

# The two sides to the real estate story

Australia's love affair with residential real estate has been given an enormous boost by a 13.6% surge in home prices in the year to December, following four flat years between 2004 and 2008. In Melbourne, Australia's property 'hot spot', the ride has been even wilder with prices surging 20% in 2009.

Should these price hikes be seen as an investment invitation or a red flag? That depends on your point of view. Economists tend to describe this surge as a bubble that could be pricked at any time, leaving heavily geared investors deep in debt. However, real estate and property investment marketers tend to be bullish, believing there are solid reasons for the jump in prices. They can't both be right, so investors should carefully examine both arguments before committing to a hefty mortgage.

The economists would argue against property investment at this time, claiming Australian residential property is already 50% overpriced and these inflated values cannot be sustained. Critics also point out that Australia already has the most unaffordable housing in the world, based on the ratio of median household income to median house prices.

Current average house prices in Australian capital cities are equivalent to over seven years of average earnings, up from three in the 1980s. In other words, these analysts warn, Australian home prices are inflated and the bubble could burst at any time, leaving investors with a mortgage worth more than the property itself. This risk is highest for first-time buyers and speculative investors who tend to borrow heavily, making them more susceptible to even small interest rate rises. (A recent survey reports that after only a 0.75% cumulative interest rate increase in 2009, 45% of new first home buyers were in mortgage stress and/or defaulting on their loans).

On the other hand, those who argue that steep increases in Australian home prices are the result of underlying economic realities rather than dangerous overheating also have some strong arguments on their

side. The Real Estate Institute of Australia counters that housing affordability, the ratio of average home price to average income, is not the deciding factor and suggests that other issues such as supply and demand, population growth and rental demand, should also be considered. Certainly, with one of the world's strongest economies, a fairly stable interest rate regime and few inflation worries, Australia is one of the most desirable places in the world to live. Since government projections are that the population of Australia is set to double in the next 50 years, all those extra people have to live somewhere. Undoubtedly, the demand for rental property remains high. In Sydney, for example, the rental property vacancy rate was 0.53% in March 2010, a strong incentive to become a landlord.

So, is this a good time to invest in a residential property, or time to steer clear? Only hindsight will give the answer, but we suggest that if you go ahead and invest, take care not to over-commit and leave yourself vulnerable.