A good time to buy

There are several reasons why now is a good time to get into the market. Let's take a look at what they are. CHRISTOPHER JOYE

In the second half of 2011, I argued in these pages that it was becoming a good time to buy. I also maintained that we would see much improved activity in 2012.

The old war between housing extremists, like the infamous Steve Keen, who predicted enduring price falls of 20 per cent or more, and realists, such as myself, who expected a cyclical recovery, renewed with vigour.

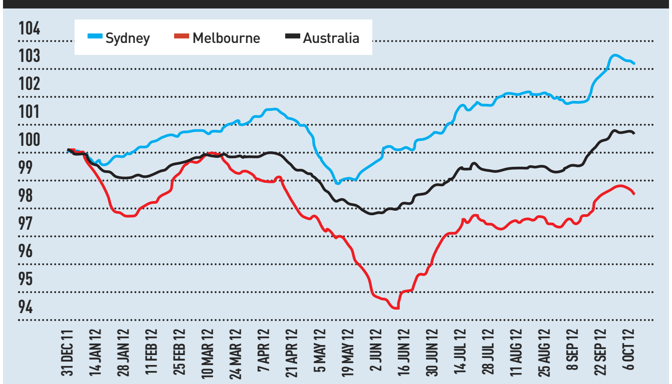
Many doomsayers in 2011 felt vindicated by the modest four per cent price falls, which they claimed were the harbinger of more housing gloom. As in 2008, they have been proved wrong.

In 2012 Australian house prices have started slowly accreting care of the Reserve Bank of Australia's (RBA) very loose monetary policy. We've seen especially strong, double-digit annualised capital growth in the major cities following a trough in early June (refer to my first chart).

Across the nation, home values are now up by about 0.6 per cent for the first time in 2012. In the month of September, dwelling prices surged at their strongest pace since March 2010.

Sydney, which I have long favoured as an investment destination, has been the outperformer, with prices rising by 3.1 per cent in the year to date.

RP DATA-RISMARK AUSTRALIAN DWELLING VALUES 2012



It's sobering to recall that when the RBA last dropped its cash rate to three per cent in April 2009, house prices across Australia jumped 14 per cent that year and inflated a further five per cent the next.

In Melbourne, home values spiked by a stunning 36 per cent over 2009 and 2010.

Australia's $4 trillion housing sector is exceedingly interest rate sensitive. In 1993 the value of all housing debt divided by the value of disposable household incomes was 55 per cent. Today that ratio is three times larger at around 150 per cent.

So when the RBA slashes rates, as it has been doing of late, prices tend to respond quite quickly. This is particularly true in Australia where the vast bulk of all loans are fully "variable" and generally move in line with the RBA's cash rate.

Today you can get three-year fixed-rate loans for around 5.3 per cent, which is below the official 5.6 per cent low recorded by the RBA during the global financial crisis. You can also get variable rate products for less than 5.6 per cent, which is only half a percentage point above the record nadir over the past 40 years.

It isn't, however, just about home loans. The RBA also determines savings rates, which are one of the key substitutes for housing investments. If you aren't buying a home, you probably have your cash in the bank.

Australians expect annual inflation to be just under three per cent, based on the average Westpac-Melbourne Institute survey estimates over the past six months.

The RBA's October cut will drive the average bank deposit rate down from 3.7 per cent in September to about 3.45 per cent. This is more than 100 basis points below its July 2011 level.

The news for online savers is worse. In September the average online deposit rate was 3.55 per cent. It will now be around 3.3 per cent, just 0.15 per cent above the record low in the April 2009 crisis.

More strikingly, the RBA will have shrunk online savings rates by a painful 155 basis points from their October 2011 peak.

Most savers will be earning skinny, if any, "real" returns above their cost of living, and this assumes the central bank keeps consumer price inflation within its target two to three per cent band.

Yet housing's expected returns have improved out of sight in the minds of main street.

According to RP Data-Rismark, the average gross rental yield is about 4.5 per cent. If buyers suppose house prices simply track incomes and transaction costs sap, say, 1.5 per cent per annum, they'll be targeting attractive total net returns of circa 7.5 per cent.

Since the marginal cost of residential funding has dropped

It's sobering to recall that when the RBA last dropped its cash rate to three per cent in April 2009, house prices across Australia jumped 14 per cent that year and inflated a further five per cent the next.

...when the RBA slashes rates, as it has been doing of late, prices tend to respond quite quickly.

from more than seven per cent in 2011 to less than 5.8 per cent today, many will be banking on earning leveraged returns in double-digit territory.

This comment about leverage is important. Housing is a unique investment class for several reasons. First, you can get loans from the bank for terms that are longer – typically 25 years or more – than any other form of credit. This means you don't have to worry about "refinancing" or rollover risks.

Second, the cost of secured housing debt is lower than any corporate or small business borrowing rates. It's especially cheap considering its 25-year term.

Finally, you can get higher loan-to-value ratios in housing than anywhere else. So your debt is long term, inexpensive and there's a lot of it available if you need it.

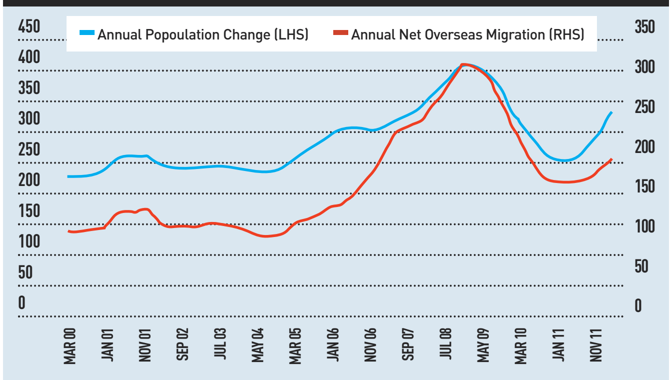
While housing leverage can amplify your returns, it also heightens your risks.

Since 2000, about one in 10 property investors have lost money on selling their home. So, remember, it's not a one-way bet.

Beyond 40-year lows in mortgage rates, improved affordability and recovering house prices, another reason it's time to buy is the rebound in population growth rates.

Over the cycle, population growth is the biggest driver of housing demand. New building approvals have been weak for years. A dip in population growth, and net overseas migration particularly, following the last Federal Election, put a dent in Australian housing demand. But as my second chart shows, population growth is now rising rapidly, fuelled by a bounce in net migration.

ANNUAL AUSTRALIAN POPULATION GROWTH (,000)



Housing cycles tend to be slow-moving beasts that unfold over a period of years. There is, therefore, no immediate rush to dive into the market. But it's certainly time to start thinking about it. **api**

Christopher Joye
is a director of Rismark and a leading housing and financial economics commentator.