Charter Insight

Near-Term Apartment Completions in the COVID-19 Market

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RESEARCH

The completion and settlement process, in at least the short term, will be a more challenging process as a result of the impacts of COVID-19, of which those stakeholders properly informed will be better able to mitigate some of this additional risk.

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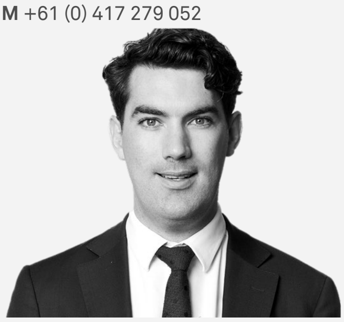

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This process is already complicated in more supportive circumstances but has been made more difficult by the current impacts of COVID-19 on the market.

This will not impact all developers equally, due to individual projects having different product mixes, apartment sizes, quality of finishes, local amenity in addition to purchaser circumstances. The pricing and market conditions within which specific projects were launched and in which they eventually settle will also play a role. This may create variances in mortgage valuations, and the potential ability or willingness for purchasers and developers to absorb any shortfalls in valuation if they occur.

Elevated completions are anticipated across the three major eastern seaboard cities through Q3-2020 (13,230 apartments) increasing from Q2-2020 (10,130 apartments) and above that anticipated through Q4-2020 (10,560 apartments). Charter has observed construction delays across the market, with some projects that were originally anticipated to complete in Q2 2020 (prior to the harder lockdown impacting the construction industry) now being projected to complete through the second half of 2020. Recent restrictions on construction in Victoria will result in some completions being further delayed.

See Figure 1 below: Quarterly Apartment Completions Q3 2020 – Q2 2021 Eastern Seaboard Markets.

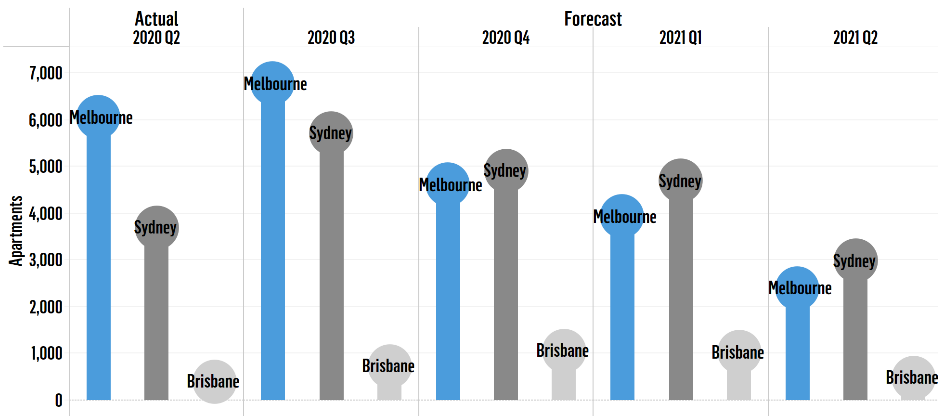
Melbourne is anticipated to record approximately 6,800 apartment completions through Q3-2020 before moderating to 4,600 through Q4 2020 with additional softening projected through early 2021. Sydney, by comparison, is anticipated to record relatively more consistent completion numbers through the remainder of 2020 and the beginning of 2021 with between 4,700 and 5,700 quarterly apartment completions projected through that period.

Profiling of specific geographic locations along with the projected scale of short-term project completions can highlight where some of the settlement pain points may be.

Melbourne

Anticipated completions through the balance of 2020 are concentrated within the Central and Inner markets. Larger, centrally located projects that were launched through peak periods (2016-2017) may have some additional

Figure 1: Quarterly Apartment Completions Q3 2020 – Q2 2021 Eastern Seaboard Markets.



