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John McGrath's Market Review – Autumn 2011

As 2011 gets well and truly underway we find ourselves in the midst of one of the most important selling periods for some time. Everyone is asking whether the market will gain traction and build upon some early positive signs. I believe the 'green shoots' that we saw appearing in 2010 will continue to build momentum and I continue to predict that we will see solid growth in almost all major residential markets across Australia. With a continuing shortage of property around the country, rising rents and a rebounding economy the drivers are in place for a strong year in property.

For this review, we have analysed the new drivers impacting the property market, and see many more positives than negatives. Key factors are an improving economic climate, population growth and a severe housing shortage as summarised in the table below.

Key Drivers of the Property Market 2011

POSITIVE	NEGATIVE
Market confidence. Increased buyer activity. Mortgage lodgements up 9.1% (Dec 2010 vs Dec 2009)	**Rising interest rates.** Standard Variable home loan rates up from 5 to 7% in 12 months. If rates rise to 8% this would have a detrimental affect to our view on price growth.
Economic confidence. Australia among the world's best growth economies.	**Mortgagee overhang.** Continued mortgage stress and mortgagee sales in some markets will delay price growth.
Population growth. 1.8% p.a. Among the highest of any OECD nation.	
Ongoing property shortage. Construction at 30-year lows. The National Housing Supply Council estimates Australia is undersupplied by 200,000+ dwellings.	
Increasing rents. A continuing rental boom in most capital cities.	
More investors. Higher yields.	
Self Managed Super Funds. New Source of Investor Funding unlocked.	
Offshore buyers. Increasing buyer activity from China, Singapore, HK and Malaysia investing in Australia.	

The Positive Drivers

- **Market confidence**: While clearance rates have had a slow start this year, one indicator that has bucked the trend is mortgage applications – one of the best forward indicators of the market. AFG Mortgage Index* data for Dec 2010 shows national home loan lodgements were 9.1% above those of Dec 2009. All states were up, led by VIC (18.1%), NSW (14%), WA (6.1%), SA (4.9%) and QLD (1.4%).

* Australia's largest mortgage broker

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- **Economic confidence:** We are among the world's strongest economies due to huge offshore demand for our commodities. The power behind our economic growth has shifted from west to east as big economies like the US, UK and Europe faltered during the GFC*. With our new international reputation for economic resilience, we are seeing many more offshore buyers migrating here from China, HK, Singapore and Malaysia.

  ***** (Source: Macquarie Bank Market Focus 2010).

- **Population growth:** At 1.8% per annum, our population growth is among the highest of any OECD nation. Such high population growth coupled with low building approvals will continue to apply pressure on housing. There is no quick fix for the undersupply even with changing government policies on land releases.

- **Ongoing property shortage:** New housing construction is at 30-year lows and many more people are living alone. The National Housing Supply Council (NHSC) estimates Australia is undersupplied by around 200,000 dwellings, with projections this could rise to more than 600,000 by 2029 based on current trends.

- **Increasing rents**: Population growth and the undersupply have led to low vacancy rates and high rents with average yields of 4.5-5% in prime metro locations.

  A new rental boom is on the horizon for Sydney as rents could soar by up to 9%. Fuelling this is Gen Y's desire for CBD and lifestyle living. They are renting longer to save a better deposit. Of all the capital cities, Melbourne tenants are in the best position with December vacancy rates at 3.6%. All other cities were under 2%. In Brisbane, there has been a surge in rental demand due to the floods but this is a temporary spike.

- **More investors:** AFG reports investors taking up 35% of all new loans nationally and 41% in NSW.

- **Self Managed Super Funds:** We are now seeing the strong emergence of DIY Super investing in property. I believe this will have a huge impact on the investor property market and the supply and demand issue. Last year the law was modified to allow negative gearing for self-managed super funds (SMSF) and this created new demand. Buying property using a SMSF loan can increase investors' net return on a newly built property by more than 50% compared to buying the same property personally. This is due to super tax rates (15%) being much lower than personal tax rates.

