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Get set for weaker conditions across the board in residential property markets

Pace of price growth to continue to slow, with price declines likely

Monday, July 11 – While residential prices are forecast to remain relatively stable in 2016/17, rising supply and weakening investor demand will play an increasing role in the price outlook of Australia's capital cities over the next three years, according to leading industry analyst and economic forecaster, BIS Shrapnel.

According to the company's *Residential Property Prospects, 2016 to 2019* report, a combination of lower population growth and increased dwelling completions will see most undersupplied markets tip into oversupply in 2016 and 2017, while excess stock in other markets is likely to persist. Although interest rates are expected to remain low, and even potentially fall further, the adverse demand/supply balance is likely to dampen price growth, with median house and unit prices in all capital city markets forecast to be lower in real terms by 2019.

Price growth across the country has mainly been a Sydney and Melbourne story, with median prices across the other capital cities showing only limited growth or declines. Both the major cities have been supported by reasonably positive economic conditions and an underlying dwelling deficiency. This has attracted significant growth in both owner-occupier and investor demand. In contrast, the weaker recent price growth in the other capital cities has been consistent with an excess stock and/or a weak local economic environment.

BIS Shrapnel senior manager and study author, Mr Angie Zigomanis, said the rate of price growth in Sydney and Melbourne has slowed in 2015/16. Investor demand has been a key driver of the upturn in both markets and moves by the regulator to slow growth in bank lending to investors have seen investors retreat. At the same time, dwelling completions are rising to record levels and the increasing supply/demand imbalance will increasingly dampen price growth. In particular, the boom in apartment construction over the last couple of years is creating a disconnect in the supply balance between detached houses and units, with a resulting difference in their price outlook.

"In fact, nearly all capital cities are building apartments at record rates on the back of the recent strength in investor demand," said Zigomanis. "As these projects are progressively completed, it is likely that there will not be enough tenants in a number of cities to support rents and consequently values upon completion.

"National population growth in 2014/15 was at its second lowest level since 2005/06, with net overseas migration falling from 229,400 persons in 2011/12, to 176,500 persons in 2014/15 – although there have been wide variations across the states. Nevertheless, with the majority of net overseas migration classified as 'long term overseas visitors' – that is, temporary but not permanent arrivals – this reduction is likely to be impacting most on the rental, and therefore apartment, sector."

Nationally, BIS Shrapnel anticipates a record 220,000 new dwellings will have been commenced in 2015/16, and this will translate to a peak in new dwelling completions in 2016/17. A record 49 per cent are expected to be multi-unit dwellings, with many being larger apartment buildings with longer construction time frames that will translate to further strong completions in 2017/18. Total dwelling construction compares with an average underlying demand for 159,200 new dwellings per annum over the next five years. As these dwellings reach completion, all states with the exception of New South Wales will have moved into oversupply, or be experiencing an increasing oversupply.

"With the price pressure of the stock deficiency of recent years being steadily alleviated, BIS Shrapnel expects all markets to steadily weaken and bottom out over 2017/18 and 2018/19, with house prices largely flat or in decline over this period," said Zigomanis.

Meanwhile, the change in gears from resource investment to domestic demand driving the economy continues to be slow and economic growth nationally is muted. Without a substantial acceleration in economic conditions, employment and income growth will also be slow. Even in the stronger growing states of New South Wales and Victoria, there is further limited upside to prices.

A further headwind to the residential markets are regulatory guidelines initiated by the Australian Prudential Regulation Authority (APRA) in 2015. The resultant tighter bank lending policy targeted at investors has seen investor activity weaken across all states.

"In New South Wales and Victoria in particular, where the strength of investor demand has been a key driver of the Sydney and Melbourne residential markets respectively, the decline in investor activity has slowed the pace of price growth," said Zigomanis. "As investor expectations of capital gains are reduced, investor demand is expected to weaken further, creating additional downward pressure on prices."

The detached house market is less reliant on tenant demand and more exposed to owner-occupiers. Progressive cuts to variable interest rates have been having a positive impact on owner-occupier demand, with growth in lending to owner-occupiers in 2015/16 partly offsetting the decline in investors. This should continue to support median house prices in most capital cities over at least 2016/17.