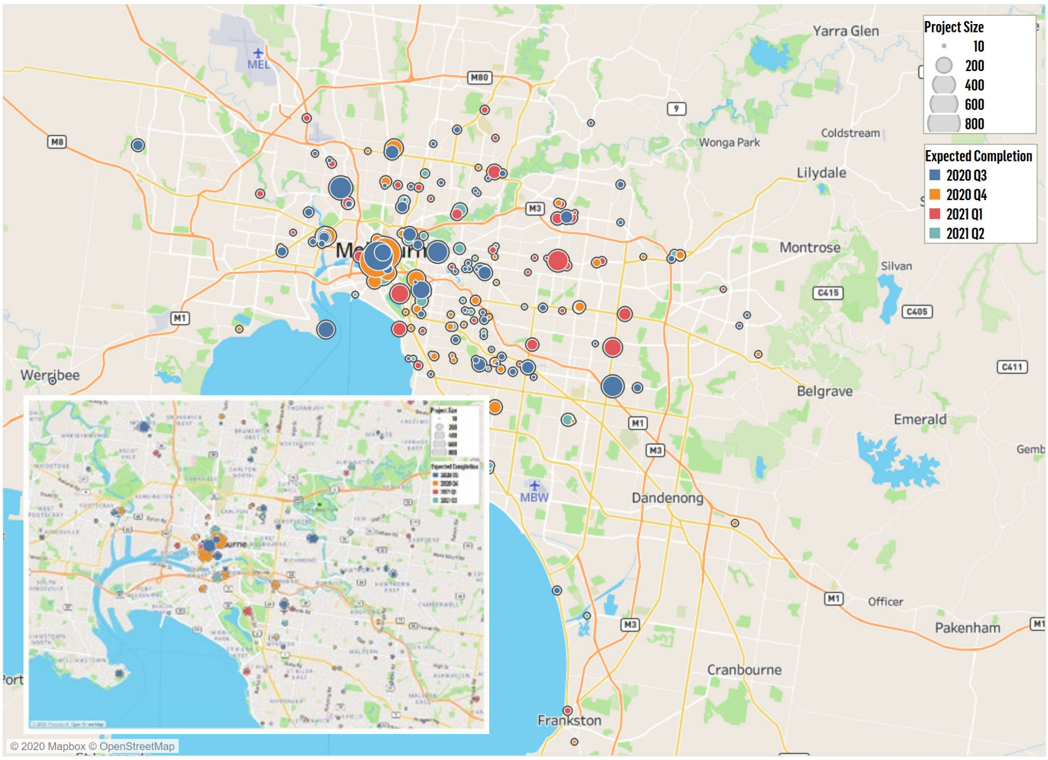
Source: Charter Keck Cramer

challenges to navigate through the remainder of 2020. The majority of projects, however, are a relatively smaller in scale and are predominantly located in the inner and middle region eastern suburbs of metropolitan Melbourne. Much of this reflects a broader market shift that occurred post 2015 as investor directed policies eroded their participation in the market.

See Figure 2 (right) and table below.

The average project size across metropolitan Melbourne has some significant variation, being predominantly between 50-75 apartments per project, although there is significant scale within the Central City region (average project size of 259 apartments).

Figure 2: Apartment Completions Q3 2020-Q2 2021 Metropolitan Melbourne



Source: Charter Keck Cramer

		Count of Projects					Average Project Size				
		2020		2021			2020		2021		
		Q3	Q4	Q1	Q2	**Total**	Q3	Q4	Q1	Q2	**Total**
Melbourne	Central City	4	8	6	3	***21***	282	296	185	274	***259***
	City Fringe	9	9	7	8	***33***	119	67	70	41	***75***
	Inner	46	18	14	17	***95***	57	31	33	52	***48***
	Middle	19	16	24	6	***65***	60	56	75	56	***64***
	Outer	9	6	4	1	***20***	23	30	19	30	***24***
	Total	87	57	55	35	***234***	71	81	71	68	***73***

