Housing Affordability

MaxCap Group Research – September 2024

The big squeeze

The housing affordability crisis. There has been a big deterioration in housing affordability in 2023 and 2024, comparable in severity to the early 1990s and the mid-2000s. This time, affordability has weakened with lower real household incomes and higher mortgage rates.

A financial arms race. Housing affordability is not a new issue, given the enduring popularity of homeownership. Over time, buyers have keenly pushed up prices by bringing more income (from a second wage earner) or more debt (with structurally lower interest rates).

The Bank of Mum and Dad. In this cycle, we have seen an unusual source of pricing resilience in the housing market, as buyers brought more equity to the table, potentially from family sources (the so-called Bank of Mum and Dad) or from other pools of household wealth.

Local pressure points. At a local level, affordability measures are especially overstretched in the more desirable parts of Sydney, Melbourne and various beachside hotspots. In these markets, pricing more reflects desirability, rather than any affordability constraints.

The affordable path ahead. Given these challenges, there is a turning point for affordability ahead, particularly with the expected peak and decline in mortgage rates. Over time, buyers will also economise via shifts to more affordable apartments, suburbs or even cities.

Strategies around the affordability cycle. For investors and lenders, there are predictable shifts in demand patterns ahead, especially in an environment of considerable housing undersupply, and a need for would-be buyers to manage their entry into the housing market.

MaxCap Research Team:

Bruce Wan
Head of Research
bruce.wan@maxcapgroup.com.au

Nicholas Moorman
Research Analyst
nicholas.moorman@maxcapgroup.com.au

Further out of reach

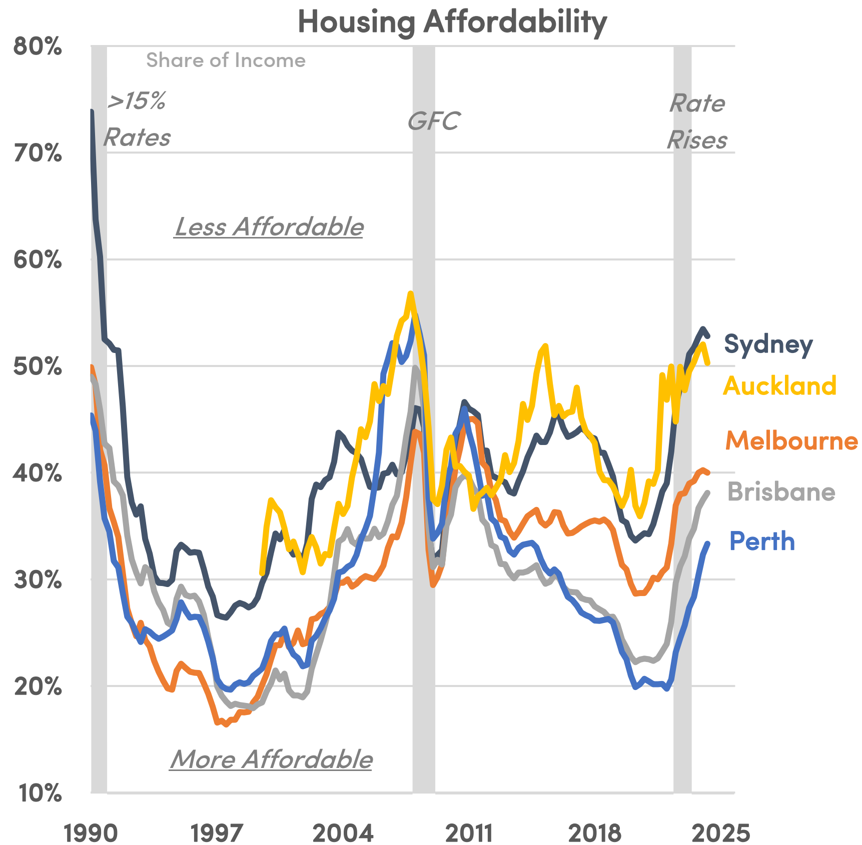
Since 2022, we have seen a dramatic **deterioration in housing affordability**, across many developed markets around the world.

