Charter Insight

Residential Market Commentary

October 2016
charterkc.com.au

"There is a 'self-governing' process for apartment projects to be underwritten by a high level of pre-commitment."

Scott Keck
Executive Chairman
scott.keck@charterkc.com.au
T +61 (0) 3 8102 8861

The market for inner urban, established residential properties remains strong reflecting the fundamentals of a lengthening low interest rate environment, increasing demand evolving from the maturing Gen Y demographic and continued overseas interest from intending immigrants and others with appropriate credentials. Over the last few years value growth of course has been strong but current levels to a degree reflect considerable equity rather than just mortgage debt, for which reason I do not believe that the market is in a "bubble", or therefore that there is to be an unexpected, sharp, downward correction. In any event, if there were a market aberration to lower values it would find support with the next rung of purchasers ready and near eligible to participate although not able to quite meet the current market.

Although global factors may be the catalyst for a gentle rise in interest rates in due course and unemployment might rise, neither of these events in Australia will be fast or therefore unexpected, nor significant in the medium term, thus sparking a severe downturn in purchaser sentiment, or therefore a significant correction. Rather, whilst forward value growth is expected to be less than in past years, it will correlate to generally lower inflation and an economy still strongly supporting private sector professionals and enterprise.

The development sector, particularly the medium density apartment market has been a focus of anxiety and speculation nationally as to the extent to which current / planned inventory may represent over-supply, weakening sentiment by investors and overseas purchasers in consequence of tightening finance and the impost of purchase levies on some parties, quality of construction, possible taxation reform, slowing of population growth and other factors. The media loves the debate and peppers its commentary with highlighted comments, often poorly expressed and wrong or non-contextual statistics which can distort the real outlook. Fundamentally, there is a "self-governing" process for apartment projects to be underwritten by a high level of pre-commitment, which means that virtually no developments are built without being sold and thus over-supply of newly completed apartments but unsold, is and is likely to remain negligible. Yes, there may be a few defaults on settlement particularly if finance is unavailable to certain purchasers although this is not expected to be significant. Consequently there is little in the way of unsold stock and that which is delivered to the market is destined to be absorbed. Indeed, by international standards, Australia, particularly Melbourne and to a lesser extent Sydney, have a very small percentage of housing in the form of apartments compared with other cities. This also applies to townhouses, which as a lower density solution to affordable inner urban housing are expected to play an increasingly significant role in housing over the next 20 - 30 years.

As Government and the strategic planning community respond to strong population growth and changing community standards we are now at a point in the evolution of our large metropolitan centres where a broader, all-encompassing understanding towards major influences is essential.

HOUSING

I envisage that there will be a strong increase in the demand for and inevitable acceptance of "soft" medium density accommodation for both owner occupiers and renters. This will express itself in more sophisticated interpretations of what is now described as "low rise apartments and townhouses". Probably no higher than 3 - 4 storeys but smaller in dwelling size, yet in greater numbers per development this model will likely be more viable for developers, cheaper for consumers, socially less controversial and more lifestyle attuned than inner urban densely focussed higher rise or detached housing alternatives.

TRANSPORT

A major shift in preference to small electric vehicles with registration and operation costs subsidised if operated on a share model. Combined with an increasing community indifference to private vehicle ownership in favour of more community sympathetic alternatives, much of our future inner urban housing designs will be less influenced by car security and storage onsite, releasing much of the land use and cost devoted to the automobile.

POLICY

There is likely to be a huge shift in social conscience and therefore support for future Governments that recognise the need for and deliver community infrastructure, particularly mass capacity, cost effective, reliable public transport and in areas of broader public safety, for cyclists and pedestrians and health and aged care real estate infrastructure.

LIFESTYLE CHAGES

In a challenged economy, the future ambitions of many younger Australians are at risk of not being achieved. This emerging younger demographic (millennials) has a changing attitude to education and career and is more short term in its focus, resulting in a more transient generational attitude impacting on accommodation and therefore the need for more flexible housing tenure and terms. There are also the needs of an ageing population which will present wide ranging social challenges, whether within the traditional family household or seeking cost effective housing solutions from the private enterprise sector.

OUTLOOK

So as suggested above, it is not just population growth and affordability alone which are driving change in the residential landscape, rather there are many other issues which manifest influence on housing and it should be recognised therefore that this need for innovation represents great opportunity.

With respect to current market conditions, I emphasise that the current levels of anxiety are not really warranted as there is not a crisis born of physical, uncommitted, over-supply rather to the contrary, the important issues ahead are more to do with maintaining an adequate supply of appropriately conceived, designed and located medium density accommodation

Within Melbourne for example, recent interim guidelines issued at State Government level have had an immediate impact on the yield and therefore viability of many inner urban apartment sites which were otherwise candidates for immediate investment. Combined with tightening finance to the development sector and rising costs, the progress of development is already stalling. Even without investors and overseas purchasers, local intending occupiers, whether first home buyers or those downsizing for retirement still demonstrate strong support for well-conceived, appropriate scale and well located inner urban projects; especially those which offer a mix including townhouses and larger not predominantly smaller apartments. Scale of development, quality of construction, development “brand” (both architect and builder) and location are all very much in demand.

Astute developers with capacity remain active for acquisition of eligible sites for future pipelines and notwithstanding much of the media about availability of “end product” purchaser finance, this also remains freely available. Although the main Banks and financiers are understandably more searching in their due diligence, well-conceived projects still attract support and most financiers are “open for business”.

TOWNHOUSES

It is interesting to observe that there is a continuing trend by developers in favour of townhouse developments, which, apart from being largely unaffected by the recently announced Apartment Guidelines, are relatively straightforward from a development perspective and with purchasers increasingly more prepared to commit “off the plan” for townhouses than a few years ago. It will always be the case that townhouses provide a preferred amenity to apartments and an affordability alternative to detached established housing and thus present a mid-point solution increasingly popular not only with first home buyers, but those downsizing from larger homes wishing to retain an inner urban amenity. We anticipate further increase in this area of activity in Melbourne.

PRICES VS VALUES

An important point for awareness, is that there is a difference between “off the plan”, pricing and value of completed apartments. This is the source of puzzlement to many, particularly purchasers settling 18 months post-contractual commitment. An “off the plan” price is invariably confused with value for the reason that an informed understanding is necessary to appreciate the difference. “Off the plan” contract prices involve delayed settlement, stamp duty savings and “newest” product, whereas two years later, an established apartment has a value which reflects immediate settlement, no stamp duty savings and a two year old product. All other circumstances being the same, there will logically be a difference between the two particularly as “off the plan” pricing is escalating at a higher rate than actual market values. Typically, the difference between the two, will vary in the range 7 - 10%. A lack of understanding about the difference can be confusing and cause implications not only for purchasers, but also for financiers and developers who for this very reason may not fully appreciate the financial mechanics of the development model and the correlated valuation process.