Home price beliefs in Australia

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"Home Price Beliefs in Australia: RBA Research Discussion Paper" by Callan Windsor, Gianni La Cava and James Hansen, April 2014

It's the ultimate Aussie barbeque conversation topic - how much is your house worth? What did the residential property market do last month? And why your house is worth so much more than your neighbour's house!

Because houses usually trade so rarely (about every 16 years seems to be the norm), it can be hard to get a genuine feel for the value of our own homes. This is particularly true if we've lived there for a long time. So, we usually infer values from the information available - and, because we're human, those inferences may well exhibit some biases. But are those biases consistent? e.g. based on city, age, income or education? And do they then affect decisions such as spending, leverage and holdings of risky assets?

Understanding all this could give us insight into client's investment behaviours and preferences. It could also help us understand if they are estimating their house values, and therefore their overall wealth, correctly. It could even give us some clues as to why they hold the level of risky assets that they do.

A recent Reserve Bank of Australia (RBA) study looked at these questions. Using data from Melbourne, Sydney and Brisbane, the study threw up some very interesting findings.

Surprisingly, housing price beliefs were, overall, unbiased. On average, people were fairly accurate with their beliefs of the value of their home. However, there was a lot of variation underlying this finding. Around 50% of people mis-estimated the market value of their home by 10% (up or down) and 25% of people were more than 20% away from market value.

People in Sydney and Brisbane were generally more optimistic about their home prices (on average, 1.8% and 2.8% above market price), while those in Melbourne tended to underestimate prices by about 2.2%. (I'm sure there's a joke in there somewhere about heat expanding one's head, but given I am from Brisbane originally, I'll let it go.)

People who lived in their houses for a longer time tended to be generally less accurate about the value of their home, over or underestimating it more.

Older people tended to overestimate the value of their homes, although the rate of overvaluation growth slowed as people got older.

Unemployment levels are linked to valuation biases. The higher the level of regional unemployment, the greater the level of underestimation.

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There was a weak, and probably not significant relationship, with income and education levels.

There were some very strong relationships as well. Higher home values (which is made up of the actual house value +/- any bias) was strongly linked to more spending. Each dollar increase in home price led to a 5c increase in consumption, which is a large effect. It was also linked to higher proportions of risky assets in portfolios.

Those who overvalued their homes were also very strongly associated with higher spending, so much so that a 1% overvaluation had the same size effect on spending as a 2% rise in income. These people also had higher debt levels (mainly housing debt) and higher weightings to risky assets in their portfolios. A 1% overvaluation was associated with a 0.16% higher weighting to risky assets in portfolios. That may not sound like much but is (apparently) the same as a 2% income increase as well.

These relationships did not appear with renters, lending credence to the study's findings. Indeed, much of the findings do make intuitive sense. If a person has lived somewhere for a long time, they may not be as in touch with property values. If the area they live in is generally more affluent (characterised by lower unemployment), they are more likely to be consuming more, borrowing more and investing in riskier assets.

So what can we take from this, in terms of dealing with investing clients?

It appears older clients, who have lived in areas with low unemployment for a long time, are more likely to overvalue their homes. This is also often associated with higher consumption, debt and equity exposure in portfolios.

Those who live in areas with higher unemployment may be underestimating the value of their home , particularly if they have lived there for a long time. They are likely to be taking less risk in their portfolio as well.

Read "Home Price Beliefs in Australia"

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