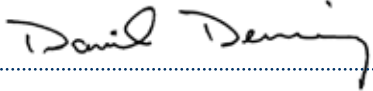


09-09

DD-WP-02

Authorised for release 01.09.09:

  
.....

Port Phillip Publishing Group  
Investment White Paper #02

ON

# **The Great Australian Property Swindle**

*What Concerned Aussie Homeowners and  
Property Investors Need to Know About  
The State of the Housing Market In 2009*

Written by Daniel Denning  
Additional Research by Simon C. Munton  
Published by Port Phillip Publishing Pty Ltd

# Contents

## **1. The death of “The Great Australian Dream” .....4**

- (1) The median Australian house will now cost you around 7 times your income
- (2) What you’re about to read may scare and anger you
- (3) Why you owe it to your future self to read this report

## **2. The Great Australian Debt Trap.....7**

- (1) The dream of home ownership is now beyond the reach of most Australians
- (2) Now comes the scary bit...
- (3) The hidden costs of buying a home

## **3. The 3 lies about property you believe.....11**

- (1) Lie 1: Property doubles in value every 7-10 years
- (2) Lie 2: Owning your own home is more secure than renting
- (3) Lie 3: Renting is “dead money”

## **4. Why the “*First Home Owners Grant*” is a ticking time bomb....15**

- (1) The FHOG is an illusion... it’s also a debt trap
- (2) Why Australia is stumbling into its own sub-prime crisis
- (3) Vulnerable Aussies are being seduced into a miserable life of debt slavery

## **5. Why the Australian Housing bubble will be the last to pop – and the loudest of all.....19**

- (1) After the party comes the hangover
- (2) The Great Aussie Wealth Illusion
- (3) The LAST thing Australians need right now is more debt

## **6. Conclusion .....25**

- (1) The days of treating your home like an ATM are over
- (2) The real choice Aussie home buyers face now

## The death of “The Great Australian Dream”

*“One of the best instincts in us is that which induces us to have one little piece of earth with a house and a garden which is ours, to which we can withdraw, in which we can be among our friends, into which no stranger may come against our will.”*

**Sir Robert Menzies**  
**Australian Prime Minister, 1942**

Buying and owning your own home is a rite of passage in Australia; an honourable and worthy commitment to be entered into at the earliest possible juncture in your working life, whatever the financial sacrifice.

It’s part of the culture here, just as in the U.S. and Britain.

**In this country your home is more than just a pile of bricks.** It’s a symbol of your self-reliance... a powerful statement of belonging to a collective identity... and the cornerstone of a stable, free, socially cohesive and democratic society.

All over Australia, parents teach their kids the importance of getting on the “property ladder” as early as humanly possible – so that, one day, you can “own your own home” and “retire mortgage-free”.

*You leave school - you get a job – you leave home – you get married – you buy a house. That’s what we did. That’s what you do.*

And you must do this at all costs. Missing out condemns you to a life of lining someone else’s pockets... missing out means you’ll die poor and hungry with no asset to see you through your twilight years. Renting, remember, while leaving a lighter dent in your monthly budget, is “dead money”...

### This all meant something when property was affordable

For decades, this *diktat* was observed diligently. That’s because home ownership was within comfortable reach of most working Aussies.

Successive post-war Governments made the pursuit of “The Great Australian Dream” a priority. House building rocketed. Low unemployment and low interest rates helped hundreds of thousands of Australians gain a foothold on “the ladder”. And at three-times income, houses were affordable to everyone.

*“Traditionally, the median house price was around three times the median household income... when the median income was just \$1,000 per annum in the early 1960s one could buy a basic house on a basic block of land for \$3,000. When the median income was \$10,000 per annum in the 1970s the median house price was \$30,000. And when the median income was \$40,000 per annum in the early 1990s the median house price in most capital cities was \$120,000.”*

***Home Truths: What happened to the Great Australian Dream?***  
**Bob Day**

You may remember the good old days where borrowing to buy a house didn't land you way beyond your means.

Those days are long gone.

As I'll show you in this white paper, the median Australian house will now cost you around SEVEN times your income. And if that's not worrying enough, the truly mind-boggling thing is that homeownership is still considered a dream worth pursuing! In fact it's actively encouraged at all levels of Australian society... even by government... *ESPECIALLY* by government.

In this chapter, I'll reveal how national incentive schemes that give new buyers "free money" to put towards buying a house are little more than a con trick to prop up a grossly inflated property bubble... a ticking time bomb sitting under the entire Australian housing market...

...You'll learn why applying for the *First Home Owners Grant* is the equivalent of buying a pet lion cub for Christmas... and you'll discover why property will never be a good investment again in your lifetime.

## What you're about to read may scare and anger you

I'll be blunt: reading this report will probably rankle.

I hope it does. And in the process, I hope it prompts you to question some of the values that have been bred into you from the moment you picked up your first Lego brick.

Make no mistake – this is the big one. It's the lie you're blindest to.

You see, I'm about to prove to you, decisively, that buying or investing in property is a reckless and unwise thing to do with your money right now. In fact, it may never be advisable again.

It may never be *affordable* again.

"The Great Australian Dream," as you know it, is over.

I'm guessing you won't want to hear that. But take it from me – if you're to survive financially after this economic depression has run its course, you're going to need to accept it, and change the way you think about long term asset wealth - fast.

By the end of this report, I hope you'll have realised that the REAL economy, and particularly, the housing market, has changed **categorically** in the past 10 years, and is continuing to change at a faster rate with each passing year.

Events, driven by institutional and personal greed and the biggest illusion of wealth for a generation, are rapidly changing your financial landscape by the month. Trillion dollar bailouts and fancy government rescue packages will not help. The dominoes are already falling. The effects of this change will start to be felt acutely later this year.

**Please understand: old doctrines will have no relevance after the credit depression (and make no**

**mistake, that's what we're in) has run its course. Those who maintain a belief in them – particularly in the value of buying and investing in property - will see personal wealth destroyed in the months and years ahead.**

*As you read through this report, unless you have thicker skin than an armadillo in a flak jacket, you will slowly reach the same conclusion.*

## That's why you owe it to your future self to read this briefing

This could be the timeliest and most important thing you read all year.

You see, much of the bloodshed from the coming Australian property market crash can be avoided. Those with open minds, who heed the dire warnings I'm about to disclose, will be able to sidestep most of the damage.

That is my firm belief. It's the reason I sat down to write this report.

I'm not saying this to wind you up or to scare you unduly. But I am being deliberately blunt and provocative about the Australian property market in order to spur you into action. The action I believe you need to take – starting as soon as you can – will be spelled out later in this briefing.

First, though, I have a sacred cow to slaughter...

# The Great Australian Debt Trap

Australian property is “seriously and severely unaffordable” today.

These are not my words. This is the overwhelming conclusion of the fifth annual *Demographia* study into housing affordability in the Western, English-speaking world. This little publicised study (results quoted below are from 4<sup>th</sup> QTR, 2008) is a very straightforward, but highly illuminating reference tool.

What it concludes should make those planning to buy Aussie property any time soon stop and think very carefully...