The best prospects for median house price growth over the next three years are forecast to be in the Brisbane and Hobart markets, followed by Canberra. In Brisbane, affordability has improved significantly after weak price performance. New construction has been concentrated in the apartment market, but there is expected to be an underlying deficiency of detached houses. While an oversupply is estimated in Tasmania overall, Hobart appears to be in deficiency, being the focus of migration from the rest of the state and from interstate. This should support some modest house price rises. Meanwhile, the interstate outflows from the Australian Capital Territory are easing, and with relatively high incomes in Canberra, this should be able to support some price growth.

The recent strength of the Sydney and Melbourne markets will be a key underlying factor behind their progressive weakening over the next three years. Strong investor demand has helped to drive both rising prices and new dwelling supply, particularly in the apartment sector. With much of the pipeline of supply in high rise apartments, new supply will continue to stay high in the next three years as projects are progressively completed. In particular, Victoria is forecast to tip into aggregate oversupply in 2016/17, and this will impact on Melbourne prices. Similarly, while the Sydney market is expected to still be in undersupply by the end of this period, a lower deficiency will alleviate pressure on prices. Together with a drop in investors coinciding with tighter bank lending policy and the reduced expectation of further capital gains, this is expected to eventually result in modest price declines.

Further weakness is forecast in the Perth, Darwin and Adelaide markets. The Perth and Darwin markets will continue to be impacted by falling resource sector investment, weak population growth and excess supply. However, with resource sector investment bottoming out in 2017/18, it is likely that the market will also trough at the same time and potentially herald some limited upside in 2018/19. Adelaide continues to face economic headwinds and the closure of car manufacturing in 2017 will be a further drag on the local economy and in turn on prices.

However, with the economy forecast to trundle along at current rates of growth there is unlikely to be any significant deterioration in the unemployment rate. Meanwhile, interest rates are expected to remain low enough to provide some support to prices as investors should be able to meet their mortgage repayments despite potentially having to discount rents to attract tenants. Consequently, owners will be able to hold their properties through this weaker period with few forced sales likely to be taking place to create significant downward pressure on prices.

Where state markets are measured to be in overall oversupply, BIS Shrapnel estimates that the excess stock will be concentrated in the unit sector, where there has been investor-driven record levels of construction. The consequences are already being seen in the unit market, with median unit price growth being below median house price growth across nearly all capital cities over 2014/15 and 2015/16. In comparison, median house price growth has been stronger, and a number of markets are still estimated to be in undersupply.

Nevertheless, all markets are forecast to experience falls in prices in real terms by June 2019. The real decline is forecast to be minimal at one per cent in Brisbane and Hobart, and as high as 12 per cent in Adelaide. Across the unit market, all capital cities are expected to experience greater real declines in unit prices ranging from eight per cent to 15 per cent over the three years to June 2019. With overseas buyers only able to purchase new apartments, the resale market will be more limited, being confined to local buyers.

Outlook for price growth by region

Sydney

After an estimated 59 per cent rise in Sydney's median house price over the three years to June 2015, price growth has slowed in 2015/16. Investors were a key driver of the market through the upturn, and the tightening of bank lending policy toward investors has seen investor activity weaken. Sydney's sizeable undersupply and low interest rates have kept owner-occupier demand buoyant, although it has not been sufficient to offset the decline in investor numbers and total demand has nevertheless slowed. Sydney's median house price is estimated at $1,055,000 at June 2016, which is only one per cent above a year earlier.

A similar minimal rise is forecast in 2016/17 as the cut to interest rates in May 2016 and a potential further cut later in 2016 continues to buoy owner-occupier demand. However, the slowing price growth also reflects strained affordability, and there is little potential for the stronger owner-occupier demand to push prices up further.

New dwelling activity has now finally started to run ahead of underlying demand. However, strong population growth – as New South Wales records healthy net overseas migration inflows and low net interstate migration outflows – is preventing Sydney's dwelling deficiency being absorbed at a greater rate than would otherwise be expected.

"Nevertheless, completions will continue to rise, and the slow erosion of the deficiency will alleviate some of the pent-up demand pressures in the market," said Zigomanis. "The slowing price growth will also discourage investors, who will continue to retreat from the market."

This will bring about median house price falls totalling three per cent over 2017/18 and 2018/19, such that the median house price in Sydney over the three years to June 2019 is forecast to be one per cent lower than in June 2016, or a real decline of nine per cent over the period. With a greater reliance on investors, who at their peak accounted for more than half of residential finance in New South Wales, unit price performance is forecast to be weaker, with the median unit price at June 2019 forecast to be five per cent below the June 2016 median.

