http://www.smartcompany.com.au

Is the Australian property market headed for a major correction?

Author: *Michael Yardney* on 15 June 2011

There is a property debate raging at present – is the future for property bright or is the bubble about to burst?

Obviously if you are considering investing in property, or about to buy a home, it would be good to know who's right.

After a number of boom years we have entered a flat period in the property cycle, but what's unusual this time around is that every state is in the slump stage of its cycle. The trouble is that the negative media surrounding this is spooking many inexperienced investors.

I've heard many theories as to why the property bubble will burst. Some doomsayers are predicting a property crash because house prices have risen too high and are now unaffordable. Others suggest we have taken on too much debt both personally and as a nation.

Just because houses prices are high or unaffordable to some doesn't mean we have a property bubble.

How have property markets corrected in the past?

To understand what's ahead, let's look at what happens when property markets got ahead of themselves in the past.

Sydney had a terrific boom between 2001 and February 2004. In fact, it was one of the best performing property markets between 1996 and 2004, helped in part by the excitement related to the Olympic Games.

After this boom the Sydney property market *corrected*. It didn't collapse – it just *corrected* – with values falling from peak to trough by -9.3% and this fall took a total of 23 months to play out according to **RP Data.**

Of course, not all parts of the Sydney market dropped in value equally – some areas held their values well. And even in the regions where values fell, property prices didn't plummet – they gently followed a downward path.

But look at where Sydney property prices are today – most properties are worth significantly more than they were at their high point in 2004.

A similar pattern occurred in Brisbane and Perth where values peaked in February 2008 after a long boom in both cities pushed their house prices well above the average national price growth. Again property prices didn't collapse – they just sauntered along allowing the fundamentals to get back into alignment.

Going back to the previous decade much the same happened in the early 1990s when we experienced "the recession we had to have". After the remarkable property boom of the late 80s, interest rates rose to peak at around 17% and the property markets around Australia stalled. But once again they didn't collapse. They just flatlined for a few years as affordability, supply and demand caught up.

The only time Australian property values dropped significantly (albeit for a short time) was after the Second World War and during the Great Depression.

In the 1940s house prices dropped 17% over a two year period, but according to John Edwards of **Residex** they jumped back and grew strongly for many years after that.

Property values also dropped during the Great Depression when unemployment was high, but times are different today. No one is suggesting that Australia is heading for a Depression; in fact we're experiencing the opposite – a booming economy. That's why talk of a property market collapse is nonsense.

Why don't Australian property markets collapse?

Well some do!

Just look at the Gold Coast, where the values of some properties have fallen by 40%.

But here's why… the Gold Coast is driven more by speculation than by underlying supply and demand fundamentals. The large fall in prices there is because there is too much developer stock on the market and the fact that many people are selling up their holiday homes after the GFC.

The point is that in general our capital city property markets don't collapse because they are illiquid. People don't sell up their homes just because interest rates rise or when times get tough.

What could cause a property market collapse?

Looking at what has happened in the past, both here and overseas, the factors that could make our markets collapse are:

- A **depression** or a severe recession – no one is suggesting this is likely in the near future with the mother of all mining booms buoying up our economy.
- **Unemployment** levels so high that a mass of people can't afford to keep their homes. Again this is unlikely to occur with unemployment levels being as low as they are.
- **Interest rates** rising to levels that cause home owners to default on their mortgages. Hopefully the RBA won't allow this to happen.

Why property won't crash

There are a number of reasons why we won't see major falls in home prices in our capital cities any time soon. We have:

- Robust population growth fuelled by immigration and to a lesser extent strong natural population growth. While immigration levels have dropped, we're still growing at a faster rate than any other country in the developed world.
- A healthy economy that will continue to perform at a level that is the envied by much of the Western world and will create jobs for anyone who wants one.
- A sound banking system with reasonable interest rates, tight lending practices and low default rate.
- A shortage of properties in some locations, which means rents will rise.
- Difficultly getting finance for new developments and rising construction costs, which means new developments will be more expensive and underpin the value of established homes.
- A healthy level of household debt. Sure we are borrowing more, but the debt tends to be in the hands of those who can afford it. Many Australians are saving more, taking on less credit card debt and paying off their mortgages faster than they need to, which improves the state of their personal finances. This in turn reduces the risk of house prices collapsing if interest rates rise or the economy hits a speed bump.

- A culture of home ownership – 70% of us own or are paying off our homes. In contrast to some overseas markets, Australians have high equity in their properties and a conservative debt position. In fact, half of all homes have no debt against them.

What’s ahead?

There’s no sugar-coating it… Australian house prices are high, but affordability has increased over the past year thanks to flat property prices and wages growth. Recent research from Rismark shows the average dwelling price-to-disposable household income ratio has fallen from a peak of 4.7 times in December 2009 to 4.2 times in the 2011 March quarter.

Yet there is still a large demand for housing – people are still getting married, having babies, getting divorced and coming from overseas. And if they can’t afford to buy their homes they are going to rent and this will force rentals up.

The bottom line is we are now moving into the stabilisation stage of the property cycle where values may only grow a few percent higher than inflation for a few years, but it’s a time when investors will be compensated by higher rents.

Of course, being a buyers’ market will mean that an informed investor will be able to pick up a great investment property below intrinsic value if they do their research and negotiate wisely. And when they look back in a few years time they’ll wonder why they didn’t buy more properties while others were waiting for the bubble to burst.

Michael Yardney is the director of Metropole Property Investment Strategists, a best-selling author and one of Australia's leading experts in wealth creation through property. For more information about Michael visit ***www.metropole.com.au*** *and* ***www.PropertyUpdate.com.au****.*