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Brief: RBA_MENT

Shaky foundations

Property Forget the Australian dream of owning your home. Research shows you may be better off renting, writes **Rebecca Thistleton.**

Buying your own home is an emotional decision – triumph at seeing the sold sticker on your dream home, relief at getting the OK for your loan and inhaling sharply at the first mortgage payment. But what if paying weekly rent and relaxing were the better financial option?

While many believe the security of owning a home can offset the highs and lows, renting can be an easier option – and now the Reserve Bank of Australia says it may be smarter financially. The RBA's research discussion paper "Is housing overvalued?" blows a hole through the ingrained belief that property values always rise. Its analysis shows slowing price growth rates make renting more attractive than buying.

So does avoiding mortgage and interest repayments, as well as home purchase costs and stamp duty, mean it is possible to rent your way to riches? Home ownership is core to the Australian psyche, more so than a number of other Western countries. The question that the paper's authors, Ryan Fox and Peter Tulip, posed – and their conclusions – sparked mass media debate about home ownership and renting.

The heart of the RBA's argument is based on 2.4 per cent, a little figure, which represents the real rate of house price growth since 1955 annualised over that time. That's nominal growth of 5 per cent once you take into account inflation.

In more recent times – over the past 10 years – it's slowed to 1.7 per cent a year.

The RBA says if prices continue on that 2.4 per cent long-term trajectory, the cost of buying a house would be the same as renting. Remember, that's actually 5 per cent nominal growth – the figure most of us use. But if growth slows, as some forecasters predict, and continues to hover around that 1.7 per cent, from now on average home buyers would be financially better off paying rent instead. That's based on buying costs including conveyancing fees, stamp duty, maintenance, wear and tear and mortgage payments.

At today's values, home prices would need to rise 5 per cent a year for buyers to recoup all these costs compared to renting.

At a micro level, a house is worth what a buyer is prepared to pay, with sentiment playing a big role in home-buying decisions. The RBA has found prices are sensitive to assumed capital gains. The paper's authors say future growth expectations implied by today's house prices are in line with historical norms – prices have risen in line with expectations – and the long-term annualised real growth rate of 2.4 per cent should allay fears of a price bubble.

Economic and property commentators have welcomed a gradual slowdown in house price growth since – especially in the past two years – it is considered unsustainable.

