


As housing cools down, location will be the key

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Over the past three to four decades, Australia property prices have benefited from a rising tide. Anyone who purchased a property in the 1980s is probably sitting on a lot of equity, almost irrespective of where that property is.

What seemed to be an endlessly rising tide was stimulated by several events that are unlikely to repeat over the next three to four decades.

As such, it is more important than ever for investors to select the right locations to invest in.

Perhaps the most significant event was the increase in borrowings. Australians have been willing to borrow more and more. Australian banks are lending two to three times more to

borrowers than they were three to four decades ago. It is not uncommon today for an Australian to borrow up to 10 times their annual income.

Banking deregulation in the 1980s and 1990s also added to the rise in borrowings by opening up competition, which halved home loan profit margins. Almost overnight potential borrowers were being approached (marketed to) by the banks, not the other way around.

Borrowing capacity peaked just before the GFC in 2008-09. Since then, tightening regulation and responsible lending laws have caused a contraction in borrowing capacity. From here on, it is likely that any increases in borrowing capacity will now be tied to incomes.

Of course, Australia's strong population growth has contributed to housing demand and price appreciation. Australia has been growing at a faster rate than many other developed countries, mainly due to our higher immigration.

This is probably the only factor that I expect to continue to contribute to rising house prices. In a global context, Australia's handling of the virus will be looked upon very favourably. In the

long run, I expect Australia will enjoy increased demand for immigration.

Assuming the government's skilled immigration policy remains unchanged, our population growth rate is likely to recover quickly and remain unchanged.

Another factor that has stimulated property prices is the growth in family income.

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It is a lot more common for both spouses to work compared to 50 years ago. In fact, often it is necessary for both spouses to work in order to afford to live in their desired location. This transition from a one to double-income households can only occur once.

The currently benign wage inflation rate has been well documented. In 1980, average weekly earnings was \$815 in today's dollars. Today, average weekly earnings is \$1815. That equates to a 2 per cent real growth rate over the past 40 years.

I'm not aware of any economist that is predicting wages will grow at this rate over the next 40 years.

Of course, there is always a relatively small percentage of the population that enjoys above-average increases in income. Sadly, the gap between rich and poor gets wider each year. COVID has contributed to this as the lockdowns have impacted lower income earners. This means locations that are dominated by higher income earners might experience higher levels of property price appreciation in the future. As such, the property value gap between blue-chip locations and outer suburbs is likely to widen.

Drive around any newly developed residential suburbs and you will quickly notice that the dwellings are massive, especially compared to homes built pre-1970s. More bedrooms, bigger living areas and smaller backyards. The amenities are also better than what you find in older homes.

These improvements all contribute towards the general increase in property values. But there's a limit to what you can build. It's unlikely that rise in improvements will continue to contribute the same uplift in property values as it has over recent decades.

In summary, the dramatic increase in borrowings has fuelled property prices, but borrowing capacity has peaked. The transition to double-income families and rising wages also contributed to property prices, but family incomes have stagnated. Therefore, the one major contributor that is likely to remain is population growth.

As the saying goes, in a rising tide, all ships rise. Since the early 1980s, Australian property prices have benefited from a rising tide. You could have purchased a property in the early 1980s in any capital city in Australia and it would have made you a lot of money.

But the tide may not continue to rise. The factors that have helped lower-to-middle income earners increase their purchasing power over the past few decades probably won't repeat themselves. Middle and outer ring locations may experience lower property price growth rates.

This means the type and location of the property you invest in will matter a lot more over the next few decades than it did over the previous cycles. In other words, it is critical to embrace an evidenced-based asset selection methodology so that you invest in the right property in the right location.

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