Newcastle and Wollongong

Residential property prices in Newcastle and Wollongong usually benefit when Sydney experiences strong price growth and migration into these regional centres increases. Wollongong also benefits from a high level of commuters into Metropolitan Sydney and the current buoyant Sydney employment market. Vacancy rates have been tight in Wollongong for some time, but are now also tightening in the Hunter Region and more particularly Newcastle. Price growth in Wollongong was estimated at five per cent in 2015/16, while declining resource sector investment has created weaker economic conditions in the Hunter region, and median house price growth was only one per cent in Newcastle in comparison.

However, with the market tightening in Newcastle, price growth should begin to pick up, particularly as Sydneysiders continue to seek refuge in more affordable markets. Nevertheless, with some economic challenges still in place, price growth is forecast to still be contained at a total six per cent over the three years to June 2019, with some potential for further upside if the economy shows more strength. More moderate price growth totalling six per cent is also forecast in the three years to June 2019 for Wollongong, with affordability likely to be more strained given the earlier 35 per cent growth estimated over the three years to June 2016.

Melbourne

The Melbourne market experienced aggregate price growth of 36 per cent over the three years to June 2015. Buyer activity and price growth was initially concentrated in the higher value inner and middle ring suburbs, and has more recently expanded to the outer suburbs. The Melbourne market has been underpinned by strong net overseas migration inflows, as well as unprecedented net interstate migration. Net interstate migration inflows are now the highest of all states for the first time on record. Population growth has consequently been sufficient to continue to largely absorb the progressive increase in dwelling supply that has been coming through in the past three to four years. Moreover, despite record completions in 2015/16, the state is still estimated to have a marginal deficiency overall at June 2016.

However, median house price growth is estimated to have slowed to three per cent in 2015/16 (to a median of $765,000 at June 2016), partly due to some easing in investor activity as banks tighten lending standards in response to APRA guidelines, and partly due to the market moving closer to balance over the year.

Moreover, new dwelling construction, particularly for apartments, continues to rise to new heights. At the same time, some downside is anticipated to emerge for population growth, particularly as the shutdown of automotive manufacturing begins to impact on local employment. BIS Shrapnel anticipates that an emerging oversupply will be concentrated in the apartment sector as the current pipeline of projects work their way through to completion.

“The emergence of an oversupply and potential for weakness in the state economy will increasingly place downward pressure on prices,” said Zigomanis. “While the excess stock is expected to be concentrated in the apartment sector, there is nevertheless likely to be an impact on house prices as well.”

Median house prices in Melbourne are forecast to fall by a total of one per cent over the 2016 to 2019 forecast period. After a minimal two per cent rise in the median house price forecast in 2016/17, a subsequent decline of three per cent is forecast in the following two years. After accounting for inflation, prices are forecast to fall by eight per cent in real terms. Given the level of apartment supply due to come through, there is greater downside in the apartment sector, where the median unit price is forecast to fall by a total eight per cent in the three years, or 15 per cent in real terms.

Brisbane

Brisbane’s estimated median house price of $520,000 in June 2016 represents a minimal one per cent increase for the year. Median house price growth in the Brisbane market has been patchy, recording 4-6 per cent growth in each of the prior three years.

The Queensland market has been in underlying deficiency in this period, with Brisbane experiencing vacancy rates below the balanced market rate of three per cent in this time. In addition, Brisbane's median house price remains six per cent below its June 2010 peak in real terms. Together with the low interest rate environment, affordability in Brisbane is at levels seen in the 2000s.

"A deficiency of stock, low interest rates and relatively affordable housing would normally drive a solid upturn in prices," said Zigomanis. "However, the Brisbane market is being held back by the weakness of the Queensland economy, which in turn has resulted in weak employment conditions and low population growth.

"At the same time, the new apartment market is booming, particularly in Inner Brisbane. This will impact on new dwelling supply overall, and without any significant rebound expected in population inflows, the apartment sector is likely to move into oversupply, with some impact across the housing market too."

Together with still relatively subdued economic conditions and net interstate migration inflows at a low level, price growth is forecast to be modest. However, in comparison to some other capital cities, price declines are not expected for houses due to the housing sector being relatively affordable and in undersupply. In contrast, rising completions of apartments will see weaker performance in the unit sector.

A total rise of seven per cent in the median house price is forecast over the three years to 2019, while the median unit price is forecast to fall by a total six per cent. This corresponds with declines of one per cent and 13 per cent in real terms respectively.

