PROPERTY

STILL A SAFE BET?

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BY PAUL MIRON

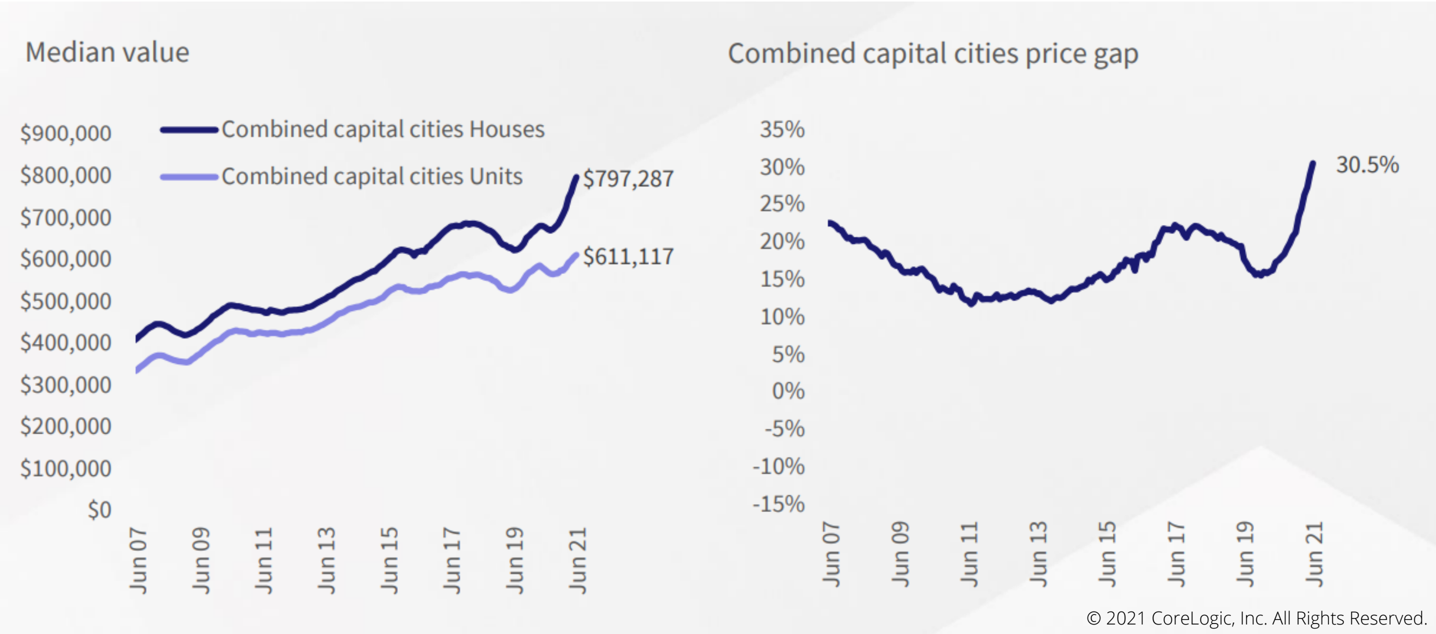
The latest official property data figures have been released, indicating Australian houses prices in some capital cities have risen as much as 29% - the sharpest increase in the residential property market since 1988. What makes this even more astounding is that this occurred during a once in 100-year pandemic and negative net migration growth, the first time since WW2.

While most of us are scratching our heads in disbelief, bank economists are upping their forecasts. Their consensus is that the property market still has another 10% to 17% in appreciation to go in the coming 12 months. Essentially bank economists have generally got it wrong during COVID-19, with their first estimating that property prices would drop by over 30% in 12 months. The truth is, prices increased by over 15%.

As stated in many of my previous articles, the health of the property sector in Australia is fundamental in enabling economic recovery and stability.

The real questions to ask are:

- What are the critical drivers of property prices?
- Are there any structural changes anticipated in the property market?
- Are there any other factors that play a role in contributing to property prices?