- Certainly, this erosion can be seen in both Australia and New Zealand, where **housing affordability indicators** – measured as a combination of household incomes, mortgage rates and dwelling prices – have weakened markedly due to rapid population growth, inadequate housing supply, rising mortgage rates and falling real incomes.
- Across these major cities, the worsening in housing affordability has been broad, but not entirely uniform. The affordability challenge – in the context of local household incomes – has been relatively **more pressing in specific cities**, particularly in Sydney and Auckland.
- In 2024, this lack of housing affordability is approaching (and in some cases exceeding) the **previous cyclical peaks** seen in history, especially during the high-rate environments immediately before the early 1990s recession (when mortgage rates peaked at 17%) and just ahead of the Global Financial Crisis (before the sharp cuts in rates).
- More so in this cycle, the challenges of housing affordability is stretching well beyond the sale market and into the **rental market**. Indeed, ultra-low vacancy rates (August 2024: 1.3%) are still adding considerably to rental growth and financial distress for renters.

There are profound **economic and social consequences** associated with poor housing affordability.

- The issue of housing affordability carries **disproportionate effects** for the young, the poor and the most vulnerable in society. More specifically, a lack of affordable housing limits access to essential shelter, increases financial distress, reduces labour market mobility, contributes to overcrowding, diminishes quality of life (with longer work commutes) and adversely impacts on social equality. Consequently, there is increasing political pressure for policies to address this issue.

Indicators of housing affordability have deteriorated significantly since 2022, on the back of marked undersupply, falling real household incomes and most acutely with higher mortgage interest rates.



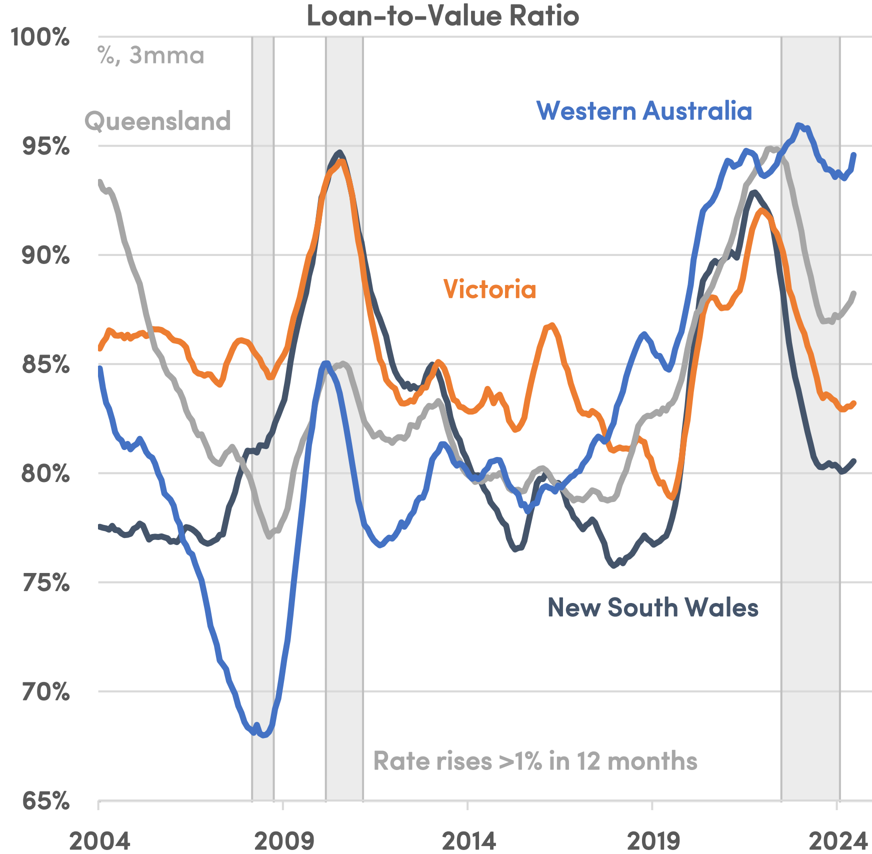
Source: ABS, Corelogic, Proptrack, RBA, MaxCap Group (September 2024)

The financial arms race

Undoubtedly, there are longer-term **structural factors** impacting housing affordability, above and beyond the near-term cyclical drivers.

