Booms, bubbles and balloons

In two recent professional development seminars, speakers were encouraging about the future of the residential property market and about corporate governance.

In a salutary example of the mysteries of markets, real estate has run a dividing line through the investment community, separating those who love it from those who hate and fear it. As an asset class, residential property has treated investors to a roller-coaster ride in which the objective is not to get to the end but to predict at what point the upward progress changes to a downward plummet.

Speakers at a recent Securities Institute PD seminar volunteered their views on the question: "Residential property—a bubble set to burst?", and generally agreed that the answer is no.

David Rees of the Commonwealth Bank pointed out that Sydney property prices had risen 23% in the past 12 months, with residential construction up 40%. "That's what you'd call a boom," he said. However, rising residential property prices were a global phenomenon, he said, caused by volatile sharemarkets and low interest rates. Australia-specific factors were not necessarily significant.

For most of the twentieth century Australian house prices, relative to the average wage, equated to five years' earnings. Since the mid-1980s, that had increased to 10 years, making housing twice as expensive, a rise perhaps driven by the emergence of two-income families.

Rees did not believe the resulting high mortgage debt levels were a danger. Borrowers had tended to repay more than was required in times of low interest rates, so provision for a rise in rates was already built into their budgets.

The residential property market would experience peaks and troughs but because of structural changes "the future will be unlike the past", Rees said. People were behaving differently, shifting wealth around their portfolios, for example by borrowing against their property to invest in other assets.

Rees suggested that property prices would continue to gain support from Australians' increasing wealth. Over the next 20 years, about $700 trillion could be directed to superannuation; a part of this could go to residential property.

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While the current property price momentum might be unsustainable, the effect would not be that of a bubble bursting—more of a balloon gradually deflating.

John Edwards of Residex, a property-value research organisation, emphasised the difference between the house-and-land market, characterised by high returns and low risk, and the general housing market which was influenced by the low returns from home units.

In the house-and-land market, he saw the approach of a "resting" phase. "I don't think we've had a boom yet," he said. "I think the boom is about to come, until about 2007.

"We believe the housing market needs some cooling. The risk to the unit market is a high vacancy rate. People are being persuaded to use their home equity to invest in units that will be hard to rent."

Rory McLeod, of Landsbury's International, focused on demographic factors, pointing to the shifting influence of first-home buyers, mature "trade-up" buyers and older "empty-nesters" buying into the home-unit market. Barry Lambert, of Count Wealth Accountants, claimed that financial planners found residential property investment "too difficult" because it was overpriced compared with other assets, subject to capital gains tax and yields dependent on rent increases, and provided poorer returns than good businesses.

EDUCATE OR SUFFER

Investor education is the most powerful protection against the "robber barons and carpetbaggers" responsible for corporate collapses, according to Charles Macek, chairman of Sustainable Investments Research Pty Ltd.

Macek, a veteran of Australian fund management and corporate performance analysis, was speaking at a PD seminar on sustainability and corporate governance risk. He shared the podium with Erik Mather, of Westpac Investment Management.

"What is different about the current cycle is the depth and breadth of the greed and bad behaviour," Macek said. Greed and short-termism were the prime reasons behind the "appalling" standards leading to corporate disasters.

He suggested that corporate governance should be based on principles rather than rules, and that business should develop a clear view of the benefits of good governance.

Mather also emphasised the need to understand the intangible benefits of corporate governance. He pointed out that one-third of ASX 200 companies failed to meet industry-generated guidelines on board independence. "There is no evidence that exhibiting good governance does anything to detract from share prices," he said. J

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