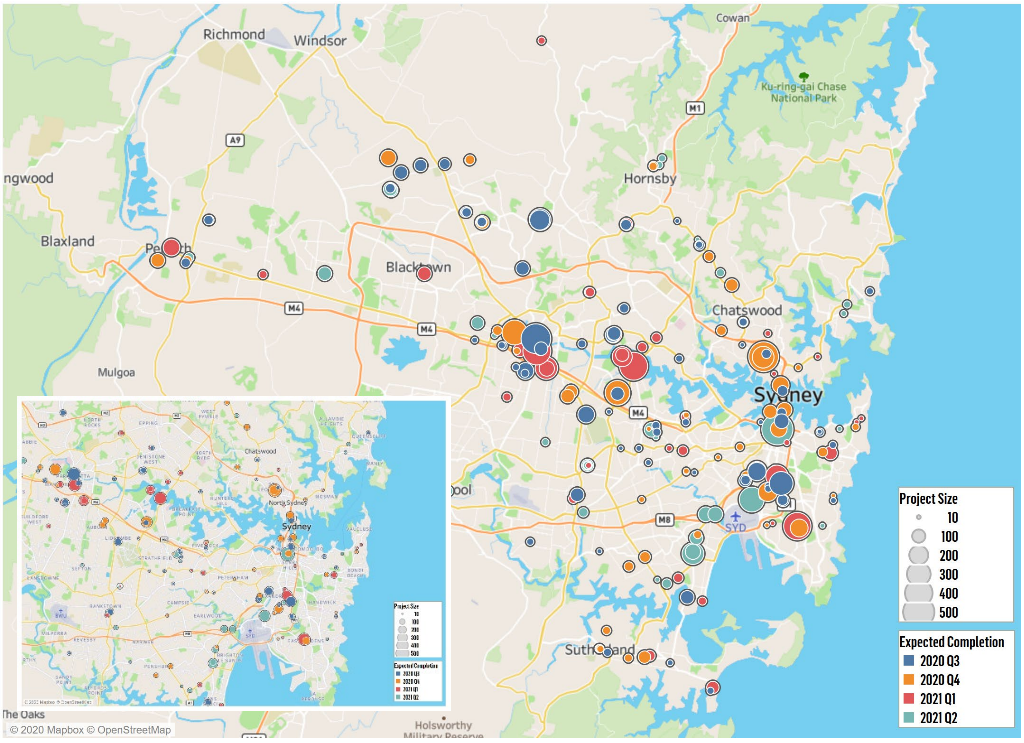
Sydney

Projects to be completed through metropolitan Sydney are largely extending between the Central City markets along the M4 Motorway to Parramatta and the City to Airport corridor with the majority of short-term supply to be completed within the Middle region.

See Figure 3 (right) and table (next page).

Outside of the Central City, where the average completed project size is anticipated to comprise 119 apartments, the other regions of metropolitan Sydney share similar sizes of approximately 60-75 apartments per project.

Figure 3: Apartment Completions Q3 2020-Q2 2021 Metropolitan Sydney



Source: Charter Keck Cramer

		Count of Projects					Average Project Size				
		2020		2021			2020		2021		
		Q3	Q4	Q1	Q2	**Total**	Q3	Q4	Q1	Q2	**Total**
Sydney	Central City	4	4	1	1	***10***	56	112	43	479	***119***
	City Fringe	6	5	5	4	***20***	89	89	82	31	***76***
	Inner	12	13	13	5	***43***	36	84	58	76	***62***
	Middle	38	22	29	24	***113***	58	77	98	57	***72***
	Outer	30	14	10	8	***62***	67	88	63	77	***72***
	Total	90	58	58	42	***248***	60	85	81	71	***72***