The study uses the “median multiple” – median house price V median income – to rate housing affordability in cities across the UK, US, Australia, Canada, Ireland and New Zealand, then it ranks each city thus:

- **Median multiplier of 3.0 or less** = **Affordable**
- **Median multiplier of 3.1 – 4.0** = **Moderately unaffordable**
- **Median multiplier of 4.1 – 5.0** = **Seriously unaffordable**
- **Median multiplier of 5.1 and over** = **Severely unaffordable**

Now I’m not going to regurgitate vast chunks of this report here. It’s available online if you want to study it in depth. You should. But there’s something in the report you need to know urgently about the current affordability of Aussie property, and it’s this:

Rank	Nation	Metropolitan Market	Median Multiple	Rank	Nation	Metropolitan Market	Median Multiple
1	Australia	Sunshine Coast, QLD	9.6	32	Australia	Geelong, VIC	6.0
2	United States	Honolulu, HI	9.1	34	United Kingdom	Aberdeen, Scotland	5.9
3	Australia	Gold Coast, QLD-NSW	8.7	34	Australia	Albury-Wadonga, NSW-VIC	5.9
4	Canada	Vancouver, BC	8.4	34	Australia	Darwin, NT	5.9
5	Australia	Sydney, NSW	8.3	34	Australia	Rockhampton, QLD	5.9
6	United States	San Francisco-Oakland, CA	8.0	34	United States	San Diego, CA	5.9
7	United States	San Jose, CA	7.4	34	New Zealand	Wellington	5.9
7	Canada	Victoria, BC	7.4	40	Australia	Mackay, QLD	5.8
9	United States	San Luis Obispo, CA	7.3	41	Australia	Townsville, QLD	5.7
10	Australia	Bundaberg, QLD	7.2	42	United States	Bridgeport, CT	5.6
10	United States	Los Angeles, CA	7.2	42	Ireland	Galway	5.6
12	Australia	Adelaide, SA	7.1	42	Australia	Launceston, TAS	5.6
12	Australia	Melbourne, VIC	7.1	42	Australia	Maitland, NSW	5.6
14	Australia	Mandurah, WA	7.0	42	United States	Miami-West Palm Beach, FL	5.6
14	United States	New York, NY-NJ-PA	7.0	47	United States	Boulder, CO	5.5
16	United Kingdom	Belfast, Northern Ireland	6.9	47	New Zealand	Dunedin	5.5
16	United Kingdom	London, England	6.9	47	United Kingdom	Edinburgh, Scotland	5.5
16	United States	Santa Cruz, CA	6.9	47	United States	Santa Rosa, CA	5.5
19	Canada	Kelowna, BC	6.8	51	Ireland	Cork	5.4
19	United Kingdom	Southwest Region, UK	6.8	51	United States	Oxnard, CA	5.4
19	Australia	Wollongong, NSW	6.8	51	United Kingdom	Wales	5.4
22	United Kingdom	London Exurbs, England	6.7	54	United States	Boston, MA-NH	5.3
23	Australia	Newcastle, NSW	6.6	55	Australia	Bunbury, WA	5.2
23	New Zealand	Taraunga-W, Bay of Plenty	6.6	55	New Zealand	Hamilton-Waikato	5.2
25	Canada	Abbotsford, BC	6.5	55	New Zealand	Napier-Hastings	5.2
26	New Zealand	Auckland	6.4	55	United States	Seattle, Tacoma, WA	5.2
26	Australia	Perth, WA	6.4	55	United Kingdom	W. Midlands Region	5.2
28	Australia	Brisbane, QLD	6.3	60	Australia	Canberra, ACT-NSW	5.1
29	Australia	Hobart, TAS	6.2	60	United Kingdom	East Midlands Region, England	5.1
30	Australia	Caime, QLD	6.1	60	United States	Eugene, OR	5.1
30	New Zealand	Christchurch	6.1	60	United Kingdom	Perth, Scotland	5.1
32	Ireland	Dublin	6.0	60	Australia	Toowoomba, QLD	5.1

The table on the previous page shows the 60 least affordable places to buy property in the English speaking Western World.

Remember in the 70s, 80s and 90s when the kind of house you'd want to buy and bring up a family in cost roughly three times your annual salary?

Well, no more.

As you can see above, now you'd be looking at spending 5 times your salary AT LEAST to buy a regular house in or around any state capital in the country. In fact, as you can see, Australia possesses SEVEN of the top fifteen least affordable property regions covered by the study.

*You REALLY think there's no housing bubble here?*

At the top end of the scale these figures are truly frightening. They make the dream of home ownership seem like a delusional fantasy...

**The stark truth is this: an average house on the Sunshine Coast costs nearly TEN times the average salary! In Sydney you need 8.3 times your annual income... in Melbourne and Adelaide you need more than 7 times your salary, and so on.**

Who can afford these prices?

Moreover, which ordinary Aussie would want to be saddled with a debt at TEN TIMES their annual salary? Who wants to work 6 or 7 day weeks just to meet mortgage payments? Where's the fun in that?

*"The least affordable markets are generally in Australia... the Median Multiple has escalated sharply..."*

**5<sup>th</sup> Annual Demographia International  
Housing Affordability Survey**

Working your way through this study leads to one inevitable conclusion:

**The dream of home ownership is now  
beyond the reach of most Australians**

A dream is one thing. Reality is another thing altogether. So let's put "The Great Australian Dream" to one side for a moment so I can show you the REAL financial burden the average Australian commits to when they buy the average Australian house in 2009... (All of the following figures are correct at the time of publication)

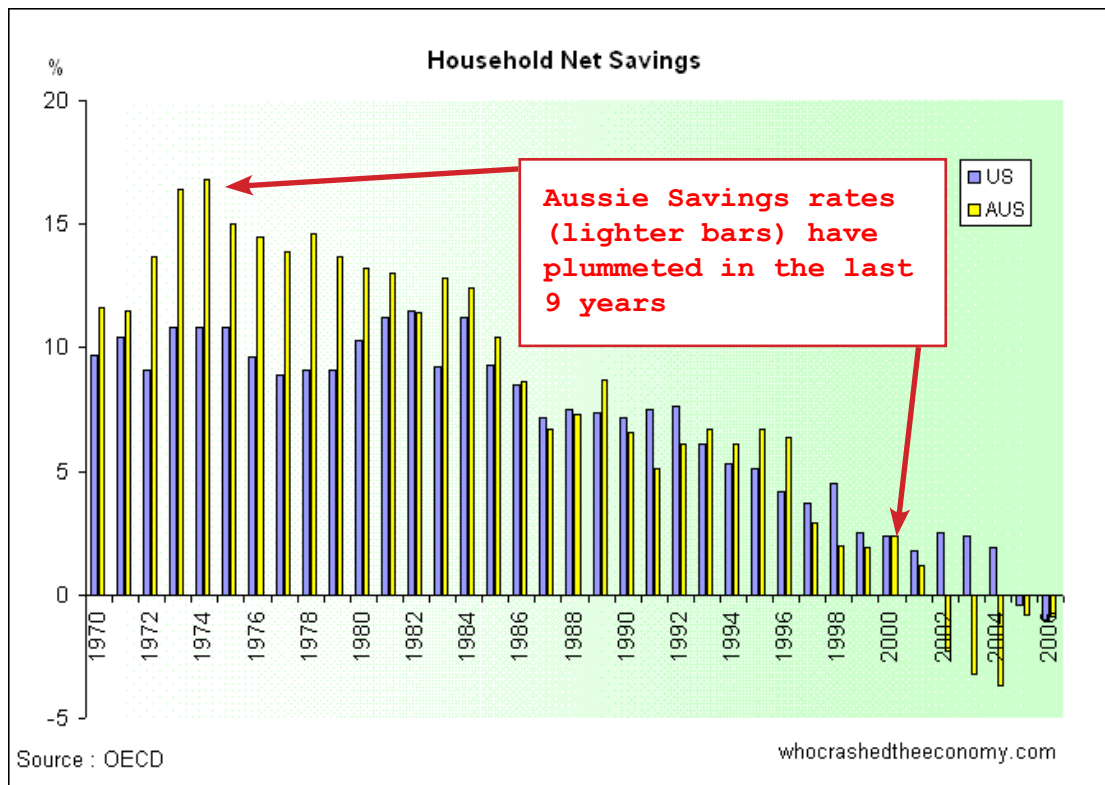
- The median Australian salary is \$60,658 a year (source: industrysearch.com.au)
- The median Australian house price is \$450,000 – **that's 7.41 times the median salary!** Hardly the 3 x times salary multiplier 1990s homebuyers enjoyed... (source: Australian Property Investor)

Let's say a young median wage earner convinces the bank to lend him the money to buy the median house... He has the following capital to put up:

→ **\$14,000** *First Home Owners Grant* from the government (expires September 30th 2009)

→ **\$31,000** gift from generous parents totalling a 10% deposit to lodge with the bank

Like tens of thousands of Australian home buyers, he has no savings of his own... as you can see from the chart below, Aussie saving rates have fallen through the floor since the turn of the millennium.



