

Australian Residential Property
Market Update
June 2009



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When the Global Financial Crisis (GFC) launched itself into our lives about 9 months ago we moved into unknown territory, however financial experts have been proven correct in their assessment that the fundamentals of the Australian Economy the Banking system and Residential Property market remains strong. After contracting by 0.6% in the December 08 quarter the economy surprised many by rebounding with 0.6% growth in the March 09 quarter with many arguing that a recession has now been avoided. CommSec's Craig James expects the Australian economy to rebound far quicker than Federal Treasury with 2.1 per cent growth tipped for 2009/10 and 4.1 per cent growth in 2010/11.

Prestige residential properties have been hit hard whilst the lower end of the market (driven mainly by first home buyers) has performed strongly and overall the residential property market is in pretty good shape. One of the biggest challenges is making sense of the constant new statistics and information being presented by the media, politicians and business groups every week.

First, let's talk about **property "cycles"**. Experienced investors understand that all booms come to an end and then after an adjustment period another boom begins that we all want to be part of. (We also need to recognize that different states and cities in Australia have their own "cycle" within the overall Australian one.) The fact remains that now the market is abuzz with buying activity from astute investors that recognize that the property market is at the start of a new cycle that features low pricing, strong rental returns and low interest rates. Market commentator BIS Shrapnel believes that any downturn will be short and sweet and be followed by a "runaway boom". In the years to come, many investors that did not take action will look back on 2009 as the year they should have done more.

Next let's look at fundamentals – **supply and demand** – which underpins all property markets. The GFC has meant that Banks and Lenders have pulled the pin on thousands of developments across the country by either withdrawing funding or demanding onerous conditions on developers – particularly on high density apartment projects. What this means is that tremendous additional pressure has been added to an already undersupplied market – BIS Shrapnel says that "Banks are financing people buying stock but not developers". The problem is hard to fix because even when the supply "tap" is turned on it is years not weeks or months before that supply hits the market in the form of completed properties.

Recent home price data from RP Rismark have shown that **property values** grew in all capital cities (except Perth) over the first four months of 2009 by 2.8% nationally. Darwin, Melbourne and Sydney gained the most. Strong demand is fuelling the market due to the population growing at its fastest rate in 40 years, record low interest rates and strong rental returns. Strong rental yields and an uncertain share market are enticing investors back to the property market. Interestingly units (+3.3%) outperformed houses (+2.7%) in the first quarter of 2009.

Many people still have a "wait and see" attitude and are concerned by the potential **unemployment** risk to them over the coming 12 months or so. Craig James, Chief Equities Economist for Commsec believes that the fears about job losses have been "overdone" and that companies have been creative in cutting hours and salaries rather than jobs. Unemployment will undoubtedly rise but it shouldn't result in a kind of instability in house prices. Residex states in its latest quarterly reports that "the only real certainty is that rents will continue to rise and even substantial cuts to overseas migration will not solve the housing shortage problem" that continues to exist across the country. The **rental yield** for units across Australia is 5.24% and houses 4.7% and with low vacancy rates nationally these will move up and make residential property even more appealing to investors.

Fixed rates are always a good barometer of how the banks see **interest rates** moving in the medium term and they are worth keeping a close eye on. They normally track pretty closely to the variable rate however over the past 2 months the major banks have all put their fixed rates up substantially – the clearest indication yet that they believe interest rates may have bottomed out and that upward movements in rates may come earlier than previously expected. The latest home price data confirming prices have gone up will strengthen the RBA's case for continuing to keep rates on hold and make the chances of more interest rate cuts less likely.

One of the significant outcomes of the GFC is the way that **Banks** have tightened their lending criteria and processes to make it more difficult for property buyers to borrow money. In particular it is now much more difficult for self employed people and investors seeking "low doc" loans. It is interesting to note that Banks will come out of this cycle with

extremely strong balance sheets that will feature higher profit margins and with minimal bad debts which are good for the long term stability of the Australian Financial markets – watch out for record Bank profits in the years ahead!

Overall, the market seems to be at the bottom of a new cycle with growth being driven from the bottom end of the market whilst prestige property devaluations dominate at the top end. A low interest rate environment is a ripe time for investors - with price growth likely to flow into the mid market over the next 2-3 years. Time is a crucial commodity in every property cycle and a bottoming / rising market is the best time cyclically to invest “off the plan”.

Good luck to all

Grant Ryan, Research Director, Ironfish.

Australia - City by City Analysis

Adelaide:

South Australia posted the strongest economic growth of any State over the March 09 quarter with state final demand up 2.0 % which was a real boost for the Resource state. According to Residex, median Adelaide house values rose 1% and units 0.6% in the first 3 months of 2009 to underpin stability in South Australia’s capital. After enjoying a boom year in 2007, 2008 was a year of adjustment and consolidation and that continues in 2009. Adelaide still has the lowest median house value of any Australian mainland capital city and this “affordable” tag continues to serve the city well. Rental returns remain solid.