Brisbane

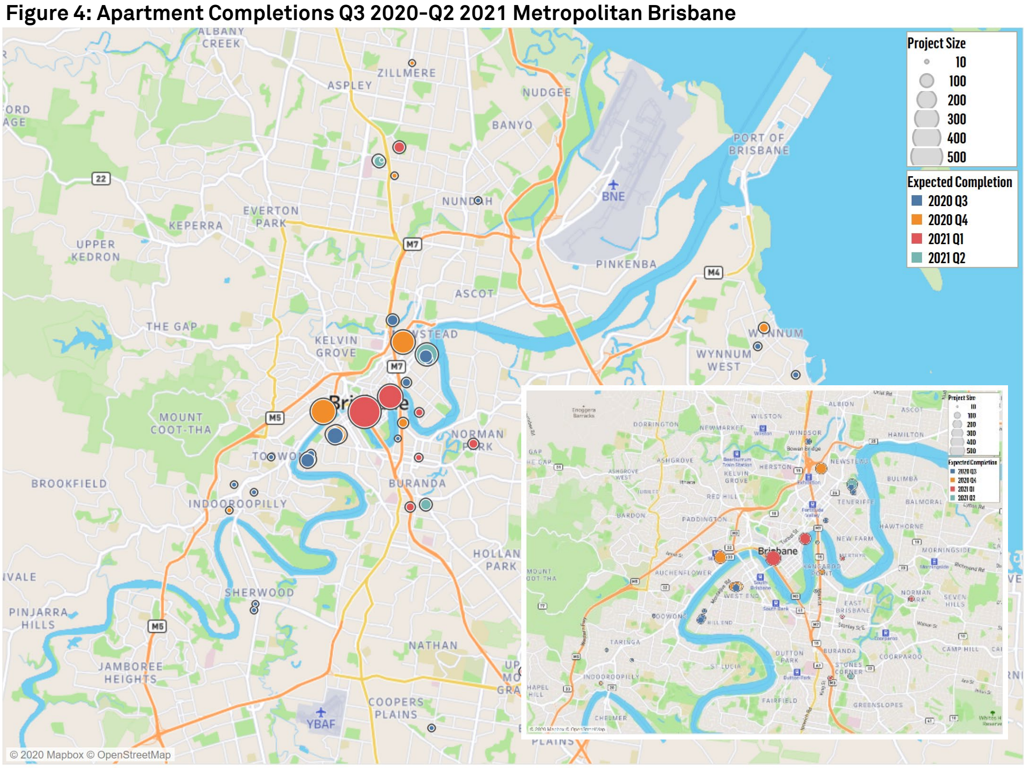
Apartment completions across metropolitan Brisbane through 2020 are relatively subdued with a collection of larger projects located within the Central City region. The supply is predominantly located within the City Fringe market.

See Figure 4 (right) and table (below).

In Brisbane, project sizes exhibit significant geographic variances with projects of scale located within the Central City and City Fringe, and smaller projects located in the Inner, Middle and Outer regions (average project size between 25-35 apartments).

Source: Charter Keck Cramer

Figure 4: Apartment Completions Q3 2020-Q2 2021 Metropolitan Brisbane



		Count of Projects					Average Project Size				
		2020		2021			2020		2021		
		Q3	Q4	Q1	Q2	**Total**	Q3	Q4	Q1	Q2	**Total**
Brisbane	Central City	-	1	2	1	***4***	-	42	366	13	***197***
	City Fringe	8	6	2	1	***17***	62	151	54	214	***101***
	Inner	4	1	3		***8***	25	16	30	-	***26***
	Middle	5	1	2	5	***13***	16	12	47	50	***33***
	Outer	2	3			***5***	21	26	-	-	***24***
	Total	19	12	9	7	***47***	38	88	114	68	***70***

Purchaser and Counter Party Risk

As a result of the impacts from the onset of COVID-19 there are increased risk factors with regards to counterparty risk (purchsers' increases settlement risk) through the next 6-12 months (and potentially beyond depending on any long-term economic effects).

Some purchasers may have lost employment or had hours reduced due to COVID-19, impacting their incomes and consequently their ability to acquire financing for settlement.

There may be reduced willingness of investors to tip in additional equity (via from their own savings or by selling other assets) to make up any potential valuation or funding shortfall. It is noted that a recovery in the equities market has limited any losses through Q3 compared to those likely to have been measured in Q2.

