
THE AGE

Shorten battered & bruised

Age
Thursday 9/7/2015
Page: 1
Section: General News
Region: Melbourne Circulation: 106,843
Type: Capital City Daily
Size: 996.00 sq.cms.
Frequency: MTWTF--

House prices 'should be higher'

Peter Martin
Economics Editor

Despite fears of a property bubble, Australian house prices are 30 per cent undervalued, the widest such gap in three decades, research conducted within the Reserve Bank has found.

The research found current price expectations neither "unusual" nor "irrational".

Delivering the preliminary results to a session on housing at the Australian Conference of Economists in Brisbane, and stressing that they should be attributed to him and not the bank, Reserve senior research manager Peter Tulip said that whereas a year ago home prices were "fairly valued", today they are about "30 per cent undervalued".

The change has been brought about by much lower mortgage rates and by changes in bond prices that imply mortgage rates will hug their present historic lows for a further decade.

In the past year, Sydney house prices have climbed 16.2 per cent, Melbourne prices 10.2 per cent and national capital average prices 9.8 per cent.

But Dr Tulip and his co-author, Ryan Fox, argue rising prices say nothing about whether home ownership is good value compared with the alternative, which is renting.

"We find that owning a house costs 30 per cent less than renting," Dr Tulip told the session. "That is, houses are 30 per cent undervalued.

"Another way of interpreting our results is to look at the

Continued Page 6

Age
Thursday 9/7/2015
Page: 1
Section: General News
Region: Melbourne Circulation: 106,843
Type: Capital City Daily
Size: 996.00 sq.cms.
Frequency: MTWTF--

Property prices 'should be 30 per cent higher'

From Page 1

expectations underpinning current house prices.

"Our results suggest that those expectations currently look fairly reasonable. They do not show unusual optimism, they do not show irrational exuberance.

"But this hasn't always been the case. Just one year ago … we found that houses were fairly valued – that is, the cost of buying was about the same as the cost of renting.

"What has changed since then is that real long-term interest rates have fallen substantially. That fall made housing more attractive relative to renting, despite the increase in prices."

Dr Tulip and his co-researcher compared the cost of renting and buying identical properties, avoiding the common trap of comparing national average rents with national average prices. Because owned homes are typically "bigger and nicer" than rented homes, a lot of the apparent price difference reflects a quality difference.

They calculated the annual cost of a bought home from the purchase price, the transaction cost, the expected mortgage rate and the running and depreciation costs offset by expected capital gains.

The annual cost of owning a home bought in April was likely to be 2.7 per cent of its value. The annual cost of renting the same home was likely to be 3.9 per cent.

"So you can either pay 2.7 per cent of the value of the property to buy, or you can pay 3.9 per cent of the value to rent," Dr Tulip said. "The undervaluation is 30 per cent.

"It's unusually wide, the widest in at least 30 years … Under our assumptions, owning a home is now more attractive, relative to renting, than it has been at any time in the past 30 years."

The change in the past 12 months is partly the result of this year's two interest rate cuts, which have brought the typical discounted mortgage rate to about 4.6 per cent.

Dr Tulip said that even more important was the change in bond yields, which meant the market was now expecting little change in interest rates for a decade. A year ago the market had been expecting interest rates to climb.