Charter Insight

Global Capital & Australian Residential Real Estate

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RESEARCH

International investment into Australian housing markets has become an increasingly significant and controversial issue. The growing participation and influence of international investors is changing the positioning of Australian residential real estate within the global context.

This Charter Insight seeks to briefly explore the complex and evolving narrative of international investment into Australian residential real estate.

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GLOBALISATION AND REAL ESTATE

Australia's residential real estate markets are increasingly subject to the related factors of globalisation and asset commoditisation. The strength of demand for Australian housing is being facilitated by the increased opportunity for global investors to acquire international housing as investments (or future places of family residences).

Global capital is impacting Australia's real estate markets because whilst real estate is geographically anchored, capital from institutions, corporates, and more recently households, has become increasingly mobile and willing to cross borders to maximise returns, minimise risks and seek portfolio diversification.

GFC AND THE FUNDAMENTAL CHANGE IN CROSS-BORDER CAPITAL FLOWS

Australia's comparative isolation and market size have historically sheltered Australian housing markets from international interest. In the pre-GFC era international housing investment was dominated by European, American and Middle Eastern sources. However, the weight of capital and favourable conditions that emerged post-GFC across Asia is altering the traditional position and functioning of Australian housing markets, especially off-the-plan apartment projects, to the new sources of global investment.

RELATIVE PURCHASING POWER - SAME ASSETS, DIFFERENT NARRATIVES

Foreign exchange and the relative purchasing power of international investors have become significant in Australian housing markets.

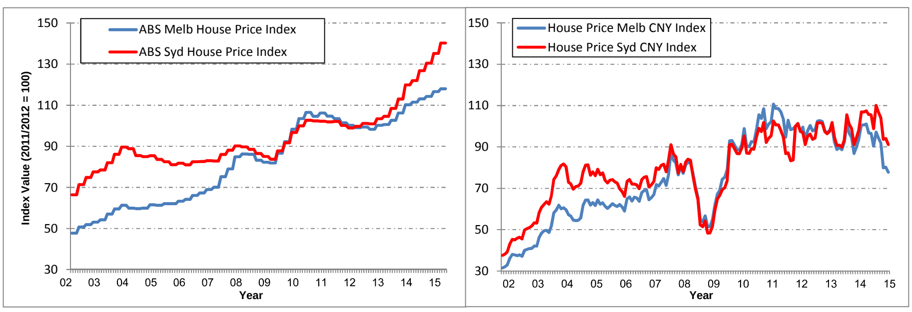
Changes in currency values have a greater impact in residential markets where individual purchasers are more likely to be exposed to foreign exchange risk given they are less likely to adopt hedging strategies of institutional investors in commercial real estate markets.

Capital mobility and the relative difference in international currencies imply that the prices of Australian assets to an international purchaser can be very different to the prices faced by domestic purchasers. In the case of China, the structural changes in capital mobility and desire for international investment by a growing middle class have had a significant impact upon the Australian real estate market narrative. As a result of changing currency values Australian assets are now much cheaper, which has intensified the level of capital investment into Australia.

To local purchasers, house prices across Melbourne and Sydney have trended upwards since the early 2000s with some intermittent moderations. This price increase has accelerated (especially in Sydney) since 2012 and highlighted housing affordability issues once again (although asset price rises are only one element of this debate).

Alternatively, however, from an international purchaser's perspective (in this case China) when the relative purchasing power from currency values are taken into consideration Chinese purchasers have experienced a very different price story. From the Chinese perspective, house prices in Melbourne have recorded a general decline in price from 2010/2011 (in Chinese Yuan terms) and Sydney prices have been stable, despite the acceleration in prices to domestic purchasers. The same narrative applies to both Singaporean and Malaysian purchasers.

Australian House Price Index & Australian House Price (Chinese Yuan) Index, Sydney and Melbourne (2015).



SOURCE: ABS, RBA, Charter Keck Cramer.

PUSH-PULL FACTORS AND CURRENCY

It is interesting to note that through the early 2010s, Chinese investment in Australian housing was still significant, despite the fact that Australian prices were relatively more expensive to Chinese purchasers at the time than they were to local purchasers. This situation suggests the existence of significant push factors that were affecting Chinese decision-making beyond the pure financial parameters.

This phenomenon highlights the differing means by which international and domestic purchasers value and price residential real estate as an investment. Australian housing represents a store of wealth that is underpinned by confidence in domestic institutions (property rights, freehold title and transparent markets, among others) which foreign purchasers may pay a relative premium for, but which domestic participants expect and therefore do not attribute any additional value towards.

The impacts of relativity in asset value and pricing demonstrates the overarching importance of global macro-conditions in incentivising international purchasers and capital flows beyond local targeted interventions (taxes/levies on international purchasers), unless these interventions are equally significant.

Whilst Chinese purchaser participation has been evident in Australia for a number of years it will be interesting to watch how the compounding factors of a comparative discount, coupled with volatile and still opaque Chinese equity and capital markets, will impact the Australian domestic property market in the short term. These factors will only be intensified by the continued liberalisation and greater (albeit still controlled) openness of Chinese capital markets.

The new reality for the Australian property market is that it is feeling the first round impacts from profound cyclical and structural changes in a new source of purchaser demand. This is causing distortions in market activity and performance that has been especially concentrated in the higher priced submarkets of Sydney and Melbourne.

THE EVOLVING DYNAMIC OF LOCAL REAL ESTATE MARKETS

The internationalisation and commoditisation of residential real estate is causing a decoupling of the relationship between the Australian purchaser (as investors) and rental markets. Current prices are no longer dictated by rational yields.

Given global participation, off-the-plan Australian real estate assets now have a greater pool of potential and willing purchasers to draw from. In addition, the motives of some international purchasers appear to be divorced from the asset's inherent capacity to earn a comparable yield to that anticipated by a local purchaser.

This changing context is contrasted against the rental market where the pool of potential occupiers is still limited by a smaller localised 'renter' population. Although the influx of international purchasers may, conversely, be growing the pool of renters from those locals unable to enter the market as purchasers, this growth is still lower than the increase in global purchasers.

There is a risk however, that higher levels of new supply may be produced by the development industry in response to absorption by the greater pool of international purchasers. However, local investors will still have to navigate the softer rental conditions without the capacity of international participants to balance and clear the occupier market.

In short, it is easier to match assets to a global pool of purchasers (where capital is able and willing to be deployed) than match those same assets with occupiers in the local rental market.

THE UNITED STATES IMPACT

While the narrative regarding the weight of Chinese and broader Asian capital into Australia is well documented, a less explored component remains the potential impact of a recovering United States (US) economy and how normalisation of its monetary policy may indirectly place pressure on Australian real estate prices.

This impact will not necessarily derive from increasing US outbound capital but rather enhancing the purchasing power of Asian capital into Australia, especially to the extent Asian currencies (including Chinese Yuan) are linked to the United State Dollar (USD).

As US cash rates normalise, it can be expected that the AUD will fall (as capital finds a relatively increased return in a safer global reserve currency). While this may increase the international competitiveness and rebalancing of the Australian economy away from resources, it could also translate into a further effective decrease in the relative price of real estate for international purchasers.

The US Federal Reserve has signalled this normalisation is likely to commence in the later stages of 2015, with these impacts to be priced further into the currency when there is more clarity around the timing of the move.

NEW REAL ESTATE REALITY

Australia has entered a new period in the internationalisation of its real estate markets. Capital markets are more open and willing to invest, and due to global macro-market forces, real estate asset prices are relatively cheaper to international purchasers than they are to local purchasers.

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