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The drivers of house prices

The house market is not a global market like commodity markets. Thus, if house prices in Cape Town are cheap relative to Melbourne, potential buyers of houses in Melbourne do not flock to Cape Town, thereby pushing up prices in Cape Town. Put differently, fixed properties – with the emphasis on 'fixed' – are not globally tradeable or transportable like crude. Because one cannot live in Cape Town and commute daily to Melbourne, prices in Cape Town will not eventually – through arbitrage – equate those in Melbourne. But one can buy Saudi-Arabian crude (a transportable commodity) and deliver it in South Africa.

The main short-term drivers of house prices are growth in household incomes in a city ("the economy, stupid") and interest rates. The two combined can be seen to constitute 'affordability'. Because cities' growth paths may differ, it is preferable to evaluate house prices by city.

As for interest rates, the world is in an era of extraordinarily low interest rates, which inevitably pushes up asset prices, including the prices of real estate and stocks. This of course has the effect of making the rich even richer, thereby increasing wealth disparities. This is apart from the global economy that is progressively demanding more knowledge workers and fewer menial workers. Thus, both wealth and incomes are getting more unequal. These are forces that no politician can control, although Mr Tump of the US is doing his best.

A longer-term driver is building-construction-cost inflation. If house prices of existing stock are too low relative to the cost to construct new houses, the supply of new houses will be depressed because there is little incentive to developers, thereby eventually stimulating house-price inflation of existing stock. On the other hand, if prices of existing houses go into a bubble (prices exceeding building-cost inflation), new supply is stimulated, thereby eventually creating an oversupply (the bubble bursts), which then of course depresses prices.

There are also three non-economic or extraneous factors that influence house prices:

First, in a few world-class cities, Chinese buyers are – or until recently have been – laundering money by buying in a few North-American West Coast and Australian cities; or they are, pure and simple, investors hedging their bets on the Chinese economy. Examples are Vancouver, San Francisco and Los Angeles in North America, and the Australian cities of Melbourne and Sydney.

Second, well-meaning politicians who decree that new housing developments aimed at the middle segment must include low-priced units, thereby decreasing the viability of developments by compressing profit margins and lengthening the sell-out period. The medium-term effect of this intervention (dampening new supply) is of course house prices that rise faster than incomes, thereby making housing less affordable to everyone (except the lucky few who get subsidised housing units). Superficial research seems to indicate that Vancouver, San Francisco and Los Angeles fall in this category.

Third, environmental impact assessments (EIAs) are necessary, but they take a minimum of 18 months in South Africa. These inevitably retard new construction. And they are expensive, which impact house prices.

I made the point above that the level of household income in a city is one of the determinants of affordability, and therefore prices. The implication of this truth is that where the incomes of the high-income segment are growing faster than the incomes of the lower segment, it stands to reason that the lower-income earners will eventually be priced out of the core city or other upmarket areas. This is especially true of the central area of successful cities like Cape Town and just about all world-class cities. In economically-deprived areas like Johannesburg's CBD, this phenomenon does not exist. Thus, to create *meaningful* housing access to the poor in the CBD of Cape Town, the powers that be should aim to make Cape Town's CBD a failed urban area. A first step, I suggest, is to abolish the Central City Improvement District (CCID). If this remedy is a bit too thick, the long-term strategy should be to establish and successfully run efficient, affordable public transport from the outlying, less expensive, suburbs and townships. Affordable public transport implies nearly always subsidies by the taxpayer. So, either way, giving access to the poor and not so poor, to the CBD will cost the taxpayer. But it is an unavoidable cost.

Note that I used the phrase 'to create *meaningful* housing access to the poor'. By 'meaningful' I mean that one cannot physically transfer all the townships and suburbs to the Cape Town CBD because it is physically and economically impossible. At best one can create a few high-rise social and 'affordable' housing sites. However, to be honest, this would be no more than a political gesture.

It pains me, but who said the world was an equal or fair place?

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