Gold Coast and Sunshine Coast

House prices on the Gold Coast and Sunshine Coast have generally moved in tandem with Brisbane, benefiting from the same drivers of population growth as the capital; that is, primarily net interstate migration inflows and, to a lesser extent, overseas migration.

However, there has been more recent strength in both of these markets compared to Brisbane. An extended period of weak construction has meant that both of these markets are in undersupply, which is being reflected by tight vacancy rates. Both the Gold Coast and Sunshine Coast are now seeing moderate price growth come through. Median house price rises were in the order of five to six per cent per annum over the three years to 2014/15, although appear to have slowed slightly to the three to four per cent range in 2015/16.

From an economic perspective, large construction projects such as Pacific Fair, Commonwealth Games infrastructure and the new light rail line in the Gold Coast have contributed to local employment, as has the emerging upturn in residential building. Consequently, further price growth totalling 11 per cent is forecast for the Gold Coast over the three years to June 2019. Total price growth over the next three years is forecast to be slightly lower in the Sunshine Coast at seven per cent with the major Sunshine Coast University Hospital largely completed and fewer new projects to sustain the local economy.

Townsville and Cairns

The Townsville market has steadily weakened as the impact of falling resource sector investment has impacted on housing demand, causing vacancy rates to rise and rents and prices to ease. In contrast, the Cairns market did not experience the same benefit from the mining investment boom, with the post-Global Financial Crisis collapse in construction now resulting in a dwelling deficiency emerging.

The Townsville market is forecast to continue to weaken, with investment in resource sector projects expected to progressively decline through to 2017/18. Prices are forecast to bottom out in 2017/18 and stabilise the following year. However, it will still take time for an upturn to come through given vacancy rates – which are currently at over six per cent – will take some time to tighten. Some upside exists in Cairns, where a combination of low interest rates and tightening vacancy rates have contributed to a 19 per cent rise in the median house price in the four years to June 2016. Strengthening local economic conditions, with a lower Australian dollar contributing to strong growth in local and overseas tourism, are contributing to a more buoyant employment environment.

Consequently, cumulative price growth over the three years to 2018 is expected to be six per cent in Cairns, while a four per cent decline is forecast in Townsville. Significantly, in real terms, by June 2019, the Townsville market is forecast to be 35 per cent below its December 2007 peak – more than a decade earlier. In particular, sharp rises in insurance costs after recent cyclones in Queensland's north appear to have had a significant impact on the Townsville market, where the lack of rental growth means cash flows for investors have deteriorated, whereas rent rises in Cairns have somewhat offset some of this impost.

Adelaide

Adelaide's estimated median house price of $465,000 at June 2016 represents a four per cent increase for 2015/16.

"With only a moderate oversupply estimated to have been in place in 2015/16, the Adelaide market appears to be responding to low interest rates," said Zigomanis. "However, as population growth continues to weaken and the excess supply expands, greater downward pressure will be applied to prices.

"South Australia already has the highest unemployment rate of the states and continues to face headwinds in a number of industry sectors, with jobs in the steel sector at risk and jobs in the automotive sector to decline. Net interstate migration outflows continue to rise."

As a result, the residential market in Adelaide should remain challenging. The median house price is forecast to be flat in 2016/17, before declining in 2017/18 and bottoming out in 2018/19. In total, the median house price forecast to be two per cent lower at June 2019 than at June 2016, with a similar decline expected in the median unit price. In real terms, median house and unit prices are forecast to decline by around 9-10 per cent.

Perth

The Perth residential market continues to weaken as declines in resource sector investment have a negative impact on employment and population growth. Perth's median house price is so far estimated to have declined by eight per cent to $550,000 in the two years to June 2016.

"Purchaser demand is weakening, with demand across first home buyers, subsequent home buyers, and investors flagging," said Zigomanis. "Net overseas migration inflows have slowed rapidly, while Western Australia recorded a net interstate migration outflow of 4,300 persons in calendar 2015, after experiencing a net inflow as high as 11,400 persons as recently as in 2011/12.

"Consequently, vacancy rates have risen to around six per cent, while house and unit rents have fallen by 16 per cent and 17 per cent from their 2013 peaks. Perth's median house price is forecast to continue to fall over 2016/17 and stabilise in 2017/18, when mining investment is expected to bottom out. The corresponding decline in new residential construction is expected to also see the oversupply begin to be absorbed."

