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For further information:

Angie Zigomanis
BIS Shrapnel
Tel: 03 8679 7300
A/h: 0402-323-843
Email: azigomanis@bis.com.au

Robert Mellor
BIS Shrapnel
Tel: 02 8458 4200
A/h: 0418 235 277
Email: rmellor@bis.com.au

Cameron Wells
Watterson Marketing Communications
Tel: 02 9929-7533
A/h: 0414-867-057
Email: cameron.wells@watterson.com.au

Current multi-tiered residential property market to continue

Low interest rates driving the improvement in residential markets but the outlook to be uneven.

Monday, July 1 – While the green shoots of recovery appear to be emerging in a number of Australia's residential markets, leading property industry analyst and economic forecaster, BIS Shrapnel, anticipates that the improvement will be uneven across the country. While the upturn is likely to strengthen in some markets over the next three years, some recently recovering markets are forecast to tail off, while others will remain flat for the entire period.

According to the company's flagship *Residential Property Prospects, 2013 to 2016* report, the improvement in the residential market in New South Wales should continue over the next three years, being joined by Queensland from 2013/14.

The emerging strength in Western Australia and the Northern Territory is likely to continue in the short term, but residential activity is expected to slow with state economic prospects weakening as the resource boom winds down. Conditions in the remaining states and territories are forecast to continue to be dampened by underperforming economies and an excess supply.

BIS Shrapnel senior manager and study author, Mr Angie Zigomanis, says the general improvement in residential markets since the latter half of 2012 has been initiated by the low interest rate environment. Since October 2011, the official cash rate has fallen by 200 basis points, translating to a 160 basis point fall in variable rates.

"The current standard variable rate of 6.2 per cent is the lowest level since 200 – outside of the GFC-induced low interest rates in 2009," says Zigomanis. "Also, outside of 2009, home loan affordability in all capital cities is at its best level since the first half of the 2000s.

"As a result, we are seeing some improvement in some residential market indicators. Lending to both owner-occupiers and investors has been trending upwards in the nine months to March 2013. Lending to first home buyers has also been trending upwards outside of declines in New South Wales and Queensland, where changes to first home buyer incentives have created a short term dip in demand."

However, further improvement is likely to be slow to gain momentum. From an economic perspective, the transition from an economy driven by resource investment to one driven by consumption and business and residential investment will not be seamless. Resource sector investment is estimated to have peaked (or will soon peak), while the rest of the economy remains subdued. The low interest rates are expected to eventually drive a stronger pick up in retail spending, new dwelling construction and business investment – and consequently the economy – which will take time to filter through to greater purchaser confidence.

As a result, BIS Shrapnel still expects only a modest improvement in residential market conditions in 2013/14, assisted by the potential for further cuts to interest rates. The residential market should become more buoyant over 2014/15 as the non-resource sectors of the economy improve and take over as the main drivers of economic growth.

Over 2013/14 and 2014/15, the strongest conditions are forecast for New South Wales, Western Australia, Queensland and the Northern Territory. While BIS Shrapnel estimates a sizeable deficiency of 83,000 dwellings nationally, or around half a year's demand, at June 2013, all of the deficiency is confined to these states.

"The deficiency in their state capitals has driven up rents which, together with recent weak price growth, have resulted in improved yields," says Zigomanis. "In this environment, the lower interest rates are providing the impetus for greater purchaser demand, as is becoming evident in Sydney, Perth and Darwin house prices, while we expect Brisbane will eventually follow."

In contrast, conditions in Victoria, South Australia, Tasmania and the Australian Capital Territory are forecast to continue to be tough. These states have all experienced strong peaks in construction in recent years that well exceeded demand for new dwellings. The result has been an erosion of their dwelling deficiency and/or an emerging excess of dwelling stock.

"Economically, these states are also underperforming due to a fall off in construction and a negative impact to industry from the high Australian dollar," says Zigomanis. "While some pockets may do well in the current low interest rate environment, without any supply pressures, median house prices overall in Melbourne, Adelaide, Hobart and Canberra are forecast to show little change and decline in real terms over the next three years."

BIS Shrapnel says the outlook will become more uneven across the country from 2014/15:

- A sizeable deficiency and improved affordability due to lower interest rates appear to be finally having an impact on Sydney residential prices, with the rate of price growth expected to strengthen. The Brisbane market is also experiencing a rising deficiency, although only limited growth is expected in 2013/14, before accelerating from 2014/15 as state economic conditions and confidence improve, and the upturn gains momentum.

