

Australian Residential Property
Market Update
March 2010



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Overview of the Australian Residential Property Market – March 2010

Summary – positive outlook for 2010

The 2009 year had a slow start but ended strongly in the second half of the year with overall price growth across all states and this has set a solid platform for residential property in 2010. What will become increasingly obvious in 2010 is that affordability will again feature as the key issue. Many first home buyers will be kept out of the market and many of them will be forced to remain long term renters. There is a serious supply and demand imbalance in the Australian residential property market that indicates we are simply not building anywhere near enough new homes to meet the demand of a rapidly growing population, and the situation is likely to only get worse. There are strong signals that the prestige property market pain is now almost over and we are seeing astonishing demand for high end properties which is driving amazing growth in this part of the market. 2010 should feature a shift of sales activity from the first home buyer market to a rapidly increasing investor market and owner occupier middle market.

Another interest rate rise in March 2010 was vindicated by data confirming that the Australian economy grew well above its trend rate at 0.9% for the December 2009 quarter and took total economic growth for the 2009 year to 2.7%. This incredibly robust result along with solid employment figures and buoyant business and consumer confidence has all but guaranteed the return of interest rates to a “normal” level by the end of the year. Experienced property buyers (in particular property investors) will not be deferred by this as house prices and rents are tipped to increase substantially throughout the year. The outlook is not so pleasant of course for renters.

According to the latest PRD Nationwide Quarterly Research Report, business confidence in the market has received the highest positive index result since 2002. This indicates that business is no longer looking at cut backs to staff but instead to expansion and growth which is a fantastic sign for the strength of the employment market.

The outlook for growth in 2010 is best described by Craig James, Chief Economist of Commsec and respected market commentator. He expects “home prices to rise by 8-10 per cent over 2010. The population continues to grow and not enough homes are being built. For investors, rising rents and home prices is an attractive combination”.

Supply and Demand – the market is undersupplied

The delicate balance between these two fundamental underlying factors is what drives capital growth and rental growth in the residential property market. Simply put - Australia struggles year on year to build enough new homes to cater for its growing population.

Last year Australia's population grew by over 440,000. International migration remains a key demand driver for Australia with 285,000 new migrants settling here last year. Westpac reported in its Outlook for Australian Property Markets 2010-2012 that most of the population growth occurred in the “big three” Eastern states with 113,000 to Victoria, 114,000 to Queensland and 115,000 to NSW. Interestingly, South Australia had a surge in their population growth rate to record a

respectable 1.2% growth rate for the year ending June 2009. This figure is almost double their long term average at 0.7% and was due mainly to a dramatic increase of international migrants choosing to live in South Australia.

According to Residex there were 347,912 settled house sales and 141,873 settled unit sales in 2009. These figures represent existing and newly completed homes that settled in 2009. What they do not show is the specific demand and supply equation of new homes that need to be supplied to the market each year in order to meet new demand. Different commentators quote different figures with John Edwards of Residex stating that at least 170,000+ new homes are needed each year (ANZ believes the figure to be closer to 200,000) and yet only about 130,000 - 140,000 are approved or commenced each year. This creates a lot of market pressure on prices and the shortfall of supply accumulates each year, and with no foreseeable change in this pattern.

Why don't we just build more homes some people ask? There are a range of reasons including high state and federal taxes, growing construction costs, bureaucratic and lengthy planning and approval processes, and now more severe funding difficulties that were exacerbated by the global financial crisis. All these factors combine to make it slow, expensive and risky for developers to bring new projects online. The end result is that because fewer projects are built, the undersupply will underpin price growth into the future. There is always going to be strong demand for quality properties near transport, amenity (and particularly in Australia's major cities which attract most overseas migrants).

