Are high real housing values really a good thing?

By John Loos

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Are high and forever-rising residential property prices really a good thing? Many seem to think so, but perhaps not if one considers the broader economic benefits of affordable property.

For those of us that produce the country's various house price indices, the general feeling one gets is that the property industry, investment professionals, and indeed much of the public, see it as a good thing when a house price index shows "strong growth" (whatever that may mean), whereas an "air of gloom" can be felt when we enter a period of low house price inflation or even deflation.

Understandably, lending institutions, and mortgage borrowers alike, don't really want to see home values decline in nominal terms, because it is that value which determines the ease at which a financially pressured home owner can "trade out" of their property and settle the entire debt. The nominal home value provides security.

So, the best form of "downward" price correction, from a systemic risk point of view, if the economic fundamentals require it, is one that happens gradually in "real" terms, i.e. one still gets nominal house price increase, but at a rate below that of general inflation in the economy (general inflation normally measured by the Consumer Price Index or CPI).

But, while "sudden" downward house price movements are, we believe, undesirable, that doesn't mean that "low" house real price levels are a bad thing.

Significant residential supply side constraint

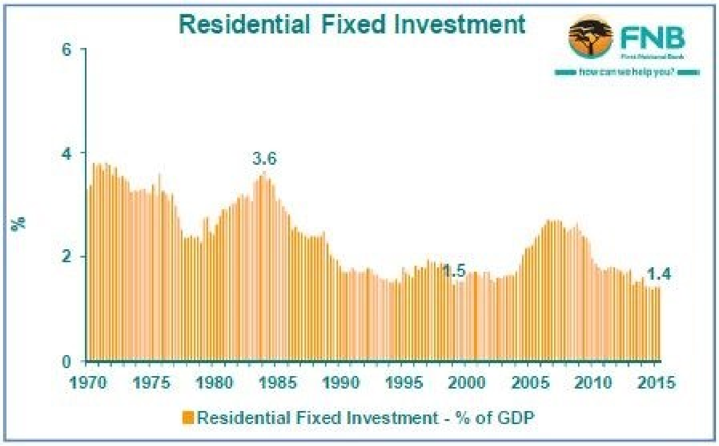
Currently, real house price levels remain not far off the all-time recorded high achieved back at the end of 2007, at levels that still dwarf anything seen in the few decades prior to the start of the new millennium. They were driven to these high levels by the largest residential boom on record, and although the home buying frenzy of the pre-2008 boom has long since abated, real house prices never corrected very far. Massive global and local monetary and fiscal policy stimulus largely saw to this.

But it has also been a significant residential supply side constraint since 2008 that has also assisted the residential market to move back to a good balance between supply and demand despite a mediocre economy at best, demand that remains at a level which is a far cry from the boom period.

Yes, the residential development sector appears to have "cut its coat according to its cloth", developing far less than at the height of the boom period, perhaps not through choice, but possibly more due to the capacity of the residential development, construction and materials sector having shrunk following the hard recessionary knock of 2008/9, thus sustaining high costs of development.

Supply constraints may go further. Urban land scarcity is increasingly becoming an issue, when referring to land with the necessary infrastructure availability.

And so, supply constraints, and thus high costs of residential fixed investment, appear to be key in constraining the level of residential fixed investment to 1.4% of gross domestic product (GDP), an even lower percentage of GDP than the multi-decade low of 1.5% reached in the first quarter of 2009, just after that extreme 1998 interest rate shock. Admittedly, not all of the blame can be laid at the foot of "supply-side" constraints. South Africa's household savings rate is totally insufficient to fund a high level of residential fixed investment.



Fantastic, many residential investors and home owners would probably say to themselves. But, taking a broader view, is it really that fantastic?

I would say, perhaps not. If South Africa's economy was growing at 10% per annum, was nearing full employment levels, and home values were sky high because everyone was sufficiently resourced to afford a home, it would be a different story. But in a weak growth economy, with an extreme unemployment rate and rising social tensions and instability? That's not the time to be experiencing relatively expensive property values more due to limited supply than due to strong residential demand.

Giving an area a competitive advantage

There are far too many advantages of having the majority of households, if not all, housed in formal homes, whether it be owned or rented formal homes (I'm not fixated on home ownership). Much has been written about these advantages. Formal housing normally implies electrification, water and sanitation. It takes a society's health levels upwards, as well as its education levels and general social well-being.

Those advantages are at the "affordable" end of the market. Higher up the price ladder, the potential advantages of "relatively affordable" property are numerous too, most notably in attracting skills to a region or area, skills that are essential in order to give that area/region a competitive advantage, thereby boosting its economic performance.

So it was not surprising last week to see reports of PWC's "2015 Good Growth for Cities" Index, ranking UK cities in terms of economic performance and quality of life, ranking London as one of the lowest. One key reason that stands out? "A lack of affordable housing" (admittedly not London's only shortcoming).

Where high home prices can impact negatively is in the area of the "lower paid professions", such as teaching, nursing or members of essential services such as the police force. These activities are crucial in giving a region or area its competitive advantage, because they influence the quality of certain crucial services such as education or health care. So let's consider a town such as Stellenbosch, a major university town and with a significant school-going population too. But it is also a town whose lifestyle has attracted much wealth inflow, and whose property values are high by South African standards. Can the town's large contingent of educational staff afford property in the town? Or does this start to become a constraint that can challenge academic standards over time because a portion of educators believes it can be financially better off working and living in cheaper towns/regions? Will Bloemfontein and Nelson Mandela Bay ultimately have better education than Johannesburg in part due to a cheaper lifestyle in those cities, a lifestyle influenced by home values?

A more desirable situation

When one considers these potentially negative impacts of a lack of affordable property in a region, which can eventually possibly constrain its economic growth, then it becomes less clear that high real home values are all a good thing.

This certainly is not to argue in favour of some sort of price control. Supply and demand forces should always determine the price. But somehow bringing about a greater supply capability, which leads to considerably lower real home values, and significantly greater portion of the population being housed in formal housing? Greater skills "mobility" due to less "in-affordable" regions, especially for lower paid but crucial professionals?

That seems to be a more desirable situation from an economic performance point of view. It may not be what all of us homeowners or investors want to hear. But ultimately, a better economic performance benefits us all. South Africa's cities are experiencing steady urbanisation pressures on land availability. The key challenge is a combination of making more land available as well as utilising existing land better through clever densification, in order to make housing more affordable, as well as to make good public transport more accessible and viable. Should that happen, it would be a key benefit to city economies, even if it were to hypothetically mean that our house price indices decline in real terms as a result.

"Up and up and up" in real home values is not all good, despite many of us seemingly wishing for this.

ABOUT JOHN LOOS

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