- The Perth and Darwin markets have already commenced their recovery. While there should be enough momentum to continue solid purchaser activity into 2013/14, the rate of price growth is forecast to begin to slow from 2014/15 as the pipeline of current investment in resource projects is increasingly worked through, with unemployment beginning to rise and migration and population growth slowing.

- Low interest rates should keep prices relatively stable in Melbourne, Adelaide, Hobart and Canberra. However, these regions are expected to continue to experience challenging economic conditions, and with solid levels of construction in recent years, these markets are estimated to be close to balance or in oversupply. Without any supply pressures, barely any movement is expected in prices over the next three years, with median house prices forecast to fall in real terms. Canberra may also experience additional downside depending on the direction of public sector employment after the upcoming federal election.

By the end of the next three-year period, all markets are forecast to be impacted to varying extents by rising interest rates. The change in gears from resource investment to domestic demand driving the economy will be slow, although it will eventually come through and begin to have a positive effect on the economy and employment later in 2014, with the Reserve Bank expected to move to push interest rates from their current extremely stimulatory level towards a neutral level over 2015 and 2016. While early rises may have little initial effect, the cumulative rise over the two years will eventually impact on residential demand.

Through 2015/16, the rising interest rates will begin to slow the strengthening markets in Sydney and Brisbane, contribute further to the weakening of the Perth and Darwin markets, and postpone any recovery in the Melbourne, Adelaide, Hobart and Canberra markets.

Outlook for price growth by region

Sydney

Sydney's estimated median house price of $670,000 in June 2013 represents a four per cent increase over 2012/13. The Sydney residential market now appears to be gaining some momentum after being weak for the best part of the last decade.

The strength in the Sydney market has been the result of a sustained period of underbuilding that has resulted in low vacancy rates and strong rental growth since 2007. Demand has been encouraged by improved home loan affordability, with BIS Shrapnel's measure of affordability indicating that – apart from when variable interest rates were at record lows in 2009 – it is at its best level since 2001.

“The improved yields and reduced gap between rental income and mortgage repayments is attracting investors back into the Sydney market in larger numbers,” says Zigomanis. “This is being reflected in the pick up in price growth, as well as off-the-plan sales for new apartments and new apartment construction”

“On the negative side, first home buyer numbers have fallen in 2013, although this is largely the result of successive changes to first home buyer incentives by the state government that has pulled demand forwards. We anticipate that first home buyers should begin to improve back to normal levels through 2014 as the impact of these changes wash through. This will add to dwelling turnover and help to drive slightly stronger growth in the coming years.

“We are forecasting total price growth in Sydney over the three years to June 2016 to be 19 per cent, or a moderate 5.9 per cent per annum.”

Newcastle and Wollongong

Residential property prices in Newcastle and Wollongong usually benefit when Sydney experiences strong price growth and migration into these regional centres increases. With affordability in Sydney relatively attractive in a long term sense, an acceleration in prices in these regions is expected to be a little behind that of Sydney, picking up over 2014/15 and 2015/16 as a combination of price rises in Sydney and an expected tightening in interest rate policy begin to reduce affordability in the capital.

As a result, total growth in the median house price in both Newcastle and Wollongong over the three years to June 2016 is forecast to be 18 per cent and 17 per cent respectively and more concentrated in the latter two years.

Melbourne

The seven per cent decline in Melbourne’s median house price over 2011/12 appears to have stabilised in 2012/13, with the city’s estimated median house price of $545,000 at June 2013 representing a four per cent rise for the year.

However, BIS Shrapnel believes that this improvement has been largely underpinned by the reductions in interest rates over 2012/13, rather than any fundamental drivers creating upwards pressure on prices. Record levels of new dwelling construction from 2009/10 and continued strong supply of apartments have meant that supply is exceeding underlying demand and should result in vacancy rates rising.

Victoria is also facing economic headwinds. Notwithstanding the recent falls in the currency, a high Australian dollar has impacted on manufacturing sector employment, and with major construction projects winding down, growth drivers for the state economy are subdued. The price growth in 2012/13 was concentrated in inner and middle ring suburbs where the population has been less exposed to the weaker sectors of the economy.

“Further growth in Melbourne’s median house price is likely to be muted given the lack of pent up demand and weakness in the state economy,” says Zigomanis. “Nevertheless, with interest rates at their current low levels, and with the prospect for further easing in rates in 2013, there should be enough to edge prices up despite these negative factors.

“Consequently, median house price growth in Melbourne is forecast to be minimal, totalling five per cent over the 2013 to 2016 forecast period. After accounting for inflation, prices are actually forecast to fall by four per cent in real terms.”