But Mr Average Aussie is scared to death about missing the FHOG deadline... his parents are too – so they help him out. That means he has **\$45,000 in total** –10% of the purchase price of the house he wants to buy.

### Now comes the scary bit...

This means Mr Average needs to borrow **\$405,000** (90% loan-to-value ratio) from the bank over 25 years... at a generous low interest rate of 4.68% (right now, mortgage rates are the lowest they've been since 1970). This rate is fixed for two years; then his mortgage becomes a variable rate product, i.e. it reverts to whatever the standard rate is at the time and tracks it henceforth.

The bank agrees and sets Mr Average's monthly repayment at \$2,293 (or \$27,516 per year) – of which just 59% pays off the capital! (source: money.ninemsn.com.au)

Mr Average's after tax pay is just **\$47,538.13** a year – or **\$3,961.50** a month. That means the

percentage of his take home salary he spends on shelter is a whopping 57.88%!

You are defined as being in “mortgage stress” in Australia if this figure is above 30 per cent. As you can see, the average Australian is immediately in at almost double that figure. Once he’s paid his mortgage each month, he has just \$1,668.50 a month to cover ALL his other bills and expenses...

**That’s quite some commitment – particularly in a recession where jobs are under threat...**

To live the same “Great Australian Dream” his parents did, the average Aussie is buying a house that costs over SEVEN times his salary, and spending well over half of his take home pay to service the home loan.

And that’s not all...

## Don’t forget the “hidden” costs of buying a home!

- Mr Average has to pay stamp duty to the government up front on his new place – which comes to a whopping **\$23,972.40** on a \$450,000 house
- **Plus** he needs to find solicitor fees of approx \$700 up front
- **Plus** building inspection fees of approx \$495 up front
- **Plus** mortgage arrangement fees (scandalous!) of approx \$92.40 up front
- **Then** there’s mortgage insurance / protection to pay every month – this could be anything...

And let’s not forget the biggest hidden cost of them all: **interest rates**. These are currently at their lowest level in Australia for 39 years... What would Mr Average do if they rose quickly to a not inconceivable 8.5%, and pounced on him the moment his 4.68% “honeymoon” fixed rate deal ran out?

**What would he do if he suddenly had to find an extra \$968 a month out of his already decimated take home pay to service his mortgage?**

You see how quickly “The Great Australian Dream” has become a nightmare for Mr Average Aussie... and how readily his parents and the government have consigned him to a miserable life of debt slavery – all in the name of *The Great Australian dream*...

You buy your child a cute lion cub for Christmas – soon enough it becomes a 250KG killing machine.

## The 3 lies about property you believe

The problem with buying property is that it's SO deeply ingrained in the nation's psyche; we can no longer see the wood for the trees financially.

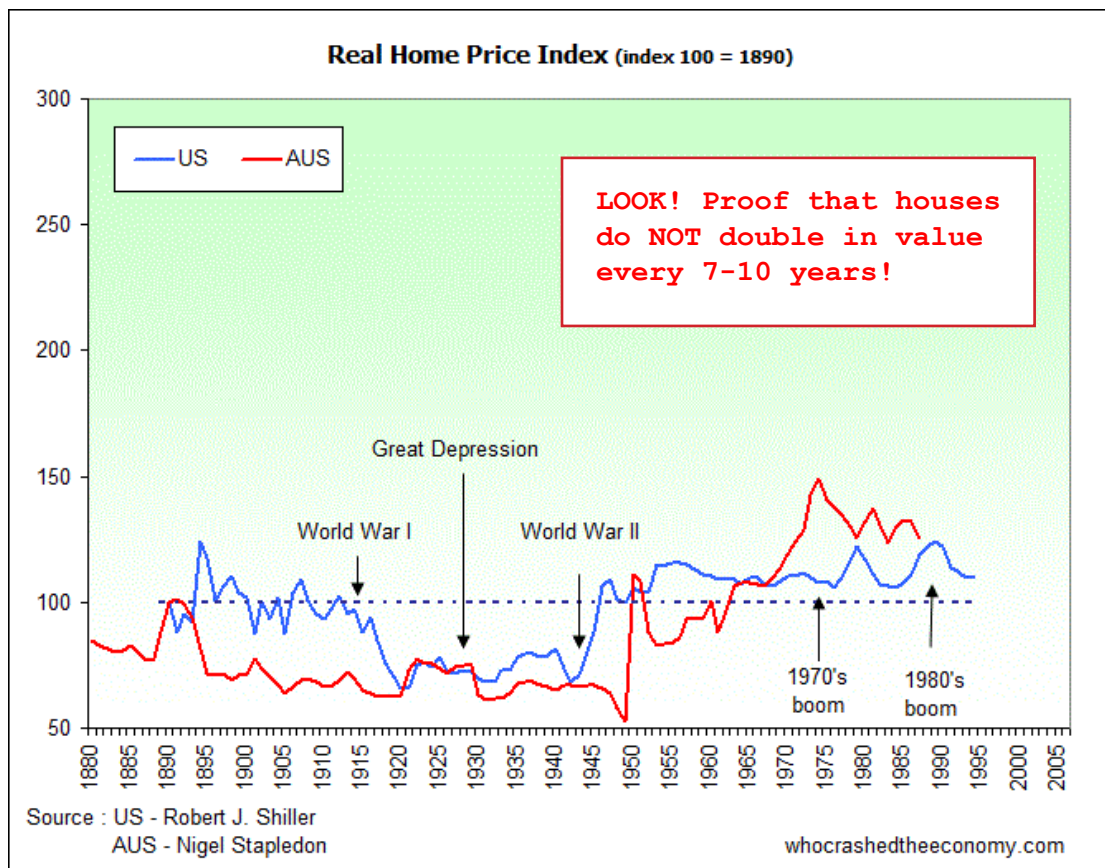
In our haste to occupy a rung on the ladder, we make quick, badly-informed decisions that confine us to years of debt-induced misery.

The worst part of all is that many of these snap decisions are based on urban myths and falsehoods. If you think property is a good idea in spite of the overwhelming economic and empirical evidence to the contrary, you need to see the following lies for what they are:

### **Property lie 1: Property doubles in value every 7-10 years**

This is a classic myth real estate spruikers trot out to shift investment properties to gullible buyers. Take a look at the chart below, produced by Nigel Stapledon from the University of New South Wales.

The red line shows Australian and U.S. property prices adjusted for inflation from 1890 to 1995. As you can see, there's no perpetually rising curve here. In fact, there were plenty of periods where house prices fell.



Yes – there ARE periods where house prices have risen, but certainly not by double every 7-10 years. That is a lie.

Okay, you've probably noticed that the lines on this chart stop in the year 1995.