Throughout 2008, building approvals for new projects were very slow and this has resulted in tightness in the property market for “quality new stock”. The March ANZ Property Outlook reported that “housing finance approvals (for South Australia) increased over 25% from October 2008-Jan 2009 this year signifying strong demand”. This was also evidence that housing affordability had again improved too. The outlook for the next 12 months is positive with the rental market still tight and availability of new ‘quality’ projects limited.

Brisbane:

After a boom 2007 and holding steady in 2008, RP Data-Rismark reports Brisbane houses grew by +1.6% in the first 3 months of 2009 which is positive news for the Queensland capital where supply of new properties is limited. Pent up demand for new homes will further build this year even though the QLD State economy has stopped growing, Michael Matusik reports that there were only 29,000 new starts compared to an underlying requirement of around 46,000.

Almost \$5 billion worth of residential projects have been shelved in Brisbane’s CBD since the GFC late last year. Commercial and Residential buildings throughout Australia are being shelved due to lack of funding and Brisbane is no exception. As mentioned in the main brief, even when the supply “tap” is turned on it will be years before the undersupply problem will be affected putting extreme pressure on apartment prices of recently completed projects or off plan projects that will be proceeding anyway.

Melbourne:

After a boom 2007 and a more stable 2008, Melbourne house prices rose 4.5% in the March 2009 quarter and were second only to Darwin for growth during this period. This strong result is indicative of being one of the strongest markets in the country. Melbourne has some of the best “value” properties in Australia and the first home buyer market has been fierce in the wake of the Federal Government’s “Boost” scheme and Victorian State government’s incentive to first home buyers - which have definitely given this local market a “boost”.

The median house rent of \$380 per week rose 8.6% in the past 12 months whilst the median unit rent of \$340 per week has risen 13.3% over the same period. The local rental market is still tight with rents predicted to continue to go up in the second half of 2009.

The Victorian State Government continues to offer property buyers a unique (and generous) stamp duty concession for off plan purchases and the Melbourne market has continued to attract record number of investors whether buying apartments off the plan or “new build” home and land packages. The prospect of further growth in 2009 is excellent with the ongoing strong demand and supply struggling to keep up. Melbourne – like other capital cities has had a fair share of new projects shelved due to lack of funding.

Perth:

Perth was the only Australian capital city not to record rises in house prices in the first 3 months of 2009 signaling that its correction period is still not complete although it has slowed substantially. (This is of course off the back of an extraordinary period of growth and all cycles have adjustment periods.)

The rental market continues to perform well and this is evidenced by the strong rental growth over the past 12 months for both units (+9.4%) and houses (+9.1%). House rents are coming off a low base and are still (in spite of increases) only 4.1%. Units on the other hand are at 4.9% and are likely to hit 5% in the near future.

Residex’s March Quarterly Report records the decline in values for Perth in the 12 months to March 09 to be -9.4% (units) and -4% (houses). The short to medium term growth outlook for houses is for (slow) growth, whilst units will mainly be a rental proposition in the short term. Perth is a good long term investment but will probably be last and slowest to start the next cycle of growth. One to watch though.

Sydney:

Between January and March 09 Sydney house prices rose by 3.9% according to RP Data-Rismark. Hopefully (for investors) this is a sign of things to come. This is a strong result for one of the softest performing markets over the past 10 years with annualized growth of less than 7% for both houses and units and prices “flat-lining” for around 5 years. Sydney has a chronic under-supply with demand of around 41,000 dwellings pa whilst approvals of only 16,000 pa. Sydney has the largest unit market of any Capital City with over 40,000 unit sales in the 12 months to March 09.

The Sydney rental market is still extremely tight with house and unit median rents going up 7.6% and 9.1% respectively over the 12 months ending March 09. The rental yield for Sydney units is now 5.4% and helping pull investors back into the Sydney market after a few years of lackluster interest.

Sydney’s biggest problem by far is the lack of supply of new projects – more projects have been shelved in NSW than in any other state. Investors need to be wary not to “rush” into any project just because it’s “Sydney” as there is a supply of lower quality products which will not perform as well as higher quality products over the medium to long term. The trend in Sydney is towards smaller apartments that remain “affordable” and of course close to infrastructure and transport.

Hobart:

In late 2008, the Tasmanian economy performed well above its eastern seaboard mainland states. Furthermore the March ANZ Property Outlook points out that more importantly the unemployment rate is relatively low and remains under the national average at 4.5%. It describes the Tasmanian property market as “well supported” with housing approvals having grown 25% since lows in September. First Home Buyers have been active in this “affordable” State market and account for one third of new housing finance approvals.

The rental market is extremely strong with 10% rental growth for houses (\$330 per week) and 18% growth for units (\$260 per week) over the 12 months to March 09.

Information Sources:

Australian Financial Review (AFR)

ANZ Property Outlook, March 2009

PRD Nationwide Quarterly Economic & Property Report, Issue 4 2008/2009

REIA Real Estate market Facts, December 2009

Residex Reports (March 09 quarter) for NSW, VIC, SA, WA, TAS, ACT, NT

The Matusik Snapshot series 2009

Craig James, Chief Equities Economist, Commsec – various articles

BIS Shrapnel economic seminar – March 17 2009

Various metropolitan newspapers

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