Interest Rates – returning to normal

The Reserve Bank lifts or lowers interest rates in response to the strength of the overall economy. When the economy is struggling (employment, input, output etc), rates go down slightly to encourage demand, and when it's booming, rates go up slightly to ensure growth doesn't get out of control. Consistent long term growth of the economy and the property market are the result of a controlled monetary policy and experienced investors realise this and are not afraid of inevitable interest rate changes. The current program of interest rate rises differs from many in the past though because they are not an uncertain rise to an unknown level, but simply a "return to normal and reasonable levels". Rates were dramatically cut in response to the global financial crisis in late 2008 and early 2009 to stimulate the economy. Australia (and Australian property) is now in an enviable position when compared with other nations and the residential property market is travelling nicely.

Last year, many first home buyers were drawn into the home ownership market through generous government handouts and temporarily low interest rates and so this inexperienced group is most likely to feel the impact of interest rate rises. By restoring rates to normal levels, affordability will decrease again and this will mean that more renters will stay renting and so will constrict supply and ultimately drive up rents further. This has a more negative impact on renters than investors (who will be able to offset rises in holding costs by increasing rents).

City by city Analysis

ADELAIDE

South Australia's economy is emerging from the economic downturn strongly and once various mining projects eventually come online it should strengthen further. The State government's aggressive overseas migration incentive program has been hugely successful in attracting skilled overseas migrants and contributed 44% to SA's overall population growth last year and created good demand for new properties. Most market commentators and analysts agree that Adelaide remains second only to Hobart in terms of affordability (of all the capital cities). It is however a more difficult exercise to pinpoint whether the median house price is \$396,000 (according to Residex) or \$372,000 (according to RP Data).

Adelaide enjoyed amazing growth in the previous few years and performed solidly in 2009 with 7.1% growth for houses and 6.9% growth for units according to Residex's latest market report. A strong local employment situation is helping fuel confidence in the residential property market and the Adelaide market remains slightly undersupplied (however not to the same dramatic extent as some other cities). Westpac in their Property Outlook for 2010-2012 believes that South Australia is undersupplied by around 2,360 dwellings. Adelaide's vacancy rate fell late last year by 0.1% to 1.3%, and is an indicator that the market is undersupplied. Rents for units grew by 5.9% over the past 12 months whilst median houses rental yields remained unchanged. BIS Shrapnel predicts rental growth of at least 3.4% per annum over the next 3 years.

BRISBANE

BIS Shrapnel believes that there is an extremely low pipeline of new apartment projects coming onto the market in 2010 due to the fact that "medium and high density starts are estimated to have plunged by 45% in 2009, reaching the lowest level since 2007." This shortage of new supply will put inevitable upward pressure on apartment prices and rental yields as any new buildings under construction still take long periods of time to complete and become ready to occupy. The Queensland population growth rate remains incredibly strong at 2.6% (to June 2009) despite including slightly fewer interstate migrants. The population grew by 113,000 people and this large number creates great demand for new property. It has opened up a large supply and demand gap for housing across Queensland and particularly in Brisbane.

According to Residex, Brisbane ended 2009 with 4.2% house growth in the December quarter which is arguably a sign that the local residential market is starting to build momentum after a quiet period. We predict that many investors who have been more focused on the Melbourne market for the past couple of years will turn their attention north to Brisbane in 2010.

Brisbane's rental yield for units remained steady in 2009 at around 5% with houses just over 4%. 2010 should see a tightening of rental markets due to a lack of supply of new properties onto the market.

HOBART

Residex reports that at the end of 2009 the median house price for Hobart was \$369,000, which was the lowest of any Australian capital city. According to Australia-wide valuation company Herron Todd White, the first home owners' grant last year pushed the bottom of the market along with Hobart properties under \$450,000 selling quickly whilst those over \$450,000 were slow to sell. However at the end of 2009 agents were reporting good demand across all price points. The Hobart market does not have the same volume or scale of larger Australian cities and the supply and demand equation seems reasonably well balanced. Houses grew by 5.2% and units by 7.2% for the year ending December 2009. Rental yields for houses and units are excellent at about 5% each (4.95% for houses and 4.96% for units). House rents in particular are above the national average and second only to Darwin which is an amazing 5.47%.

Solid growth of 5-6% is predicted for Hobart houses and units over the next 5 years.