I'm not hiding anything from you - I'll show you the continuation of this graph later on in this chapter. It's nothing short of *incredible*, and it proves beyond any doubt that Australians are facing the last great un-popped housing bubble of the twenty-first century.

*Trust me – if you care about what's in store for your wealth in the coming months and years, you need to see what happened next...*

That's coming up. First, I've another lie to expose...

### **Property lie 2: Owning your own home is more secure than renting**

I'm coming to the "renting" part in a moment. What I'm really interested in here is the concept of "owning your own home".

**You see, until every penny of your mortgage is paid off, you don't own anything. The bank who loaned you the money owns your house.**

And if you default on any of your mortgage payments over the 25 or 30-year term of your mortgage, your lender is entitled to take their house back to cover their loss.

So your mortgage is more of a "hire purchase" until you make that final settlement payment on your home loan. Then you can take possession of the deeds and the house is officially "yours".

A 25-year IOU is not what I'd call "secure".

In fact, the consequences you face when you take out a mortgage are just the same as when you rent: you don't pay, you get evicted. Except if it's "your" house you may have poured lots of time, effort and money into home improvements – which would make it an even bigger wrench if you got booted out.

**If you mortgaged yourself to the hilt to get onto the property ladder, you're more susceptible to the financial pressures of an economic downturn than someone who rents. That's not my opinion – that's fact.**

Remember – the median Australian house price is \$450,000. At today's low interest rate of 4.68% the average Aussie with a 10% deposit would pay back \$2,293 a month.

The median Australian rent as at December 2008, according to the *Herald Sun* is \$350 a week, or \$1,517 a month. If you lost your job in this recession, *which amount would you prefer to have to find?*

*"What we are seeing is a sharper contraction [than we previously thought] in the global economy and the consequence of that for Australia is slower growth and higher unemployment."*

**Treasurer, Wayne Swan  
March 20, 2009**

### **Property lie 3: Renting is “dead money”**

If you've ever rented a house or apartment for any length of time, you've probably heard this old chestnut trotted out. The idea being that when you buy property, you're investing in an asset, which becomes yours after 25 or 30 years. When you rent, you're just paying someone else's mortgage – that's why it's “dead money”.

But this is a dangerous cliché... let's look at those numbers again:

If you “buy” the median house at \$450,000 and you borrow \$405,000 at 4.68% - assuming that rate gets no higher (a MASSIVE assumption) you'd end up paying back a total of \$687,900 to the bank after 25 years.

So in the BEST case scenario, the cost of borrowing is a mammoth \$282,000! That's money you're effectively giving the bank for nothing. I don't know about you but I'd say that was fairly “dead”...

If you rent the average Australian house you pay \$1,517 per month. That immediately gives you \$9,312 more each year to allocate how YOU see fit. Over 25 years, assuming the gap between average mortgage payments and average rents stays the same, you'd be \$232,800 better off by renting. And that's **before** any interest earned has been applied...

Let's say that you siphoned off this \$9,312 saving every year into a deposit account and earned a very modest 4% on your money which was compounded annually. After 25 years you'd have a whopping \$428,143 to your name!

That's \$428,143 you don't need to go out and bust a gut to earn in a slow job market... \$428,143 you could put towards a better education for your kids... or towards investments that will look after you long after you stop working.

## How crippling mortgage interest is killing your retirement

Of course, you may be better off buying in the long run if the value of your property goes up by more than the value of your loan plus the premium the bank charged you on top to borrow it.

But that's a big ask... **especially right now as Australians are facing the biggest and most spectacular housing market collapse in the western world** – more on that coming up...

I understand that many people buy property as a “nest egg” for their retirement years. Take it from me; there are FAR less expensive ways to invest for retirement. The idea of just GIVING someone \$282,000 FREE MONEY – how's that contributing to your pension pot?

And, yes, I do realise you don't end up with a pile of bricks to call your own if you rent; but instead of giving nearly three hundred grand to your lender for the “privilege” of a 25-year financial prison sentence, you could put this money to work for you instead...

*...By investing it in asset classes that are better placed than property to weather the financial crisis ahead... investments that don't charge you a CENT in interest!*

**Remember – borrowing to invest while there’s a bear market in credit makes no financial sense whatsoever.**

So do you still believe you “can’t go wrong” with property?

I realise that what I’m saying in this special report isn’t likely to win me any popularity contests. Believe me, if I cared about that I wouldn’t do what I do.

But this stuff needs saying.

**Buying a house is fine if it costs three times your salary. By independent, international standards, that’s affordable and manageable.**

**In Sydney the average property costs NINE TIMES the average salary.**

**That’s just lunacy.**

Frankly, if the *only* thing you take away from this white paper is the idea that, at certain points in the economic cycle, you CAN go wrong with property... if what you’ve read makes you stop and think BEFORE signing that 25-year home loan agreement, than my objective for this report has been achieved.

Take it from me: when the fallout from the credit depression starts to flood Australia with more debt, rising unemployment and punitive inflation, the last thing you’ll need is a pair of concrete boots with a 25-year timer lock.

I realise I’m up against pretty stiff competition trying to get through to you on this – not least from the Australian government’s offer of up to \$21,000 “free money” to put towards your first home.

Sounds great, doesn’t it? Free cash from the government. Just what struggling young Aussies need to help them pursue “The Great Australian Dream”...

But it’s a huge and deadly swindle – here’s why...

## Why the “First Home Owners Grant” is a ticking time bomb that will create Australia’s own sub-prime crisis

*“I am enormously concerned that (encouraging) first home buyers has a big sting in the tail because they are the people most likely to be losing their jobs, least able to afford it and often stretching themselves because of the deadline for the first home owners grant,”*

**Neil Kendall**  
Financial Adviser, Tupicoffs

Here’s something that may shock you...

The First Home Owners Grant (FHOG) that gives new buyers up to \$21,000 “free money” to sink into their first home doesn’t make it easier to get a foothold on the property ladder.

**It makes it more difficult – and puts buyers under more pressure to take on more debt.**

Professor Steve Keen, from [www.debtdeflation.com](http://www.debtdeflation.com) says that the FHOG has cost the Government about \$200 million to date – but far from making housing more affordable for property newcomers, it has actually inflated house prices by close to \$3 billion!

How? Well, all of a sudden you get a surge in the market of buyers all competing for the same kind of properties... because all of a sudden, thanks to a five-figure government handout, these people feel “wealthy”.

And in their scramble to get on the housing ladder before the FHOG deadline passes, they furiously bid up the price of the properties they are competing for. (It’s okay to do this, because “*property always goes up*”, right?)

But, as Professor Keen notes:

*“This is all illusionary wealth that could disappear very quickly... The additional \$2.8 billion or so has come from increased mortgage debt taken on by those most vulnerable to a serious economic downturn at a time when we can see very clearly that the global recession is coming our way.”*

### So the FHOG is an “illusion”... It’s also a debt trap.

The mind-numbingly stupid thing about making this grant available is that the government has clearly failed to learn from the huge mistakes that sparked this crisis in the first place.

*Don’t they remember how it all started?*

Let me refresh your memory and see if the same alarm bells currently deafening me start clanging in your head...

In a nutshell: U.S. credit expansion policies in the early part of this decade led to very low interest

rates, which in turn led to American banks having lot of money. Believe it or not, banks don't like having piles of money lying around in vaults – it doesn't earn anything for them. They need to invest it.

Now, usually, banks look for low-risk avenues of investment: companies or people with good standing. But when there's heaps of money in the system (that's "money", not "wealth") these "good" prospects don't need to borrow any from the bank.

So what does the bank do?

