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Vaporising the Aussie Dream

Minding my own business reading the paper over breakfast the other day, I came across an article that claimed Perth (19th), Mandurah (6th) and several east coast locations to be among the 20 most unaffordable housing markets of 227 population centres in the US, UK, Canada, New Zealand, Ireland and Australia. What?! I could not believe it. Sure, we all know that house prices in Perth are verging on the ridiculous… you have to be a hermit not to hear about it every day, but where are the countless other major cities in these countries? Are our houses really considered expensive in places like New York (28th) and London (18th): cities that historically have always outranked us in house price / income ratio's? I found the relevant report on the net and yes to all of the above. To put some numbers on it: in Perth the average house price today sits at 7.6 times the average income (up from 4.0 in 2001), which is more than 2.5 times higher than the "affordability threshold" of 3.0. Another telling statistic: in 2007 no less than 70% of the average income was required to pay the average mortgage: double the 35% required in 2000.

So where does that leave us in WA? It leaves home owners under pressure of large mortgages, have-nots with the giant task of trying to get a foot in the market and investors wondering if the risks are beginning to outweigh the potential gains. House prices are still moving up in Perth's better suburbs but are on the way down in others. To buy or not to buy? And what about the Aussie Dream of owning your own home? In other countries, the dream is backed up by policy – in Holland, for instance, interest paid on an owner-occupied home loan is tax-deductible, while interest paid on an investment property loan is not. It's the other way around here. Yes, First Home Owner Grants of $7,000 help and WA Stamp Duty exemptions for first home buyers for houses up to $500,000 are fantastic, but the fact remains that buying your first own home in Perth will cost you big time. Going from say $350/week in rent for a house within 15 km of the CBD to mortgage repayments of $865/week for a $450,000 house in a lesser suburb is not going to help your lifestyle and may put serious pressure on the family.

For the lucky ones, who did buy before the "boom" and are now sitting on lots of unused equity, Perth may not be the best market either. Rental yields are increasing but are still significantly lower than most other cities and property value is actually decreasing in the more affordable suburbs. (If all else fails, you can always use the equity to buy a boat, of course, but that may not work in that well with your wealth-in-retirement plans.) Sure, whatever you may loose on an investment property initially, values do not usually slide for long and chances are that you will gain it back several times over in just a few years, but if you have the opportunity to invest elsewhere where capital growth and rental yields are better, why wouldn't you?

As a mortgage broker, I get to talk to all sorts of investors and speculation on new Australian property 'hotspots' is invariably a topic of conversation, yet relatively few actually buy in other cities – even when most have 'pet locations' over east or in Adelaide. And that's not really all that surprising considering valid concerns like: the stress of buying 'blind', not being familiar with the area or regulations and the trouble of arranging trustworthy local agents. Yet, the fact remains, that most of the best performing real estate markets are not in WA.

But let's get back to the Perth First Home Buyers for a minute… Should they really be buying their first home in Perth's over-the-top market or, perhaps, also consider other options? Take the following two young couples with about $15,000 in savings and a double income allowing them to pay $800/week for housing & investments. Couple A, the Smiths, buy a home in Perth for $420,000. Their repayments (at 8.5%, 30 year term) will take the full $800/week they have available, while their $15,000 in savings is used to cover a 3% deposit and fees.

The Baileys, on the other hand, choose to ignore the Aussie Dream for now and buy a $300,000 off-the-plan unit as an investment property in, say, Queensland. Their off-the-plan contract stipulates a 10% deposit upfront with the full purchase price minus the deposit due in May 2010, when the complex is finished. They put up their $15,000 in savings and get a personal loan over 2 years (interest rate of 14%) for the other $15,000 and put the deposit down. They'll be paying $530/week ($350 in rent and $180 in loan repayments) for 2 years, allowing them to save $270/week. In May 2010 they own $30,000 (fully paid off deposit) + $3,000 (interest earned on deposit) + $31,000 (2 years of saving $270/week + interest) = $64,000. They now buy the investment property for the price arranged in 2008, i.e. $300,000, with the $30,000 deposit and another $17,000 in fees, stamp duty and mortgage insurance, leaving $17,000 in their account as a buffer. From now on they'll require to pay $545/week in interest only repayments and body corporate fees (associated with the QLD complex) but should receive a minimum return of $280/week in rent after allowing for agent fees. They'll end up being responsible for, say, $400/week to keep renting in Perth themselves (in 2010) and $265/week to hold on to their investment property.

Without going much further into the figures, the point I'm making is that the current property prices in Perth have the potential to stifle families that choose to follow in their parent's footsteps and buy their own 3 bedroom home. The Smiths are up to their neck in debt, have nothing left to save with and could easily be put under pressure by anything to upset the current arrangement, whilst the Baileys continue to be able to save $135/week, have a serious buffer to cope with unforeseen challenges and are at all times able to sell off their investment property in the real estate market they selected. Apart from that, the Baileys will gain another $7,000 - $9,000 (depending on their income) back each year in tax – which adds up to be more than half their weekly contribution to hold it; and are, to put another myth to bed, still eligible for the First Home Owner Grant and stamp duty exemption for when they do end up buying their own home in WA.

It's all about options and making informed decisions. Just because we live in Perth does not mean we automatically have to buy into the local market. For low-end investors and first home buyers especially there may well be other, more attractive, options elsewhere. Of course, it will take some research and risk assessment, but there are WA companies that specialise in guiding you through the process and selecting the more attractive developments and areas. At Lakeshore Finance, in fact, we started to get so many similar questions from our investors that we've done a chunk of the homework for them and selected a WA-based and "Quality Endorsed" investment coaching firm with a solid reputation to provide our clients with solutions, or, at least, answers. Judging by the response so far, we've done the right thing and that does not surprise me. It's about time that people are made aware of the other options available to them – now that our once-affordable city has gone mad.

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