Brisbane

Brisbane’s estimated median house price of $440,000 in June 2013 represents a two per cent increase for the year – its first annual increase since 2009/10. Brisbane has suffered from a run up in house prices and construction through the first resources boom, followed by weak migration and population growth since 2009 that has impacted negatively on underlying demand and prevented any excess supply being absorbed. Weak state economic conditions have also impacted on sentiment.

However, conditions in Brisbane are slowly turning around. With new dwelling construction in Queensland collapsing to below GFC levels, Zigomanis estimates the Queensland residential market now has an emerging deficiency, as indicated by rent vacancies tightening from 3.9 per cent in 2010 to 2.1 per cent in March 2013. As a result, rents have started to rise. After being flat in 2011/12, the median three bedroom house rent in Brisbane increased by four per cent in the nine months to March 2013.

Affordability has also improved. Brisbane's estimated median house price at June 2013 remains four per cent below its June 2010 peak, and 11 per cent below in real terms. Together with lower interest rates, affordability is at its best level since 2003.

"While the pieces are now falling into place for the beginning of an upturn in the Brisbane market, confidence remains weak," says Zigomanis. "However, similar to the Perth market, once it appears that the market has definitely bottomed, turnover will begin to increase as purchasers seek enter the market ahead of any further price rises in increasing numbers.

"As a result, we should start to see a return of price growth in 2013/14, which will accelerate into 2014/15 and remain solid in 2015/16 as more first home buyers and investors start buying. A corresponding increase in new dwelling construction should also contribute to stronger economic conditions, particularly with a sizeable underlying dwelling deficiency expected to still be in place. By the end of 2015/16, rising interest rates will begin to impact on prices, but only after a forecast total rise of 17 per cent in the median house price over the three years to 2016, representing an average rise of 5.2 per cent per annum."

Gold Coast and Sunshine Coast

House prices on the Gold Coast and Sunshine Coast have generally moved in tandem with Brisbane, benefiting from the same drivers of population growth as the capital; that is, primarily net interstate migration inflows and, to a lesser extent, overseas migration.

With interstate migration into Queensland now at long term lows, the residential markets on the Gold Coast and Sunshine Coast have weakened considerably. Pockets of these markets are likely to remain in oversupply, which is still being worked through. Affordability relative to the eastern state capitals is not as attractive as it was in the first half of last decade. Given both these centres do not have the same employment drivers as Brisbane to attract overseas migrants, the current affordability disadvantage will result in price growth being slightly lower than for Brisbane over the three years to June 2016, totalling a forecast 15 per cent (4.8 per cent per annum) in both regions.

Townsville and Cairns

The median house price in Townsville has held up better than in Cairns since the worst period of the GFC in 2009. While both local economies were impacted by falling resources investment, sharp declines in residential construction and a weak tourism sector, the more diversified economy in Townsville has served to better support prices and construction.

After a prolonged period of underbuilding, dwelling deficiencies appear to be emerging in both of these regions. Local economic conditions are likely to benefit from increased construction, as well as from increased tourism resulting from a lower Australian dollar. This should somewhat offset declining investment in the resource sector over the next three years. Population growth has also been relatively solid considering the weakness in Queensland's net interstate migration in recent years. These factors should drive some pick up in price growth in 2013/14, with a stronger rise in 2014/15 on the back on increased confidence. Townsville should expect a greater upside to prices due to its more diversified economy, although both markets should experience moderate price growth.

Cumulative price growth over the three years to 2016 is expected to be 16 per cent for Townsville and 13 per cent for Cairns.

Adelaide

Adelaide's estimated median house price of $398,000 at June 2013 represents a minimal one per cent increase for 2012/13 after a three per cent decline in 2011/12.

"Construction in South Australia in the post-GFC years exceeded underlying demand, and the excess dwelling supply has been reflected in vacancy rates above the balanced market rate of three per cent since 2011, which in turn has impacted on rents and prices in Adelaide," says Zigomanis. "State economic conditions have also been weakened by a high Australian dollar and declining building activity, with a negative impact on confidence."

"Nevertheless, with Adelaide being the most affordable of the mainland state capitals, the reductions in interest rates have supported prices in 2012/13 and should keep price growth slightly positive over the next three years. We expect South Australia's dwelling oversupply to be absorbed by the end of this period, although the prospect of the next tightening cycle in interest rates by this time could delay the upturn in prices."

As a result, the residential market in Adelaide should remain challenging, with the median house price forecast to show only limited growth totalling six per cent over the three years to 2016, which represents a three per cent decline in real terms.