As much as a 14% increase in property price can be directly attributed to a 1% decrease in interest rates according to RBA's modelling.

Low interest rates undoubtedly are the single most significant factor that drives property prices.

Beyond interest rates, some other factors to consider are:

- Building approvals and efficiency of the planning process (supply of property);
- Net migration (increases demand);
- Employment;
- Vacancy rates.

Perhaps the most eloquent modelling recently undertaken is by the RBA's Peter Tulip, which quantifies a premium attributed to property prices due to lack of supply and planning constraints.

	Sydney	Melbourne
Additional cost to houses	$489,000	$324,000
% To the total value	73%	69%
Additional cost to units	$355,000	$97,000
% To the total value	68%	20%

Tulip's paper attributes house prices in Sydney to be 73% higher and in Melbourne 69% higher, precisely due to the lack of additional land supply and unit approvals. From an Urban Planning perspective, there is a constraint of available land. New land releases are not cost-effective for the government due to the increased cost of providing infrastructure to support new Green-fill suburbs. Continuing with the urban sprawl as a solution may have outlived its lifespan.

It is no surprise that Treasurer Frydenberg is establishing a parliamentary committee to inquire into housing supply. The unavoidable conclusion will most likely align with RBA's research, more building approvals are needed, and a more efficient and robust planning process is required. Importantly new land releases are the best antidote in keeping prices low. If adopted, it would avoid the need for macroprudential intervention to make borrowing money harder by dampening demand or increasing interest rates in an attempt to reduce property prices. These actions are ultimately counter-productive in making a property more affordable.

As property prices keep increasing and diminishing affordability for first home buyers, this issue will become a powerful political platform for debate in the next election. It is important to note that the custody of the planning process is with both state governments and local councils. And although the federal government is responsible for financing major infrastructure, voters' perception is that planning is a Federal Issue and responsibility.

COVID-19 lockouts have resulted in net migration being negative, which has dramatically reduced the demand for units. CoreLogic data below shows the premium houses over units have never been higher.

It is easy for property commentators to conclude that units are less desirable; people have lost confidence in living in units during the pandemic. Recently publicised cases such Opal towers and others have created reduced interest for units.

As Australia's property market grows in size and immigration recommence, the Sydney, Melbourne, and Brisbane units' market will have commonalities with other cities such as New York, Paris, and London. Units in these cities are not considered a secondary option to houses but a complimentary option due to the ability to live in desirable locations, close to amenities, schools, transports, entertainment, work, and avoiding the need for motor vehicles.

Units in Australia have been specifically catered for either:

- a transient purchaser who wishes to live in an apartment temporarily until they can afford to buy a house;
- Overseas students;
- Cheaper investment property option.

As a result historically, units are generally smaller in size with lower quality building finishes.

On the flip side, we believe there is a strong demand for larger, high-quality apartments. This high-end unit market is expected to grow further as the baby boomers look towards their future accommodation needs, and conventional houses will not fulfil their needs.

The state government is acutely aware of these issues and appreciates that building the correct type of units to meet market demand will keep affordability down and cater to the broader market. In anticipation, the state government has just implemented a raft of changes to ensure that build quality will continue to improve with further enhancements to the minimum standards to increase apartment sizes, natural sunlight, and general amenity for new unit developments.

The NSW building commissioner David Chandler publicly names and shames builders by policing defects, thus ensuring that developers pick up their game which in turn will protect purchasers. This will restore confidence for purchasers wishing to buy apartments, especially those who want to buy off the plan.

Despite units performing relatively poorly compared to detached houses, we believe that there will be an increase in demand for units. The challenge will be for quality supply as the demand increases. The consumer will be increasingly selective on the offering, expecting a superior or equal liveability offered in an apartment to that of a house.

In summary, as in the past, property will continue to be resilient, forming the backbone in making the commercial mortgage sector the sector that provides asset preservation that investors want along with regular income distributions.

We see a lot of opportunity within the market in the coming years for our investors.

If you would like to find out more, please feel free to contact us at Msquared to find out more.

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