MELBOURNE

The Melbourne market has been the darling of investors for the past few years and continues to grow at an astonishing rate. In the early part of last year it slowed, but it more than made up for it in the second half of 2009. According to Residex, houses grew by 14.3% (second highest to Darwin) and units by 12.3% (highest growth of any city) and Melbourne is now the second highest priced median housing market in the country behind Sydney. Perth had previously overtaken Melbourne a few years ago but now Melbourne has relegated Perth to fourth just behind Darwin. The substantial growth for both houses and apartments has been driven by the availability of affordable houses and units near the city and a huge increase in the number of overseas migrants moving to Melbourne. Westpac reports that in 2009 Victoria's population grew by 114,000 people – with 70% of these people being overseas migrants and the majority settling in Melbourne. Population growth also remains high because there are less people leaving the state than previously.

Melbourne's vacancy rate remains at about 1.3% and so demonstrates an undersupplied rental market similar to Sydney. BIS Shrapnel forecasts that rents will continue to rise by an average 5.6% per annum over the next three years.

Melbourne has major problems meeting demand for new housing and is not building enough apartments and houses currently and this is unlikely to change in the near future - which should drive further growth in 2010.

PERTH

Perth experienced a real return of confidence in the local residential market in 2009 with 30% more houses and 41.9% more units being sold during the year. Capital growth was minimal (0.8% for houses and 4% for units) but it appeared that the residential market steadied in 2009 and is perhaps poised for upward growth from the second half of 2010. This is even more likely given the new mining boom which seems to have started. Perth is always likely to be one of the most immediate beneficiaries of any surge in resource demand and this naturally feeds into employment growth, increased migration and demand for housing. Perth's population growth rate is still phenomenal at 3% in spite of many interstate departures and so once the newly created mining jobs materialise there should be a spike in interstate migration back to WA.

As mentioned earlier, Perth's median house price has once again been overtaken by Melbourne. One of the positives of the Perth market is that other cities have grown substantially (Sydney only recently). Because of this, the relative 'value' of the Perth market is emerging after a 4 year period of stabilisation and correction. According to ANZ, dwelling approvals last year fell to 19,000 and were well short of the estimated 30,000 required to meet demand so this should underpin prices and rental yields.

Perth's rental yields of 4.7% for units and 3.9% for houses have remained steady last year without changing up or down however it is fair to say that rents would rise in response to increased demand which seems to be on the way. One reason for the lack of rental growth is the movement of many first home buyers into home ownership last year. However, with rates going up, rental competition should increase and pressure on rents resume. There should be a clearer picture of the Perth market in the second half of 2010.

SYDNEY

The Sydney market seems to finally have gathered some momentum with double digit growth for both houses (13%) and units (10.4%) in 2009. Sydney was the third highest performer for capital growth of the capital cities behind Darwin and Melbourne. ANZ reports that rental yields fell slightly last year but that was partly due to the strong growth. Units attract a median rental yield of 5.02% whilst houses are 3.8%. The recently released Residex Report for NSW shows that the median house price in Sydney is now \$632,000 and median unit price is \$436,500. However median prices do not reflect the most desirable inner city areas or esteemed locations with new homes selling in the millions and 1 bedroom apartments usually now over \$500,000. Houses have quickly becoming an undesirable proposition for investors due to the high entry price and low rental yields however the unit market is a completely different story. Many commentators are tipping the Sydney unit market to be one of the star performers of 2010 including John McGrath who is on record as predicting 8 - 10% growth this year. Vacancy rates are low across most suburbs and are most commonly around 1.3% which is well under the 3% level that signifies a rental market in balance. Rents are tipped to increase again this year quite strongly. Sydney has the largest supply issue of all the major cities and BIS Shrapnel believes this will get worse in 2010 due to the low pipeline of new apartment projects.

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Craig James, Chief Equities Economist, Commsec

Reserve Bank of Australia (RBA) Cash Rate Target & Interest Rate Decision March 2010

RP Data

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