Disheartening as it sounds to owners who have

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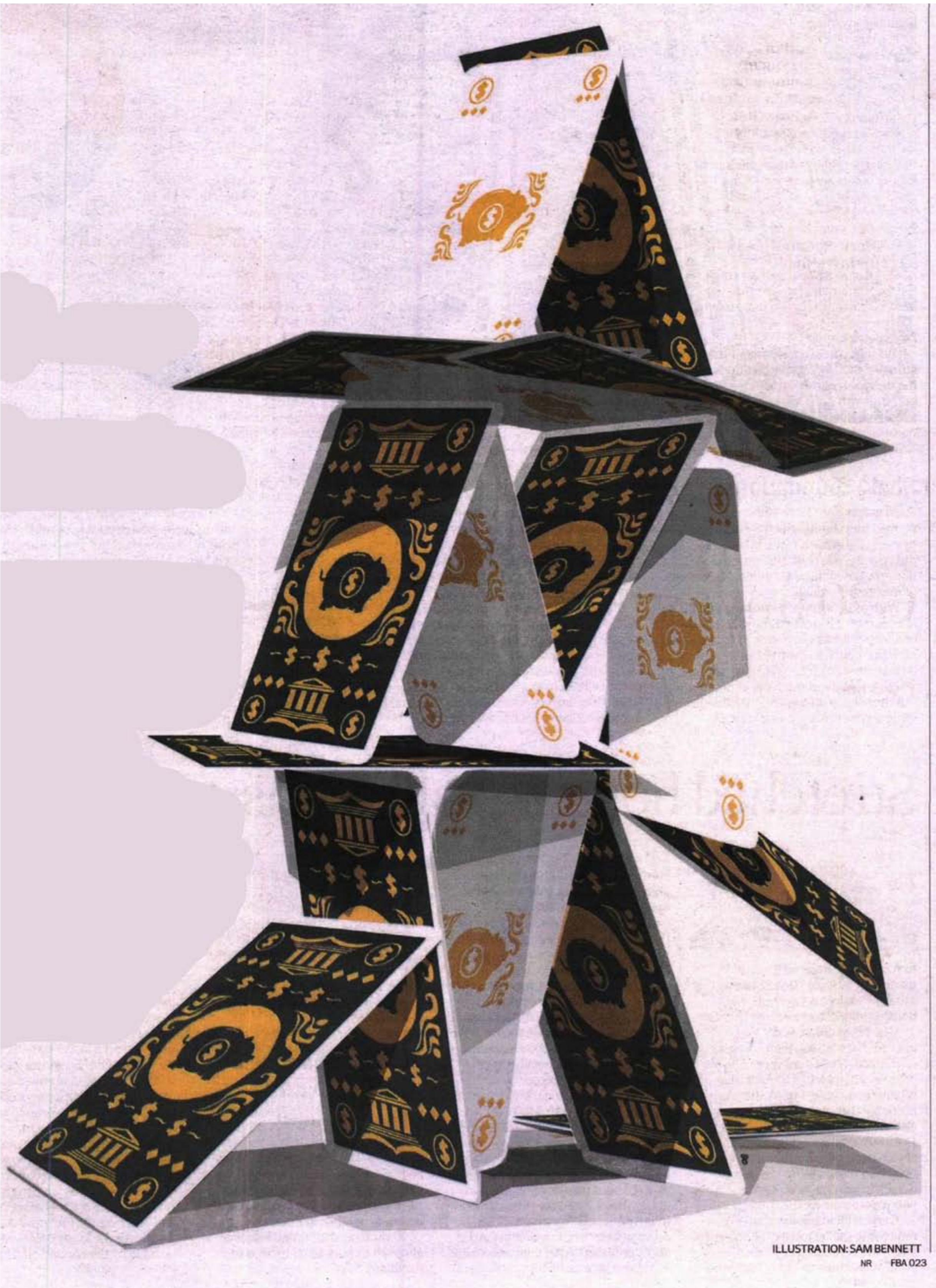

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rubbed their hands gleefully at the 2013-14 house price growth rates, imagine if prices did rise at 5 per cent: the national median house price would be $1.1 million in a decade, worsening affordability woes.

With today's interest rate lows and buoyant market, it is understandable that buyer confidence is high, so why won't prices grow at 5 per cent? Even the bulls, however, believe the end of the price rise run is nigh. Wage growth is about 5 per cent annually, but there is no guarantee growth will continue and there are job-market fears.

The RBA argues the costs of owning versus renting must be considered in the housing equation as much as comparing house prices to buyer-income ratios. The paper accounts for all the quantifiable costs to rent and to buy. RBA analysis shows the cost of buying – stamp duty, agent fees and conveyancing – is about 0.7 per cent of the home's value spread over 10 years. Home wear and tear can depreciate value by 1.1 per cent.

But it considers more than just raw numbers and acknowledges the emotional stability sought in ownership. The authors admit number-crunching cannot measure pride of ownership, security of tenure and the freedom to whack nails in the wall at will.

Further, buyers advocate Paul Osborne, founder of Secret Agent, says owner-occupiers do look for properties that offer growth opportunities. There's also a psychological benefit for a lot of people, particularly with families, who feel more secure as owners.

Housing affordability pressures and the struggle to save a deposit keep many renters out of the market, but the ability to live within the 10-kilometre radius of the CBD means plenty of tenants are happy to pay to live in someone else's property.

Financial planner Suzanne Haddan, of BFG Financial Planning, says permanent renters must be financially disciplined.

"You need to ensure you have enough saved to meet your living expenses, including rent, especially for retirement. The money that would have been used to meet the additional costs of home ownership over rent should be invested to provide the money for rent and costs of moving periodically throughout your life."

Haddan says analysis showing that renting wins out over buying makes the assumption an individual has made broader financial plans and has sufficient income, particularly once retirement approaches.

Deloitte figures show a comfortable retirement requires about $600,000 in superannuation. The Australian Bureau of Statistics estimates today's retirees move into a new life-stage with about $150,000. Many own their home, having paid down their mortgage.