- Over many decades, we have seen a clear **financial arms race** in the property market, reflecting the enduring popularity of the sector, as potential buyers eagerly bring more income, equity or debt to the equation and, in so doing, drive up housing prices to new heights.
- We have seen this with the long-running structural shift to **dual-income households**. Certainly, increased labour market participation is a clear boon for economic productivity, engagement and equality. At the same time, these households have moved to commit both incomes to larger loans and more expensive housing, accelerating price growth.
- Similarly, the move to **inflation targeting** since the early 1990s have structurally reduced inflationary expectations and neutral interest rates (notwithstanding some modest retracements since 2022). Over time, households have compensated for structurally lower mortgage rates with – again – larger loans and the move to more expensive housing.
- Meanwhile, there is a newer element to this financial arms race, which is becoming more evident with the aggressive rate hikes since 2022. Simply, there is **more equity** behind recent homebuyers, with loan size growth trailing home price appreciation. Some of that may relate to the so-called Bank of Mum and Dad (or seed equity from family members) or increased household wealth generally (from the sale of financial or other real estate assets).
- Interestingly, we have seen similar periods of increased equity or reduced leverage from homebuyers during previous market cycles. These phases of diminished leverage correspond well with prior episodes of rising interest rates, as buyers shifted from debt to equity. Altogether, this has been **an unappreciated feature** in this cycle, which has held up dwelling prices in the face of rising mortgage rates.

Given rising house prices and mortgage rates, it is interesting to see a relatively slower escalation in average loan size, as would-be buyers draw upon their pools of equity, from personal or family sources.



Source: ABS, Proptrack, MaxCap Group (September 2024). Loan-to-value ratios are inferred from the average dwelling values and average loan size (for existing dwellings).

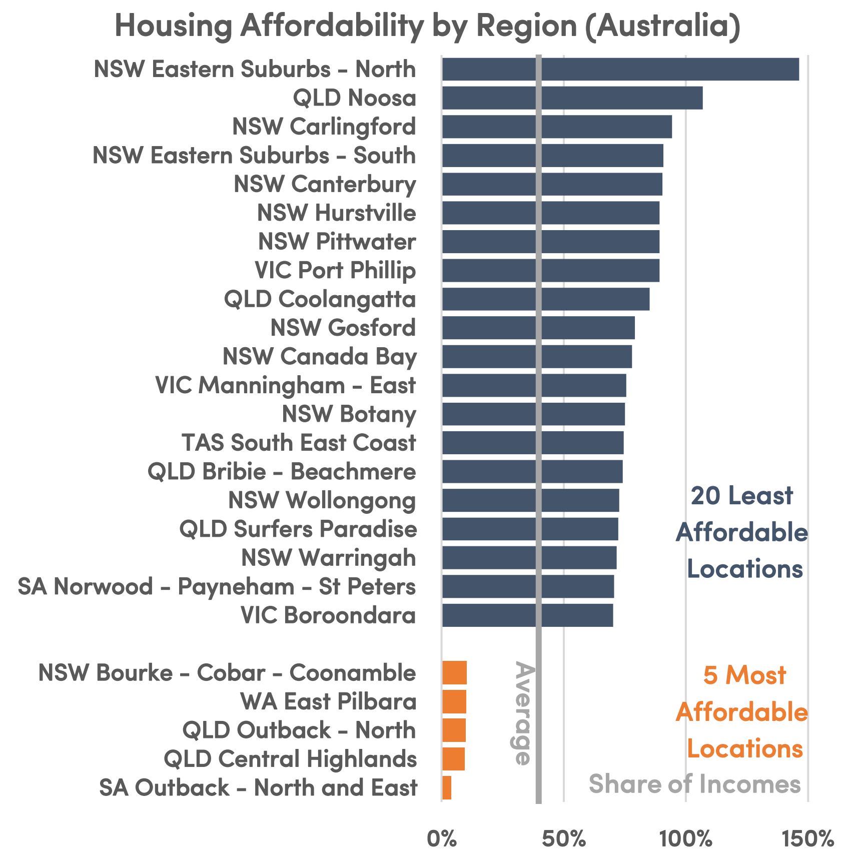
The pressure points

The housing market choices associated with where to live, what to buy, and how much to spend are ultimately personal ones. In this regard, it makes much more sense to consider **local housing affordability** with due accounting of local household incomes and local property prices.

