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Realm Investment House says rising house prices are spurring risky borrowing

APRA chairman Wayne Byres has led a housing "jawboning" effort that may or may not work. **Christopher Pearce**

by **Jonathan Shapiro**

Realm Investment House, which developed an index to measure household related risk in the economy, says overzealous borrowing spurred by inflated property prices is posing the biggest threat to the financial system.

The credit fund's models showed that regulators' efforts had initially succeeded in stabilising the threat to financial stability posed by rampant lending for housing.

But by February of this year they were warning that resurgent house price growth and an acceleration in unsecured lending had pushed its index to a point where regulators would be forced to take action again.

And as the Reserve Bank, the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission have raised concerns on housing, that prediction seems to be playing out.

"The information is still the same but what has changed is this jawboning of regulators," Realm's Andrew Papageorgiou said.

"Our hope is that this is not a sign of impotence and that they have run out of things to do."

The model uses options theory to track the P&L (profit and loss) and balance sheet of Australian households in aggregate, and emphasises the rate of change in risks,

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rather than the absolute level of risk.

Its current setting, Realm said, concurs with the comments from APRA chair Wayne Byres who recently said Australia is in a period of heightened risk.

Realm's Rob Camilleri said the volume of transactions in the property market is low, but the risk is that as "people believe in their property valuations, you see behaviours that create a problem down the line".

This effectively meant that households were borrowing more against a potentially over-valued asset or increasing their unsecured borrowings.

"Our concern is around unsecured borrowing. We don't feel there are enough transactions in the housing market but the number of people that are happy to hit the redraw, do the renovation or buy the car is rising," Mr Camilleri said.

Areas of concern

While data on those mortgage redrawing on their properties is hard to source, Realm says it used ABS data on unsecured lending, new and used auto loans and retail sales to determine whether households are using housing equity to maintain their cost of living, are engaging in value adding to their property or increasing consumption.

This is a potential source of risk as household's spend against perceived asset gains.

"Maybe [regulators] look at some of the offsets and redraws which get used as credit on tap and that gets identified as an area of concern."

Realm said the rates of change in their models had moderated but the "very large absolute prices of collateral" had become an issue.

"At these prices you could see average mortgage size rise quite meaningfully," Mr Papageorgiou said.

"They [regulators] just need people second guessing before they buy at these kinds of prices, and need to shake away the notion that its normal for middle class dwellings to trade at 100 times annual household savings," he said.

"The average family would struggle to save $20,000 after tax in a year. These days a very average free-standing dwelling in Melbourne clears for 50 times that amount at $1,000,000, this gives you some context of how large the absolute numbers are at the moment and this is a source of potential risk."

The impact on housing activity as a result of the property warnings by regulators, and the response of the banks in lifting interest rates on investment loans will be closely watched, and there is a risk that steps taken to cool demand for property loans could fade over time.

"They are looking at driving behaviour through mortgage brokers. They will try to impact their revenue model but at the end of the day to make something happen they need to change the internal rates of return from property," Mr Camilleri said.

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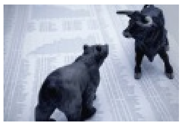

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