINANCIAL SERVICES  
PTY LTD

## Property: Bubble, Bust or Non-issue?

**Australian house prices are falling. While that is clear, opinion is divided about the long-term outlook. Are we watching a housing bubble about to burst or a pause before returning to business as usual? Or is it something in the middle, a so-called soft landing?**

Legendary US investor, Jeremy Grantham, has received widespread coverage in the local media for his view that Australian residential property is a bubble waiting to pop. He points out that Australian house prices doubled in 8 years and quadrupled in 21 years due to a prolonged economic boom, a lengthy period of low interest rates, record levels of migration, government first home owner grants, and low levels of new housing construction.

Grantham argues that the true test of a bubble is whether a new generation of young buyers can afford a first home in a capital city at normal mortgage rates and home deposit conditions. "If not, the game is over and we are just waiting for the ref to blow the whistle. The timing and speed of the decline is uncertain, but the outcome is inevitable," he says.

### Affordable housing

The question of affordability was also highlighted by the latest annual Demographia International Housing Affordability Survey which rated Australia as the least affordable country in which to buy a home. The survey covers 325 cities in seven countries including the US, UK, New Zealand, Canada, Ireland and China. Sydney was second only to Hong Kong as the least affordable city.

Demographia considers housing markets are affordable when the average home costs three times the average gross household income or less.

Not surprisingly, the US has some of the most affordable housing. The collapse of the American housing market was a trigger for the Global Financial Crisis and the sector is still struggling. Average house prices in the US are now 33 per cent below their peak in July 2006 and there are still thousands of foreclosed houses hitting the market.

# Snapshot



Using the latest available figures, Sydney homes are valued at more than 10 times average incomes. The median house price in Sydney was \$500,000 at the end of March while the average taxable income is about \$48,000. The median home price across all capital cities was \$455,000 and is lower still in regional markets. Even allowing for this, and the fact that many homes are bought by couples with two incomes, the great Australian dream chews up a large chunk of the average household's take-home pay.

## Robust economy

While international comparisons are interesting, they mask important differences.

It is true that housing stress is on the increase in Australia, though forced sales and mortgage arrears remain at very low levels. The four major banks have all reported an increase in mortgage arrears in the six months to March 2011. Westpac, which has the biggest share of housing loans, stated that just 0.59 per cent of its outstanding home loans were in arrears by 90 days or more. This is an increase of 12 basis points (0.12 per cent) since September 2010.

Australia is also in a strong economic position. The resources sector continues to boost our national coffers, incomes are growing at 6 per cent a year, and unemployment, at just 4.9 per cent, stands out among developed economies as a sign of strength. Compare that with unemployment rates of 9 per cent in the US, 7.8 per cent in the UK and 9.9 per cent in the European Union.

## Signs of a soft landing

There is some evidence that an Australian property bubble, if it is indeed that, may be deflating gently. If that is the case then it reduces the chance of a property bust further down the track.

According to the RP Data-Rismark home value index, Australia's capital city home prices were flat in the year to March, down just 0.6 per cent in seasonally-adjusted terms. Sydney was the best-performing market, up 2.1 per cent, while Brisbane and Perth were the worst, down 6.8 and 6.4 per cent respectively.

The slowdown gathered pace in the March quarter when capital city property values fell 2.1 per cent. Outside the capital cities house prices fell 1.8 per cent during the quarter.

This is bad news for some homeowners, especially those who entered the market with the help of government grants and little deposit to act as a buffer against falling prices. Many of these recent buyers could find themselves with negative equity, that is, a loan that is greater than the value of their home.

But falling property prices are good news for prospective home buyers and investors, especially now that interest rates appear to be close to the top of the cycle, because it means that value should return to the market.

**Terry Cross Financial Services**  
91-93 Wentworth Street  
Port Kembla NSW 2505

**P** 02 4276 3311  
**F** 02 4276 3389  
**E** [info@terrycross.com.au](mailto:info@terrycross.com.au)  
**W** [www.terrycross.com.au](http://www.terrycross.com.au)

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