- In assessing local housing affordability, we looked across 331 statistical areas (SA3) as defined by the Australian Bureau of Statistics, to calculate what **local incomes** can afford in terms of **local property**, given the prevailing mortgage interest rates.
- Not surprisingly, there are **massive regional variations** in local housing affordability, given the immense gulf in annual household incomes (from Manly ($210,000) to Blue Mountains – South ($58,000)) and similar ranges for property prices (from Sydney Eastern Suburbs – North ($4.9 million) to the South Australian outback ($62,000)).
- In this framework, it is **the relativity that matters**. The least affordable locations can be found in the more established suburbs of Sydney and Melbourne (despite their higher incomes), alongside the most keenly-sought parts of the Gold and Sunshine Coasts. Meanwhile, there are much cheaper housing on offer in the Australian Outback, even though there are relatively lower levels of household incomes.
- Taking a different perspective, the tally of unaffordable housing locations illustrates **the pointy end of this financial arms race**. Buyers in these locations are no longer drawing solely on personal incomes to fund their housing purchases, but rather, they are using other pools of personal or family wealth (particularly in the case of Sydney's Eastern Suburbs) or their retirement savings (in the case of the Queensland and New South Wales coastal hotspots).

In our view, the more extreme instances of housing affordability provide some telling insights on the issue, namely **the price of housing reflects its popularity**, and that relative pricing and relative affordability reveal the preferences of home buyers, both across suburbs and across countries.

Local affordability varies considerably with local incomes. In that context, it is interesting to see where the most and least affordable housing markets are, given due account of their income levels.



Source: ABS, Proptrack, MaxCap Group (September 2024). The local area groupings come from the ABS SA3 geographic segments. Affordability calculations as of June 2024.

The adjustment path ahead

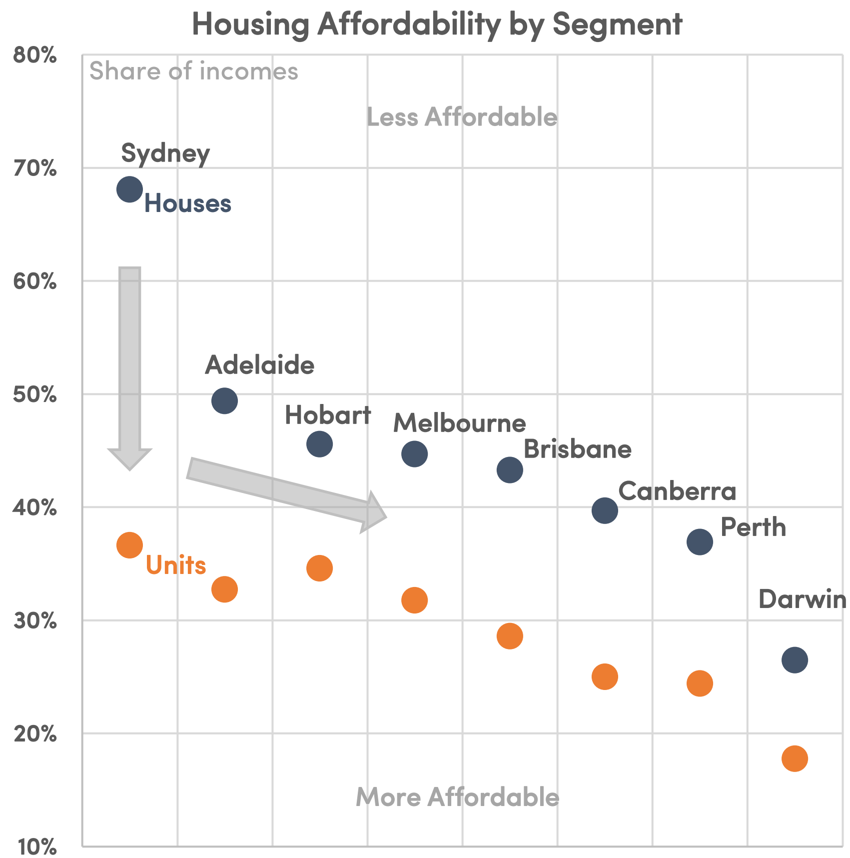
For many frustrated potential home buyers, it is often difficult to see **the adjustment path** back to a more affordable housing market.