It looks further down the ladder for investment prospects.

This includes the poor, the unemployed, those with bad credit ratings, low earners and young starters. People who dream the dream of home ownership, but had never been given the opportunity to pursue this dream previously.

US Banks incentivised and cajoled the most vulnerable groups in society to take out home loans at super-cheap introductory rates, and hundreds of thousands did. With vast numbers of new buyers in the system, prices rocketed up fast.

**Like crazed shoppers on the Boxing Day sales, new buyers rushed to the market for fear of missing out on the great property boom.**

More credit was released... house prices were bid-up and even modest property became astronomically over-valued at 6, 7 and 8-times incomes...

People didn't care because "*you can't go wrong with property*"... the banks didn't care because they could package up the loans, sell them on, and lend more...

People over-leveraged... they borrowed more and more to buy investment properties so they could cash in on 'buy-to-let'... some borrowed more than 100% loan-to-value (LTV) on a property, just to get on the "ladder".

The U.S. property bubble inflated quickly and then, inevitably, popped.

**It popped because the most vulnerable groups in society were incentivised to take out big home loans, and then struggled to pay them back. Go figure!**

## Why Australia is stumbling into its own sub-prime crisis

Now do you see the similarities with what the Australian government is doing with its "First Home Owners Grant"?

It's putting up to \$21,000 into the hands of some of the most vulnerable groups of Australians on the condition that they put it towards the purchase of a property.

If these people want to live in or near any of the state capitals – as the majority of them will - that property will cost them a MINIMUM of seven times their income!

In fact, that multiplier will probably be far higher, as these young starters will most probably earn much less

than the median Australian income of \$60,658 a year, which is what the 7-times figure is based on.

**Do you think it's responsible behaviour to encourage these people to leverage themselves to the hilt in the middle of one the most uncertain financial periods since the Second World War?**

The government seems to think so. It's obviously working on the principle that getting the marginal buyer into the housing market keeps the bubble going – which gives the impression all is well with Australia.

*But it's also the last phase before the bubble pops. And that's something you urgently need to be aware of.*

**By following the U.S. model of incentivising low income earners to take on huge debts they can not afford to repay, the Australian government is consigning our economy to the same terrible fate.**

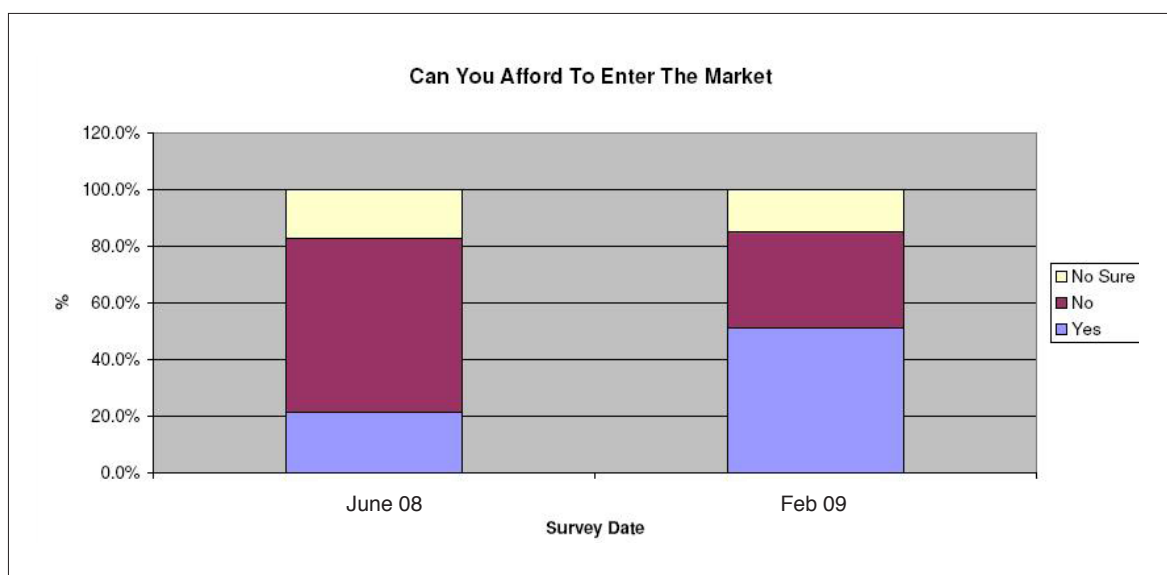
*“If you look back to the sub-prime issues earlier in this decade they were largely brought about by people being encouraged to borrow who couldn't afford to borrow.”*

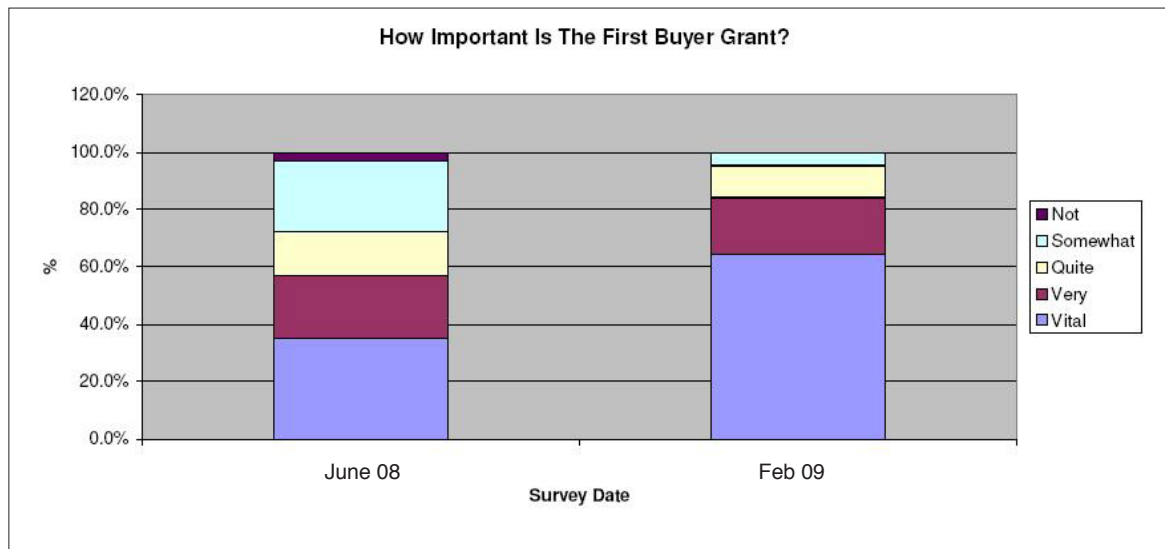
**Ralph Norris**  
**Chief Executive, Commonwealth Bank**

So are Aussie first home buyers taking the bait? You bet they are! After all, if someone offers you \$21,000 free money to pursue something you consider a birthright; you're not going to turn it down, are you? Remember: **“you can't go wrong with property... it doubles in value every 7-10 years... and renting is 'dead money'...”**

Check out the two illuminating charts below. They're taken from the February 2009 Fujitsu Consulting “Anatomy of Australian Mortgage Stress” report. Fujitsu surveyed first time buyers across Australia in June of 2008 and again in February 2009. What they uncovered is alarming in the extreme...

## Evidence that vulnerable Aussies are being seduced into a miserable life of debt slavery





These two charts show concrete evidence of the great wealth illusion that's blinding a new generation of Australian first time buyers. Worryingly, more than twice the number surveyed in February 2009 felt they could afford to enter the housing market than in June 2008.

And of these first time buyers, more than 80 per cent are dependent on the FHOG – with more than 60% of those surveyed citing the grant as “vital” to helping them buy a house.