Given the falls over the past two years, the rate of decline is likely to slow and BIS Shrapnel is forecasting Perth's median house price to be one per cent lower by June 2019 compared to June 2016 levels, representing a decline in real terms of eight per cent. Significantly, Perth's median house price has still not recovered from the mid-2000s mining boom, and by June 2019 is forecast to be 23 per cent below its earlier March 2007 peak in real terms.

Hobart

The Tasmanian residential market has been in oversupply due to a substantial supply response to significant first home buyer grants for new dwellings that were as high as $30,000. Median house price growth in Hobart has been patchy, although prices have been generally flat since 2010, with a median house price of $375,000 estimated at June 2016.

However, dwelling commencements are declining and are on track to fall below underlying demand in 2016/17. Tasmania is also experiencing an improving net interstate migration outflow, which is expected to move into a net inflow in 2016/17. The growth in interstate arrivals will largely be "tree change" migrants from the mainland (mainly New South Wales and Victoria) who are expected to increasingly take advantage of recent price gains to sell their homes to downshift to Tasmania. There are also returnees from the mining states as resource sector investment dries up.

"Hobart is expected to be the main destination for the improving interstate migration, as well as for migrants from the rest of the state," said Zigomanis. "Together with low interest rates, this should help to support modest price rises in the city, despite the oversupply at the state level."

As a result, Hobart's median house price is forecast to rise by a total seven per cent over the next three years, although this still reflects a decline of one per cent in real terms. Greater downside is expected for units as investors respond to the limited rent and price outlook, with prices forecast to remain flat (eight per cent decline in real terms) through to 2019.

Canberra

Canberra's median house price is estimated to have experienced a modest rise of four per cent over 2015/16 to $595,000 at June 2016. New dwelling activity in Canberra has been particularly strong in recent years, with apartment development being sustained at record levels.

BIS Shrapnel estimates that there is an underlying oversupply in the Canberra market, although reported vacancy rate figures have recently been below the balanced rate of three per cent. The impact of cuts to Federal Government departments appears to be dissipating. The rise in net interstate migration outflows is now turning and there is likely to be a balance or potential net inflow in 2016/17.

"Moreover, net overseas migration inflows have increased since bottoming in 2013/14, largely due to the recovery in overseas student growth that has coincided with the lower Australian dollar," said Zigomanis. "Canberra also has the highest incomes of the capital cities and affordability is not as strained as in the other cities.

"Nevertheless, there is still a significant pipeline of apartment construction to come through and this will continue to have a dampening effect on the market. Canberra's median house price is forecast to rise by a total six per cent over the three years to June 2019, which reflects a decline of two per cent in real terms. In contrast, the unit sector, where an oversupply is concentrated and which experienced a four per cent decline in 2015/16, is forecast to experience a further four per cent decline – which represents a 12 per cent decline in real terms."

Darwin

Darwin's median house price has begun to ease after peaking at $620,800 in June 2014, with declines of two per cent in each of the following two years taking the median to an estimated $595,000 at June 2016. The upturn to 2014 was driven by the ramp up in resource sector investment led by the Icthys LNG project. However, activity on this project has been running around its peak in this time and there is little further growth in work done to stimulate employment growth and price growth.

"Moreover, there was a substantial increase in new dwelling activity in response to population growth and price growth through the upturn," said Zigomanis. "With migration flows now slowing while dwelling completions continue to increase, the Northern Territory market is moving into oversupply and this is being reflected in Darwin's vacancy rate rising above eight per cent in 2015.

"Consequently, prices are forecast to weaken further as the investment phase of the Icthys project winds down, with the median house price forecast to decline by a total two per cent in the three years to June 2019, which will result in a real house price decline of nine per cent over the period. With much of the new dwelling supply being in the unit sector, median unit prices are forecast to fall by four per cent over the same period, or a real decline of 12 per cent."

ABOUT BIS SHRAPNEL

BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel helps clients better understand the markets in which they operate, through reliable and detailed market data, analysis of developments and drivers and thoroughly researched forecasts.

BIS Shrapnel compiles accurate, clearly explained and detailed information on industry sectors, markets and industries in which their clients operate. BIS Shrapnel provides market size and segmentation data, market shares, consumer attitudes and supplier reputation information, and regularly conducts both business-to-business and consumer research.

Over the company's 51-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting. The company has been forecasting commercial property markets since 1988.