- It is important to note that these housing affordability indicators have been **historically range-bound**, having swung periodically from bouts of poorer affordability (where we are now) eventually to times of better affordability, mainly on the back of the mortgage interest rate cycle.
- There are early signs of **a turning point in affordability** emerging in 2024, as we see a return to real income growth, in the context of more moderate housing price growth. However, lower mortgage interest rates remain the key catalyst for a return to better housing affordability.
- Looking ahead into 2025, market expectations of **interest rate cuts** will likely drive bigger improvements in housing affordability. However, the second leg of that road to better affordability depends on **housing supply**, particularly the extent to which builders can manage costs, navigate planning hurdles and deliver more homes on a timely basis.

In the meantime, homebuyers are making **their own affordability adjustments** in the face of a more expensive housing market.

- Looking through the affordability indicators by city and housing type, we see a relatively **more concentrated affordability crunch** for Sydney detached housing, relative to units and relative to other cities.
- Over time, we expect some degree of **housing substitution** from detached houses to units and apartments, and also from more expensive to more affordable suburban locations.
- Indeed, **internal migration** for cost-of-living reasons had been a push driver for people moving out of Sydney in previous cycles. This is a trend that we expect to return and accelerate over coming years, albeit with a broader list of potential destinations this cycle, including Brisbane, Melbourne and other regional cities.

With the widening affordability gap between different cities and housing types, we expect to see some degree of substitution over a 2- to 5-year horizon, as households shift to more affordable options.



Source: ABS, Proptrack, MaxCap Group (September 2024)

Additional information

Senior Lender of the Year, Asia Pacific | MaxCap Group | Private Debt Investor AWARDS 2023

Legal Disclaimer

MaxCap Group Pty Ltd (MaxCap) 2024 – This presentation, information and material presented therein are for information purposes only and do not constitute and should not be interpreted as either a solicitation of an offer to sell or to buy or subscribe for any financial instruments, an investment recommendation or advice, including legal, tax or accounting advice. Use, reliance or reference to any of the information contained in this report will be at the user's own risk.

Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, MaxCap or its affiliates and subsidiaries do not guarantee their adequacy, accuracy and completeness and will not accept any responsibility or liability whatsoever for any loss or damage (whether direct, indirect, incidental or consequential) resultant from any use of, reliance on or reference to the contents of this report.

In preparing this report, we have derived and relied upon, without independent verification, all information obtained from third party sources and MaxCap does not make any representation or warranty as to their adequacy, accuracy or completeness.

As a general report, this material does not necessarily represent the view of MaxCap in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of MaxCap to the form and content within which it appears.

This presentation is highly confidential and has been provided for your information only and may not be reproduced or distributed to any other person in any form without the written consent of the Trustee. The information in this presentation is current at the date of issue, and the Trustee and Manager are not obliged to notify you if it changes.

Key contacts

Wayne Lasky
Executive Chairman
wayne.lasky@maxcapgroup.com.au

Rob Hattersley
Group Head of Capital
robert.hattersley@maxcapgroup.com.au

Bruce Wan
Head of Research
bruce.wan@maxcapgroup.com.au

MaxCap Capital Team Contacts

Ben Klein	Head of Private Capital	ben.klein@maxcapgroup.com.au
Haley Devine	Director – Capital	haley.devine@maxcapgroup.com.au
Leyla Sacks	Director – Capital	leyla.sacks@maxcapgroup.com.au
Penny Tao	Director – Capital	penny.tao@maxcapgroup.com.au
Hugh Thomson	Director – Capital	hugh.thomson@maxcapgroup.com.au
Domenic Demaria	Associate Director – Capital	domenic.demaria@maxcapgroup.com.au
Ashley Feldman	Associate Director – Capital	ashley.feldman@maxcapgroup.com.au
Ben Woolley	Associate Director – Capital	ben.woolley@maxcapgroup.com.au

MaxCap Group

HEAD OFFICE

Level 34, 376-390 Collins Street
Melbourne, VIC 3000 Australia

maxcapgroup.com.au

MAXCAP LOCATIONS

Melbourne
Sydney
Brisbane
Perth
Auckland

CONNECT WITH US

LinkedIn
YouTube
Twitter