In March 2009 the Australian Bureau of Statistics reported this:

*“The number of first home buyer commitments as a percentage of total owner occupied housing finance commitments increased from 25.7% in December 2008 to 26.5% in January 2009. This is the highest level recorded since the series commenced in 1991.”*

You probably don't get why this is such a worrying statistic...

Let me tell you why: by way of a comparison, before the U.S. housing boom went manic in 2004, subprime loans accounted for about nine percent of all new mortgage originations in America.

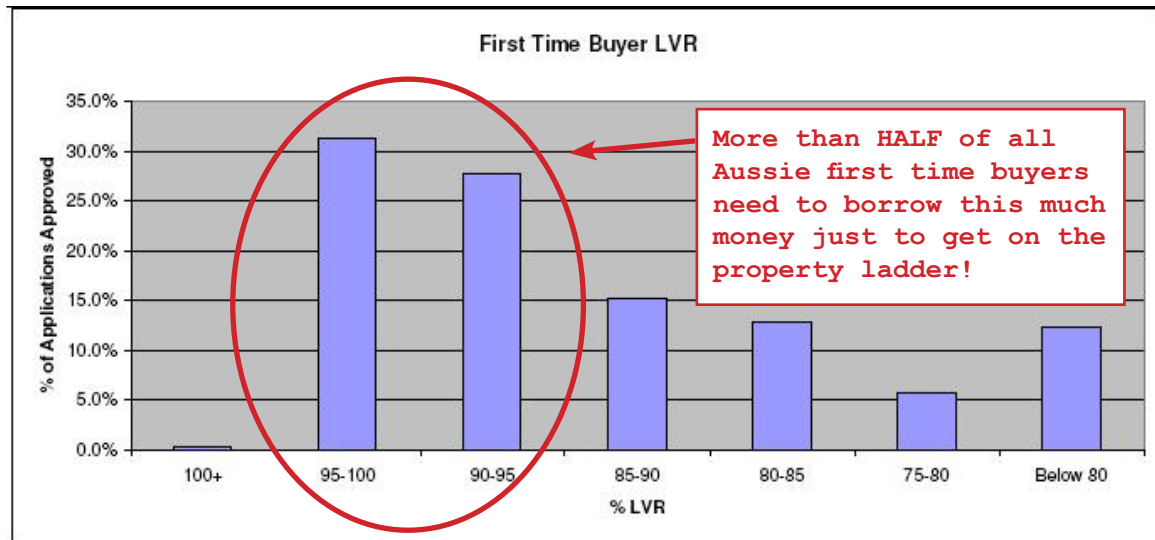
**At the height of the boom, just before the whole thing went pear shaped, this figure rose to 25% - right about where Australia is now.**

But there's an even bigger indicator that  
we're headed for a sub-prime catastrophe

The first problem we have is that vulnerable, marginal buyers are becoming a larger percentage of the Australian property market. The second problem is that, alarmingly, they are borrowing more!

According to the Australian Finance Group, loan-to-value (LVR) ratios were 66% in September of 2007. They're now at a new high of 72.7% nationally (75% in Victoria and 76.6% in New South Wales).

But first timers are borrowing well over that as this shocking chart shows:



Source: Fujitsu Consulting Industry Model, n 5,200 First Time Buyers

More than half of all first time buyers are borrowing 90% or more of the value of their house, with almost a THIRD needing more than 95% LVR!

*“It just isn’t right that the government and the real estate industry are relying on first home buyers to prop up the market... we’ve seen what’s happened with property in the US, it should warn us that encouraging people to go into property and borrowing 95 per cent is not a good thing.”*

**Martin North, Fujitsu Consulting**

Borrowing right up to the limit of your means is scary at ANY time. But when unemployment is rising, and interest rates are at their lowest for more than 30 years, it’s utter madness. How many of these new buyers are borrowing at ‘honeymoon’ introductory interest rates that later reset to standard variable rates?

I’ll tell you: the number of new buyers choosing low introductory rates has grown from 5.3% of new lending to 21.8% - a 311% increase. And according to industry outfit *Mortgage Choice*, 92% of new mortgage loans in Australia are variable rate.

***How many of these borrowers realise how badly this exposes them to rising rates – which I believe will hit Australia hard by mid-late 2010... 2011 at the latest.***

How can I be so sure? Well, by then you’ll either have huge inflation as a result of more stimulus packages, deficit spending, and an expanded money supply. Or if you prefer a positive scenario, a recovery will have taken hold by then and the RBA will be forced to raise rates to “cool things off.” Whichever way you slice it, it doesn’t look great for those who are piling into property now because “interest rates are low”.

*“Households that are considering entering into homeownership need to carefully consider their own circumstances, including whether they would be able to continue servicing their loans if mortgage rates were at some point to begin to return to more normal levels.”*

**Anthony Richards, Head of Economic Analysis Department  
Reserve Bank of Australia, Sydney - 26 March 2009**

## Why the Australian Housing bubble will be the last to pop – and the loudest of all

Australia is a proudly patriotic land. In so many ways this country is the envy of many nations in the English-speaking world.

**But if you think you're immune to global economic pressures just because you're so far away from everyone else, you need to think again.**

Housing bubbles have popped all over the civilised world in the last year to 18 months – yet most Australians I speak to swear blind that won't happen here.

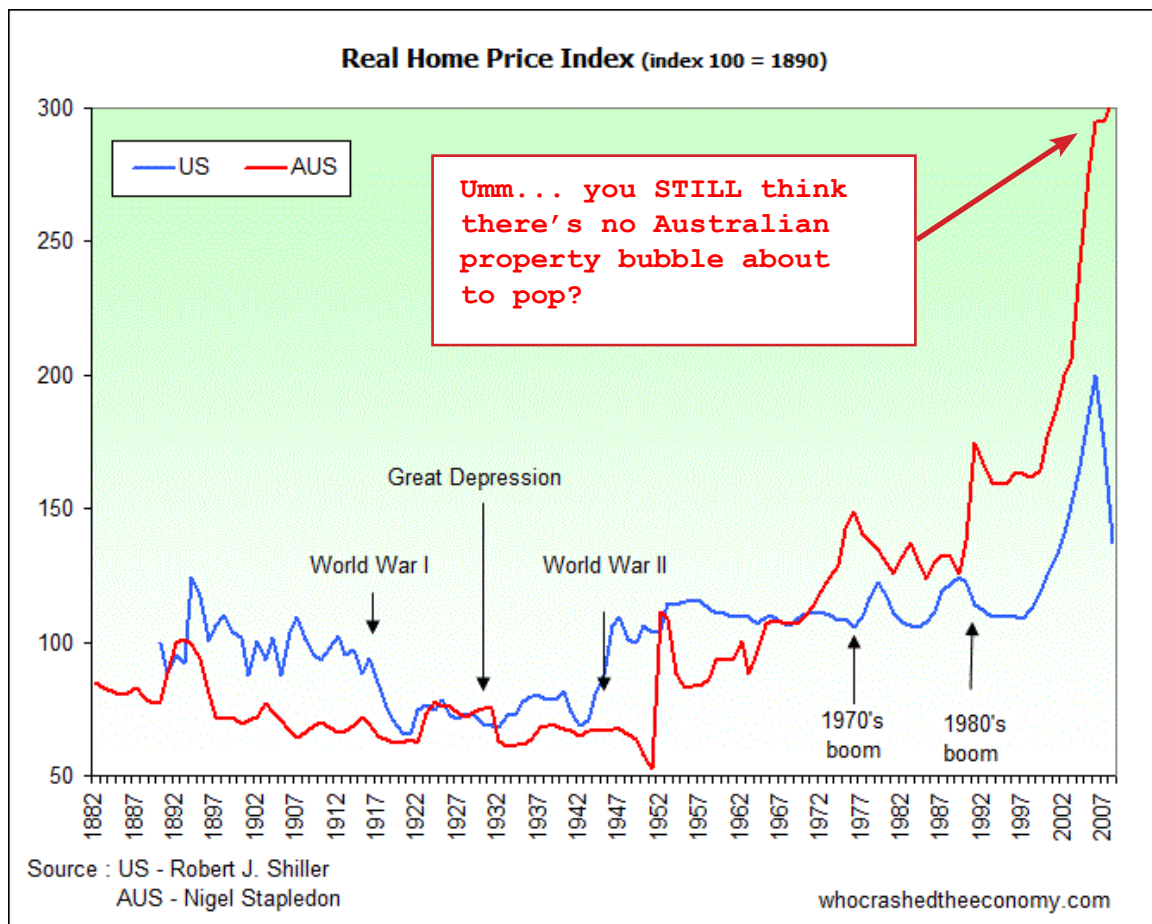
I'm sorry to tell you: they are wrong.