Perth

After being in the doldrums since peaking in early 2007, the Perth market is finally showing signs of a recovery in 2012/13, with the city's estimated median house price of $520,000 at June 2013 representing a rise of seven per cent in the year.

The improvement has coincided with a pick up in first home buyer demand, which in the year to March 2013 is up by 30 per cent on the previous 12-month period. The stronger demand at the more affordable end of the market is now beginning to flow through to higher price points as existing home occupiers trade up.

"Demand has been assisted by strong income growth in Western Australia through the downturn in prices, which together with reductions in interest rates have resulted in a significant improvement to affordability," says Zigomanis. "Pent up demand has also been rising due to strong population growth which has not yet been met by new dwelling supply, causing tight vacancy rates and strong rental growth, which in turn has encouraged both first home buyers and investors into the market."

"The emerging momentum in price growth is expected to last another 12 to 18 months before growth in the Western Australian economy begins to slow more sharply as projects in the resource sector increasingly are concluded. Price growth is forecast to begin to tail away through 2015 and into 2016 as migration and population growth slows and sentiment in the residential sector turns in line with economic conditions."

BIS Shrapnel is forecasting Perth house prices to rise by a total 15 per cent over the three years to June 2016, although this will be primarily concentrated in 2013/14 and 2014/15.

Hobart

The Hobart residential market has been hit by a period of overbuilding that has coincided with demand for new dwellings weakening as net interstate migration reverted from a net inflow of 300 persons in 2009/10 to a net outflow of 2,600 persons over 2011/12. As a result, the city's median house price has fallen by six per cent from a peak of $382,500 at December 2010, to an estimated $360,000 at June 2013.

Net interstate migration into Tasmania has largely come from "tree change" migrants from the mainland who are close to retirement and have sold their homes to downshift to Tasmania. However, weak residential conditions in the mainland capital cities over the last couple of years and the deteriorating Tasmanian economy have reduced the impetus for this tree change, while there has still been a steady level of departures of the younger population to the mainland centres.

"The consequent weakened population growth means that the current excess supply will continue to persist over the next three years," says Zigomanis. "Low interest rates will be the only positive for house prices in this period, with growth in Hobart's median house price forecast to be limited to a total of four per cent, and reflecting a decline of five per cent in real terms."

Canberra

Canberra's median house price is estimated to have fallen by one per cent to $490,000 in the year to June 2012. This is a seven per cent reduction from its March 2011 peak.

Canberra has experienced one of the strongest new dwelling markets since 2009/10 as strong investment demand has fed through to record levels of new dwelling activity. It is estimated the Australian Capital Territory's dwelling deficiency has shifted to an excess of stock, which should increase as the larger apartment projects that are under construction work their way through to completion.

"On the demand side, it appears that purchasers are also holding fire, being concerned about employment prospects in the Capital after the upcoming federal election," says Zigomanis. "The prospect for weaker employment growth, or even declines, together with the emergence of an underlying excess of dwelling stock will create downward pressure on prices.

“Nevertheless, Canberra has the highest incomes of the capital cities and affordability is not as strained. This should prevent any major price declines, with the median house price forecast to be more or less flat over the three years to June 2016 (a total rise of three per cent), which reflects a decline of five per cent in real terms.”

Darwin

Price growth in Darwin surged over 2011/12, with the median house price rising by 11 per cent, underpinned by a substantial increase in resource sector investment led by the Icthys LNG project. While the project is still well underway, price growth has slowed in 2012/13, with BIS Shrapnel’s median house price estimate of $595,000 at June 2013 representing a four per cent rise for the year.

“Strains to affordability appear to be showing up in slowing purchaser activity in the Northern Territory, with loans for owner occupation of established dwellings up by only three per cent in the March quarter of 2013 on the corresponding period the previous year,” says Zigomanis. “Growth in lending for residential investment remains solid, although is slowing, while first home buyer demand recorded its first year-on-year decline in February 2013.

“As a result, we anticipate a only a moderate rise of 10 per cent in median house prices in the three years to June 2016 – only just above the rate of inflation in this period.”

About BIS Shrapnel

BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel helps clients better understand the markets in which they operate, through reliable and detailed market data, analysis of developments and drivers and thoroughly researched forecasts.

BIS Shrapnel compiles accurate, clearly explained and detailed information on industry sectors, markets and industries in which their clients operate. BIS Shrapnel provides market size and segmentation data, market shares, consumer attitudes and supplier reputation information, and regularly conducts both business-to-business and consumer research.

Over the company’s 49-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting.

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