- **Offshore buyers** are increasingly migrating to Australia for security, education and our strong economy and currency. Sydney is presently the 4th most popular city in the world for international property investment. According to the FIRB, during the worst of the GFC (2008/09), foreign investors purchased 3639 residential properties.

The Negative Drivers

- **Rising interest rates.** Standard variable home loan rates are up from 5% to 7% over the past 12 months. A new Mortgage Choice survey reveals one in 10 recent first home buyers have sold or are considering selling due to financial stress.

- **Mortgagee overhang.** Continued mortgage stress and mortgagee sales in some markets will delay price growth.

Other market observations

- **First home buyers.** There's been a small but noticeable increase in first home purchases since mid-2010. And recent stats tell the story. According to ABS, the percentage of first home buyers was 15.6% in November 2010. 42% of recent first home buyers say high rents made buying more attractive (Mortgage Choice Survey).

  Activity among first home buyers and investors will keep the apartment market strong with gains of around 5% in most capitals in the first half of 2010. There is a continuing cycle of buyers entering the market with many incentives still available. In NSW, the purchase price for grant eligibility has been lifted from $750,000 to $835,000; there is no stamp duty on first homes under $500,000 and concessions for homes between $500,000 and $600,000.

- **The prestige market** remains patchy but some good sales have been achieved in Sydney's Eastern Suburbs recently as vendors become more realistic on price. At McGrath, we've had 20 sales above $3M since January and there are 58 homes above $3M currently listed with us. This is indicates a little more confidence among prestige vendors.

- **Canberra** remains one of Australia's strongest capital city markets with greater activity now occurring in the sub-$1M family houses sector. Investors from other capitals are increasingly investigating Canberra, where a typical $300,000 1 bedroom apartment is yielding 7%.

John McGrath's Top Metro Suburb Picks

<u>Houses</u>
- Artarmon
- Birchgrove
- Curl Curl
- Glebe
- Haberfield
- Lindfield
- McMahons Point
- Northbridge
- Palm Beach
- Sylvania Waters

<u>Apartments</u>
- Balmain East
- Cremorne Point
- Cronulla
- Curl Curl
- Kensington
- Newtown
- North Parramatta
- Potts Point
- Pyrmont
- Sans Souci

Regional Markets - Regional recovery

As predicted, the spillover effect from strong metropolitan activity has gained traction in some blue ribbon regional areas. Buyers are more motivated as the window for bargain buying is closing. We're seeing many city-based investors exploring regional centres for affordable opportunities and executives are also buying their dream retirement homes earlier.

Regionals in full recovery mode include Wollongong LGA (+11.5% in 2010 says RP Data), Blue Mountains LGA (+10.5%), Warners Bay LGA (+8.6%) and Port Macquarie LGA (+7%) with more gains likely this year. Other areas like Byron Bay and Bowral are only just showing signs of new activity.

Southern Gold Coast. There's been a noteable increase in buyer numbers at opens including investors and owner-occupiers from Sydney, Melbourne and Brisbane this year. Property values are off by up to 60% (prestige end) and yields are strong at 4.5-5.5%. No major rebound is anticipated with 3-5% growth per annum the most we can expect over the next 5 years. The beachfront 'Golden Miles' of Mermaid Beach, Hedges Ave and Albatross Ave, previously commanded $8.5 - $10.5M for vacant land. Houses are now selling for $5M-$6M. The sub-$750,000 bracket is 25% off and we're expecting more mortgagee sales this year.

John McGrath's Top 10 Regional Picks - Best Buying Opportunities

- Bowral
- Bulli
- Byron Bay
- Charlestown
- East Port Macquarie
- Isle of Capri (Qld)
- Kingston (ACT)
- Tugun (Qld)
- Wamberal
- Wollongong

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Key points and predictions

- Modest city price growth in 2011 with best results in beachside suburbs and within 10kms of the CBD
- Higher than average price growth in regional areas with the GFC recovery in full swing in many towns
- Market stability with more positive than negative drivers in play in 2011
- A new rental boom is on the horizon for Sydney with rents to soar by 9% in our view
- More investors in the marketplace, particularly those buying with DIY super funds
- The apartment market to benefit from higher activity among first home buyers and investors

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