You are facing the most spectacular housing crash of them all.

*"Since the mid-'90s, Australian housing prices have risen by 175 per cent, compared with a peak rise closer to 80 per cent in the US..."*

**The Australian  
October 18, 2008**

Remember that graph I showed you earlier – the Aussie house prices chart that only went up to 1995? I promised I'd show you what happened next:



Pretty impressive, huh?

I remind you – this chart compares Australian house prices directly with those in the U.S. over the last 125 years, after inflation.

The blue line (bottom) shows you what has happened to the American property market these last 10 years. As you can see, since 1997, U.S. prices shot up rapidly and grew consistently for 10 years straight; before crashing painfully, spectacularly down.

The effects of the US housing crash caused huge cracks in the world economy that leaders are now furiously trying to paper over with trillion dollar injections of cash here and there.

Believe it or not, the red line (top) is Australia.

The Aussie property market has, pretty much, mirrored the US trajectory in the last 15 years with two crucial differences:

- **The property boom in Australia since 1997 has grown much faster, steeper and higher than in the U.S...**
- **The Aussie property market hasn't crashed... yet!**

And STILL there's no telling Aussies that all of this housing "wealth" isn't real!

## But then – why take all this from a Yank?

I've lived in Melbourne for nearly five years now. I love Australia. And I realise how much Aussies hate to be lectured to by outsiders. So many of my friends and colleagues urged me NOT to write this report.

I must admit – I 'ummed and ahhed'...

But you know what?

It's precisely because I care so much about Australia and Australians that I HAD to write this "white paper" briefing.

I've seen what the housing market catastrophe has done to my friends and relatives in the U.S. Many of them bought property believing what you believe:

That prices only ever go up.

**Dan Denning**  
founded and edited the financial newsletter *Penny Stock Fortunes* in 1998 and edited *Strategic Investment* from 2000 to 2006.



Via his high-level, macro-economic and stock-market forecasts in these newsletters, he led over 35,000 subscribers in 70 countries to profits.

Dan's analysis for *The Daily Reckoning* is read by more than 500,000 people regularly. Dan is also a regular columnist for *MoneyWeek*, a London financial publication.

In 2002 Dan spent a year observing U.S. markets from Paris before relocating to the London offices of Fleet Street Publications. In 2004 Dan spent six months travelling the globe in search of investment opportunities. This trek resulted in the *New York Times* bestseller, *The Bull Hunter* (John Wiley & Sons).

**They made assumptions about house prices based on myths and lies. These assumptions were flawed, and now hard-working Americans are paying the price with the wealth they have been carefully building for years.**

Millions of Americans – including many dear to me - are now learning exactly how tough it is when you get the biggest financial decision of your life wrong. There's no going back. No sticking your arm up and getting off the ride. You just have to tough it out, cut back, save harder, work harder and budget harder.

After the party comes the hangover.

**Please understand: the same thing could easily happen HERE**

Look, the worst that happens is that I'm wrong about all this.

I truly believe I'm not – but if something miraculous happens that proves me wrong then at least you won't be exposed to one of the biggest collapses of personal wealth you'll ever have to experience.

*“Demand for housing finance will likely fall off towards the end of the year given the massive wealth destruction that is underway in the household sector.”*

**JP Morgan economist  
Helen Kevans**

There may even be a mini boom in Aussie house prices later this year. Another scenario is that they remain stable – either outcome will give the illusion that everything is fine.

But what if I'm *right* about the prospects for the Australian housing market?

**What If I'm Right about The Great Aussie Wealth Illusion?**

*“Few officials are prepared to discuss Australia's vulnerability to its elevated housing prices, which actually inflated more than America's”*

**Michael Stutchbury  
The Australian, October 18, 2008**

**I repeat: if the only thing you take from this report is an urgent need to think twice about buying property right now then it's “mission accomplished” for me.**

Look, I'm not some know-it-all outsider trying to deny you your right to dream the “Great Australian Dream” – I'm just trying to stop you making a decision that really could turn out to be a horrible nightmare.

Please take a look at the top line again on the chart on page 19 and understand: this situation cannot continue forever. Demand for houses will only exist while houses are considered to be affordable – and while there are enough marginal buyers being sucked into the market.

There is currently an **illusion of affordability** thanks to available credit, low interest rates and incentive schemes such as the FHOG.

But the truth is that, right now, at an average of 7-times income, Australian housing is the least affordable in the world.

The government needs these young buyers to keep the housing bubble afloat, and to maintain the façade that Australia remains unaffected by the global financial crisis.

**Politicians are trying to trick first time buyers into believing they are wealthy enough to buy property. They are not.**

*“[Australian] Home buyers have been used as pawns by governments of both political persuasion to reflate the housing bubble”*

**Steve Keen**  
**“Debtwatch” March 2009**

*“The housing price and household debt bubbles produced by John Howard’s battlers have left Australia vulnerable to the global credit shock.”*

**Michael Stutchbury**  
**The Australian**

This near-sighted policy is consigning an entire generation to a lifetime of misery and it will come back to bite all Australians on the back-side.

As we’ve seen in the U.S. once marginal buyers are incentivised to take on huge debts at 5, 6 and 7 times incomes, it’s only a matter of time before the housing bubble bursts.

By pumping more easy credit into the system... by keeping mortgage rates artificially low... and by teasing young hopeful Aussies with a “free money” deadline the government are effectively trying to put out a raging bush fire with petrol.

