8 February 2017

Looking beyond the median multiple

Measuring housing affordability

Auckland faces a significant housing challenge. Auckland Council has an important, but not unilateral, role in overcoming this problem.

Yet an overly-simplistic approach to comparing affordability here and elsewhere is not helpful. For instance, recent news coverage has focused on the fact that Auckland has a median house price to median income ratio of around 10 (the “median multiple”), which one study categorises as “severely unaffordable”. Auckland Council acknowledges that a ratio of 10 is too high, and in 2015 endorsed a bold target of achieving a median multiple of 5.0 by 2030.

But when you look at the list of the world’s “least affordable” major centres, many of the top 10 are cities like Auckland – located on the coast, with a good climate, strong service-oriented economy, rapid growth, and also consistently ranked among the most liveable cities in the world. To be blunt, the contrast with many on the list of “most affordable” cities is stark.

Median multiples stop far short of the full story of housing affordability. **Critically, they ignore interest rates.**

One could argue that the rapid house price increases we have seen over the past few years are largely due to the structural shift of global interest rates to historic lows. When interest rates fall, they increase the size of loan that buyers can service, allowing them to bid up prices of assets such as housing during times of excess demand. We’re certainly seeing excess demand, with Auckland adding 90,000 people in two years.

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Here’s some evidence.

In September 2008, when effective mortgage rates peaked, according to the Reserve Bank, the median household was able to service a mortgage for a house that cost about

4.6 times its annual income in Auckland, given a 20% deposit, a 30-year loan period, and assuming a household spends 35% of its gross income on loan repayments.

By November 2016, this multiple was almost 6.9. This is a direct consequence of the decline in effective mortgage rates (from around 8.8% in 2006 to about 4.9% in late 2016).

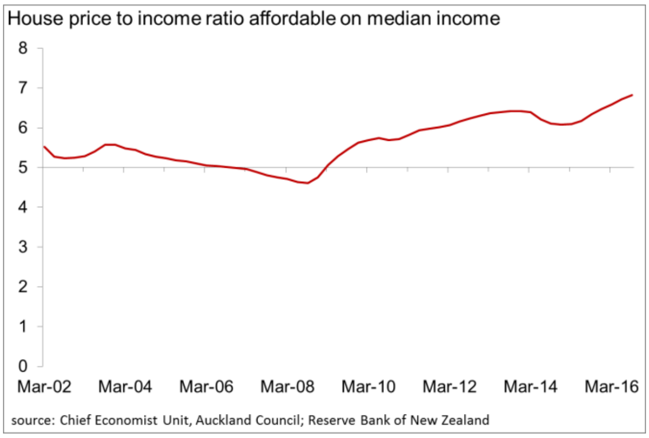
Instead, the real issue for people looking to buy a home at today's prices is that of needing a much larger deposit than when prices were lower.

In September 2008, a 20% deposit on the median house in Auckland was $84,000. By November 2016, it needed to be around $170,000.

This deposit requirement is more likely to skew the profile of home ownership in favour of existing homeowners and investors, as it takes much longer for first home buyers to save the deposit. Meanwhile, those who have paid off their primary residence have seen capital gains that have given them the equity needed to buy an investment property. The Reserve Bank's recent loan to value restrictions on investors may unwind this skewing a little, but there could be long lasting inter-generational impacts on wealth distribution in New Zealand.

But of course, interest rates are also on the way up from historical lows. A median multiple of 5.0, as targeted by Auckland Council, would mean that interest rates could rise to 8% before median income households would struggle to repay their debts. But even if we achieve the ambitious target of reducing the median multiple to 5.0, households will face the challenge of accumulating the money they need for a deposit.

And to get to a median multiple of 5.0 will require collective action from central government, the building industry, land owners, banks as well as the council.



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