In addition, how banks assess income through the initial stages of recovery for those that had lost their jobs, had hours reduced or continue on some form of support package may create additional delay in accessing finance. Employment circumstances will need to improve for a period (generally around 3 months) to create an income history acceptable by banks for purchasers whose incomes were impacted by the COVID lockdown. Of note the assessment of serviceability and lending for a potentially reduced income will also have consideration for historically-low interest rates, which may act in part to offset a potential reduction in income for some purchasers'

There may still be some market adjustment from the unwinding of government support packages across the broader economy and selected industries. While some industries have started to improve, others may yet face some shake-out through the end of 2020 and 2021. The government has highlighted a willingness to support businesses and workers to the extent that is justifiably required, however, there may remain some misalignment between the level of support provided and that required for some businesses to remain commercially viable as government support is tapered. For some individual purchasers' conditions to easily settle may differ to others depending on the current arrangements and circumstances with their employer (i.e. those that are employed and solely receiving JobKeeper compared to those whose income is supplemented by JobKeeper).

Ultimately, the composition of purchasers and individual counterparty risk will underpin individual potential settlement challenges through the remainder of the year. This will all occur in a period of unprecedented uncertainty across the economic landscape while anticipated levels of completed apartment supply are anticipated to remain robust.

Valuation Process and Settlement

The process of valuation for mortgage purposes can have relatively rigid requirements impacting the valuation process. These are primarily put in place to underpin adequate buffers for underwriting a mortgage within the context of the banks risk tolerance. Understanding the process and requirements highlights the logic that underpins this risk.

Given the capital value, the valuations for apartment settlements are usually completed within the Property Pro Short Form Valuation Report as considered appropriate by the Australian Property Institute and various service agreements with financiers.

This format requires a minimum of three settled sales within a 10% price variance over the past six months. Further evidence can be included although given the timeframes associated with completing such reports it is often not feasible to go "over and above".

As the sales to be included as primary evidence have to be "re-sales" i.e., having transacted previously and not developer first time sales, the condition of such properties can be (and is often) inferior to that of a settling apartment. Sales information and guidance with respect to first time developer sales, those having similar specifications and condition attributes to the settling apartment, can be included within the report as secondary evidence. However, as panel Valuers are required to turn these valuations around in a very short period of time, often not exceeding 48 hours, and developer first time sales information being difficult to source, this information is often not included.

Accordingly, the evidence used within the report which forms the basis of the assessment, given the varying conditions, can potentially lend itself to lower levels of value than the "off the plan" contracts.

The sales information can be fully researched and analysed and provided to the panel valuer for their consideration and possible reference within the report as secondary evidence.

With this in mind, it is beneficial for developers to be adequately informed as to the available market evidence likely to underpin valuations at the point of settlement, in addition to potentially sourcing relevant first time off the plan sales evidence to assist in making provisions as to how best to support the settlement process if needed.

Conclusion

Short-term market settlement risk is not evenly distributed, with some developers more impacted than others). The degree of settlement risk will be dependent on the compositions of stock within a project in addition to the composition of buyers as the counter party and material changes in market conditions between contracting and settlement

The second half of 2020 will provide challenges across the market that developers and related parties will need to manage. Overall economic conditions remain fragile while apartment completions will remain robust through the remainder of 2020.

Furthermore, larger and more centralised projects (generally more supportive of scale) will have to manage settlement of potential supply that were underpinned by more supportive conditions at the point of contract (i.e. 2016-2017). These projects also have potential for a larger composition of investor purchasers that were more active in the market through this contracting period.

Through this period, it will be prudent for developers impacted by elevated risks to be informed, acting on independent information and advice to remain agile through the process. This includes understanding what evidence is likely to underpin valuations at the point of settlement, and to make provisions as to how best to support the settlement process if needed.

More detailed apartment supply information is available in Charter Keck Cramer's Apartment State of the Market Report.