**The LAST thing Australians need right now is more debt!**

*“Since 1992, the disposable income of Australian households has grown at a rate averaging 6 per cent a year. But the debt of those households has grown at a rate of 14 per cent a year. As a result, households’ total debt has gone from about 50 per cent of their annual disposable income (which was low by international standards) to about 160 per cent (which is among the highest in the world).”*

**Rev the Hon Dr Gordon Moyes AC MLC**

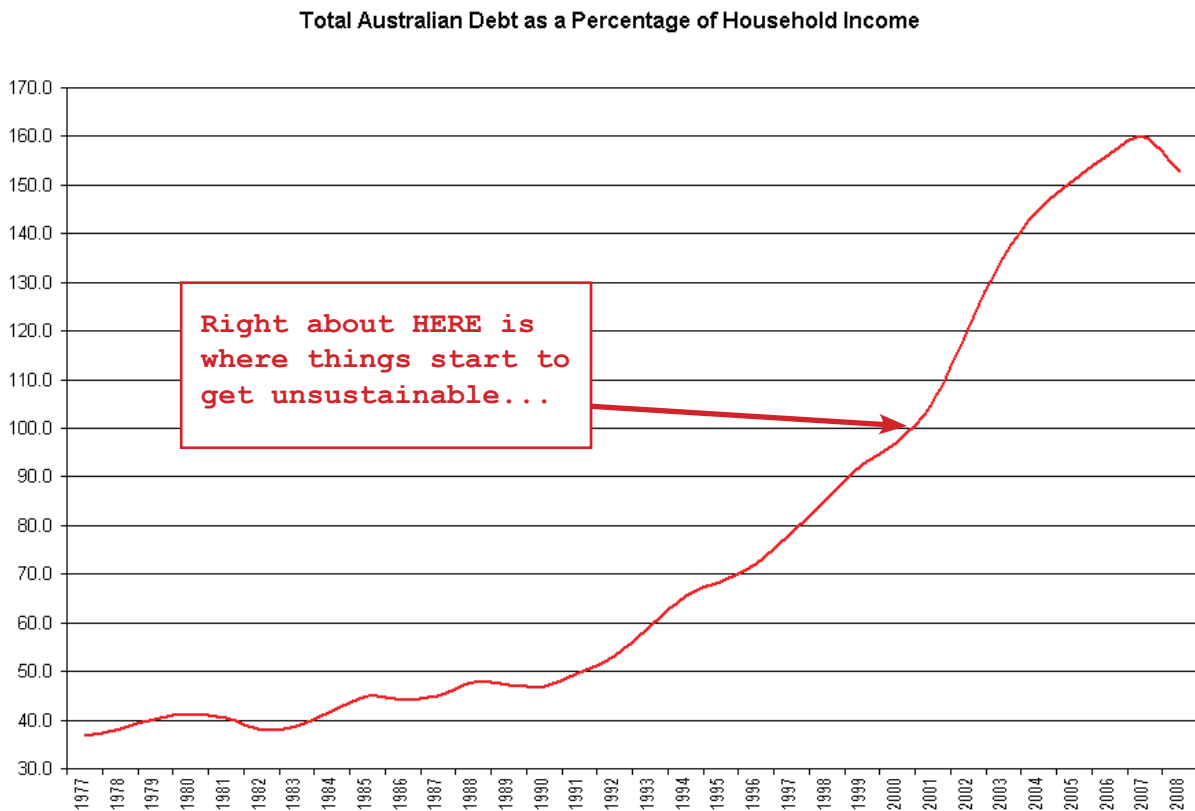
It’s not an argument that sits well with many Aussies – but to truly understand the seriousness of your predicament you need to realise that **you are in more personal debt than Americans were at the time the U.S. sub-prime crisis sent the world into turmoil.**

As *The Australian* reported in October 2008:

*“By 2008, Australian households carried 35 per cent more debt relative to their income than Americans. The great Australian middle class had become more addicted to credit and more spendthrift than the US, the*

home of consumer capitalism.”

Take a look below at how Australian household debt has grown relative to household incomes over the last three decades:



This shows you that for every dollar an Australian earns, he owes more than one dollar fifty cents.

That's unsustainable. But it's completely understandable.

Rising house prices have made everyone feel wealthy.

This, coupled with the easy availability of cheap loans, low-rate credit cards and penalty-free mortgage-switching has encouraged people to go out and spend like never before... on holidays, home improvements, new cars, big-screen plasma TVs...

We consumed until we ran out of money... then we borrowed so that we could keep consuming. Many households remortgaged and spent any gains they made from the housing boom.

Why? Because of those myths we believe about property. The main one being that house prices only ever go up. After all, if prices always go up, what's the risk?

*But prices don't always go up.*

And if you've gambled your future on perpetually rising property prices you're in for a big shock later this year...

*“We are concerned that first home buyers borrowing too much money at high initial LVRs at artificially low interest rates will ensure that Australian households remain highly geared and highly sensitive to any future increase in interest rates.”*

**Will Australian Households End Up With Too Much On Their Plate? – J.P. Morgan, April 2009**

Just like every country in the Western, English speaking world, Australia’s housing bubble will burst. It’s happened to devastating effect in Ireland and the U.S. It’s currently being played out in Great Britain – and it will happen here.

The message is clear and simple...

## Conclusion: The days of treating your home like an ATM are over

If you think that investing in property is a good idea in 2009, please understand:

- You cannot bribe your lowest income groups to borrow money to buy over-priced houses while interest rates are at their lowest point in their cycle and the threat of unemployment is higher than at any time in a generation, and expect everything to be fine.
- You cannot sustain a personal debt to income ratio of more than 160% in a global recession and expect everything to be just peachy...
- You cannot have a property market where the average house costs SEVEN TIMES the average salary and expect demand to keep soaring...
- You cannot expect to maintain the same level of discretionary spending if the amount you spend on your mortgage is higher than 30 percent of your take home salary...
- You cannot expect the credit that's been driving the Aussie property market to keep flowing when banks' access to foreign capital dries up...
- You cannot expect Australia to be the only place in the world where a collapsing credit boom does not lead to lower house prices!

The marginal Australian buyer racing to throw his FHOG deposit down right now is at the highest risk of losing his job. He has the fewest assets and he is facing the highest mortgage stress of all Aussies. He's borrowing ever larger amounts of money at variable rates precisely at the lowest phase of the interest rate cycle in 30 years.

*"With unemployment currently at just over 5 per cent, many economists are forecasting it will peak at 8-9 per cent in 2010, which will lead to a "bloodbath" in the property market as thousands of mortgagors default on their loans."*

**Glenn Milne and Nick Gardner**  
*The Sunday Telegraph, March 22, 2009*

Something has to give. If the Australian job market implodes, as many commentators are suggesting it will in 2009/10 thanks to the slump in the Aussie resources sector and slowing retail sales, things could get sticky for new homeowners, very quickly.

*"Greater than expected labour shedding could lead to increased household debt defaults, deeper household deleveraging and sharply increased chances of recession. On our estimates, a rise in the unemployment rate towards 8 per cent would be sufficient to trigger a fall of at least 10 per cent in national house prices."*

**ANZ Bank economists Warren Hogan and Katie Dean**

## The real choice Aussie home buyers face now

In 2009, the “Great Australian Dream” has become a straight choice between perpetual debt and financial freedom.

Easy mortgage credit may help you lever up into the home of your dreams. But it won't help you make the mortgage payment – and that's really the bottom line.

Whether house prices are truly sustainable at high levels comes down to affordability. And affordability comes down to the size of your monthly payment as a percentage of your disposable income.

Soon enough, those who believed the great Australian wealth illusion, those who have crammed onto the property ladder like desperate commuters in a London tube carriage will start facing some really tough choices...

*They'll have to choose between paying their mortgage and putting food on their table... paying their mortgage and putting petrol in the car... paying their mortgage or the kids' school fees...*

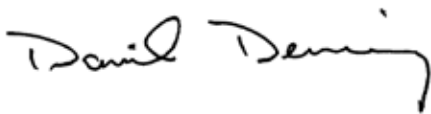
If you're thinking of gambling your financial future on perpetually rising house prices, I'd urge you to give serious consideration to the points I've made in this special report.

Please, re-read the figures... do the maths... think about the false economy of the FHOG and consider what a swift rise in interest rates would do to your disposable income before committing yourself to a huge loan you might not be able to afford to service.

I know the arguments I've made here won't be popular.

But they won't put you in the poorhouse either.

Sincerely,

A handwritten signature in black ink that reads "Dan Denning". The signature is written in a cursive, slightly slanted style.

Dan Denning  
*The Daily Reckoning*