If a tenant's superannuation is lower than their previous salary and pressure in the rental market increases their weekly costs,

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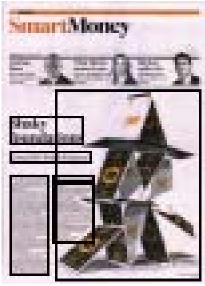

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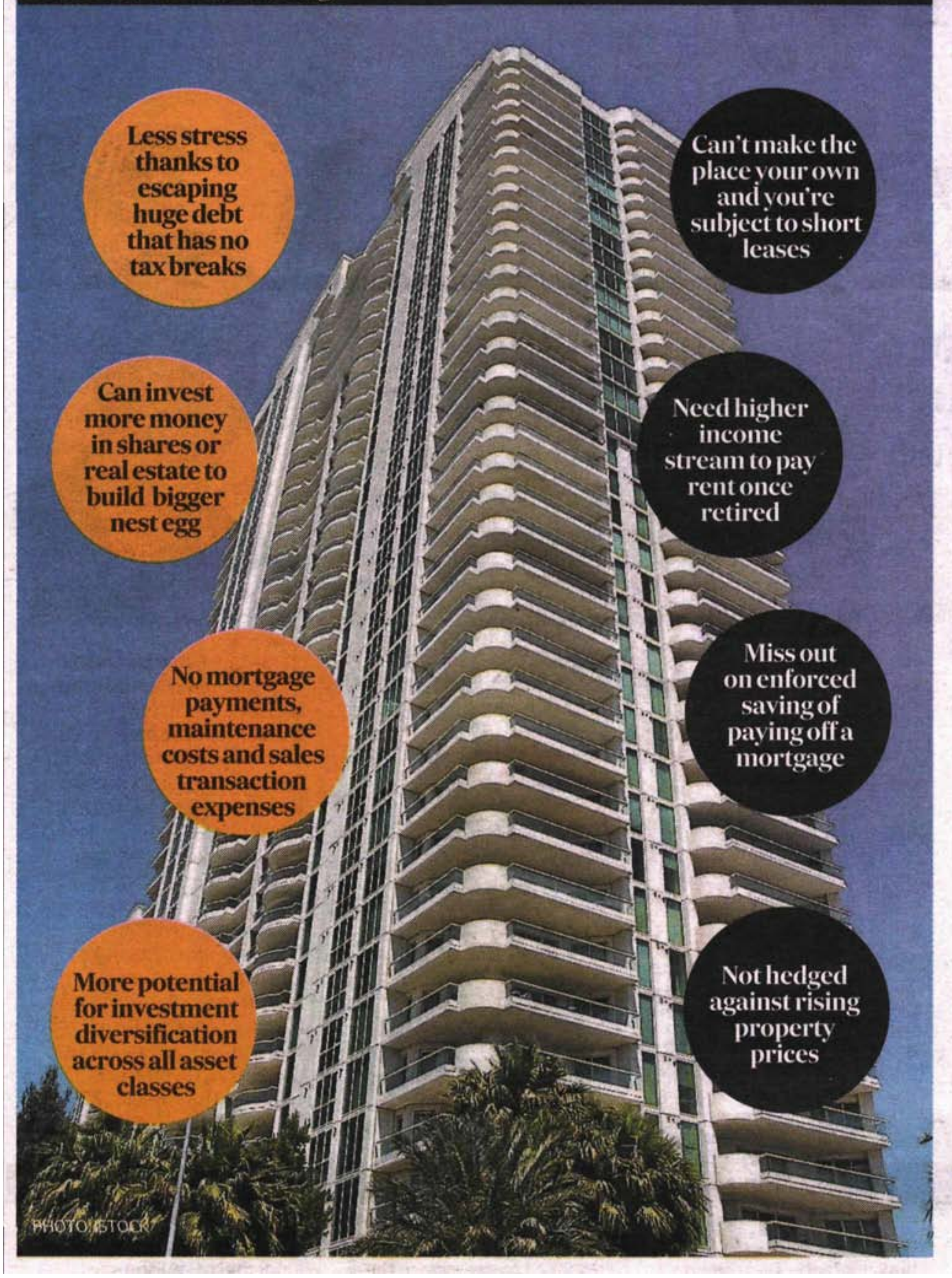
Pros and cons of leasing



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