House prices about 30pc inflated with a loan cap

Su-Lin Tan

Sydney and Melbourne house prices would be up to 30 per cent overinflated, if loans were capped at 30 per cent of household incomes, calculations by LF Economics show.

Focusing on mortgage repayment stress sensitivities as a measure of affordability, and using median prices published by CoreLogic and incomes from the Australian Bureau of Statistics, the model reveals an overinflation of house prices in Sydney and Melbourne but not in other capital cities.

LF Economics used a 20 per cent home purchase deposit on an 80 per cent loan-to-value ratio as well as the current interest rates in working out the prices of homes at a 30 per cent repayment schedule.

"Because Sydney and Melbourne are so overinflated, prices would fall but as the other cities aren't as bad, nothing changes," LF Economic's analyst Philip Soos said.

The level of indebtedness in housing particularly for Sydney and Melbourne has risen rapidly in recent years to a point where monthly repayments of mortgages have exceeded the widely accepted mortgage stress ceiling of 30 per cent of pre-tax income.

Borrowers in Sydney have used as much as nearly 50 per cent of their household incomes for mortgage repayments and 43 per cent in Melbourne, according to the recent CoreLogic PowerHousing Australia Affordable Housing Report 2019.

Adelaide Bank-REIA Housing Affordability Report for June suggested more conservative ratios of 38 per cent and 34 per cent for Sydney and Melbourne respectively.

Both results are still higher than the comfortable 30 per cent repayment ratio used by bank online calculators and mortgage finder and comparison tools. All other cities sit around 30 per cent or lower.

Further, Mr Soos said his projections were "generous".

"If I use houses rather than all dwellings, the price falls for Sydney and Melbourne would be larger. And if I were to use 30 per cent post-tax income, then the declines become even larger," he said.

There have been previous concerns the main Australian housing markets were overvalued or in a price bubble.

Bronte Capital's John Hempton and Variant Perception economist Jonathan Tepper said homes could be overvalued by up to 50 per cent in Sydney and Melbourne while *The Economist* said big city homes in Australia appeared to be more than 40 per cent overvalued.

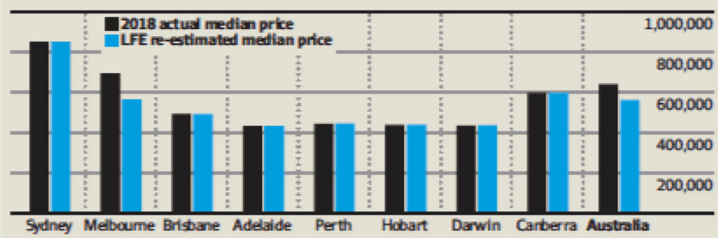
The LF Economics calculations are in line with forecasts that the two major housing markets are set to slow further.

The auction clearance rates in Sydney and Melbourne have been circling the 50 per cent mark for several weeks into the spring selling season and are now heading towards 40 per cent.

Sydney's final auction clearance rate for the previous week was 46.1 per cent while Melbourne's was 51.8 per cent. The preliminary rates last week were about 52 per cent for both cities.

Over-inflated

Australian dwelling price with mortgage payments at 30% of income ($)



SOURCE: LF ECONOMICS

The level of indebtedness in housing has risen rapidly. PHOTO: JAMES ALCOCK