

Normality resumes: Why house prices will move off the boil this year

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The internet and newspapers are awash with stories of properties selling for amounts wildly above reserve. Such news can create FOMO (fear of missing out) and further fuel buyer demand. However, price growth will level out this year.

We must put recent property price growth in context. Up until the beginning of this year, median house prices in most capital cities were materially similar to 2018 levels. Therefore, there has not been much price growth for the past three years.

In fact, it has been a tumultuous period for the property market. Tightening in credit (borrowing capacity) occurred throughout

2017 and 2018, which reduced the volume of property buyers, particularly investors.

During 2018 and 2019, the ALP's election policy of banning negative gearing and lifting the rate of capital gains tax weighed on property market sentiment. And then in 2020 we had COVID and the resultant lockdowns.

All these factors have meant that property prices were largely stagnant for the past three years. The average median house growth rate in capital cities is about 7 per cent per annum over the long term. So, if we look at it from that perspective, the intrinsic value of property today should be more than 20 per cent higher than 2017-18 levels (being three years of compounding growth). After all, mean reversion is a persistent trend in financial and property markets.

Also, we must remind ourselves that properties can sell for above reserve for multiple reasons. It is possible that the advertised reserve was unrealistic (too low). Nonetheless, there is no doubt that some properties have achieved astounding prices.

Any prospective property buyer has had good reasons to delay purchasing over the past three years, including credit tightening, the negativity surrounding the 2019 federal election and COVID.

All of these events resulted in consecutive negative predictions for the property market.

This resulted in pent-up buyer demand. But not all buyers can delay their property purchasing plans forever, particularly if they need to buy for practical reasons such as changing locations or increasing the size of accommodation (for families). But this pent-up demand will eventually evaporate and demand will normalise.

Price growth this year has been driven by higher than normal buyer demand and lower than normal property supply as listings are 36 per cent below their five-year average.

A “discretionary vendor” is someone who would like to sell a property but is not motivated to do so in any particular time frame. Discretionary vendors would have most likely delayed selling over the past three years for the reasons previously mentioned.

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If property market sentiment remains buoyant, it will encourage more discretionary vendors to sell this year, probably in spring.

By the time we get to spring, most people, especially Victorians, will have acclimatised to non-lockdown living. Meanwhile, we can hope the vaccine rollout has advanced sufficiently to reduce the likelihood of further snap lockdowns. In other words, property listings will increase materially in spring. This is likely to temper price increases.

I recall property prices jumped sharply between early 2016 and early 2017. They subsequently levelled off. During 2016 it was easy and, for some buyers tempting, to overpay for property.

In a hotly contested market, buying a property for less than fair market value is near on impossible. It is reasonable to be prepared to pay a fair market value. But there is no need to overpay. Prices can spike and then normalise only a few months later. People who overpaid in early 2016 would have been in a loss position (on paper) by the end of 2017.

It seems almost everyone is optimistic about property at the moment. But it is important to remind ourselves that it's not - impossible for property prices to come back a bit, especially if supply increases. In fact, last week, MLC's chief economist Bob

Cunneen predicted that property prices would fall 7 per cent next year off the back of higher interest rates among other things.

In the year ahead, blue-chip locations will continue to perform well. However, for the reasons described, I would not be surprised if price growth between now and the end of the year finished up at a modest 5-8 per cent.

Outer-ring locations that are dominated by lower-income earners may underperform compared to blue-chip locations. The reason is the lowest 40 per cent of income earners have been affected by COVID the most.

Locations where it is attractive to work from home and sea or tree-change districts will probably continue to be dominated by low supply, which could drive prices higher.

It seems like over the past decade or so there have been a series of once-in-a-lifetime events. The GFC, COVID, floods and fires and so on. Therefore, it is probably wise to expect the unexpected.

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