Melbourne Residential

Price declines gain momentum

Key Highlights

March 2019

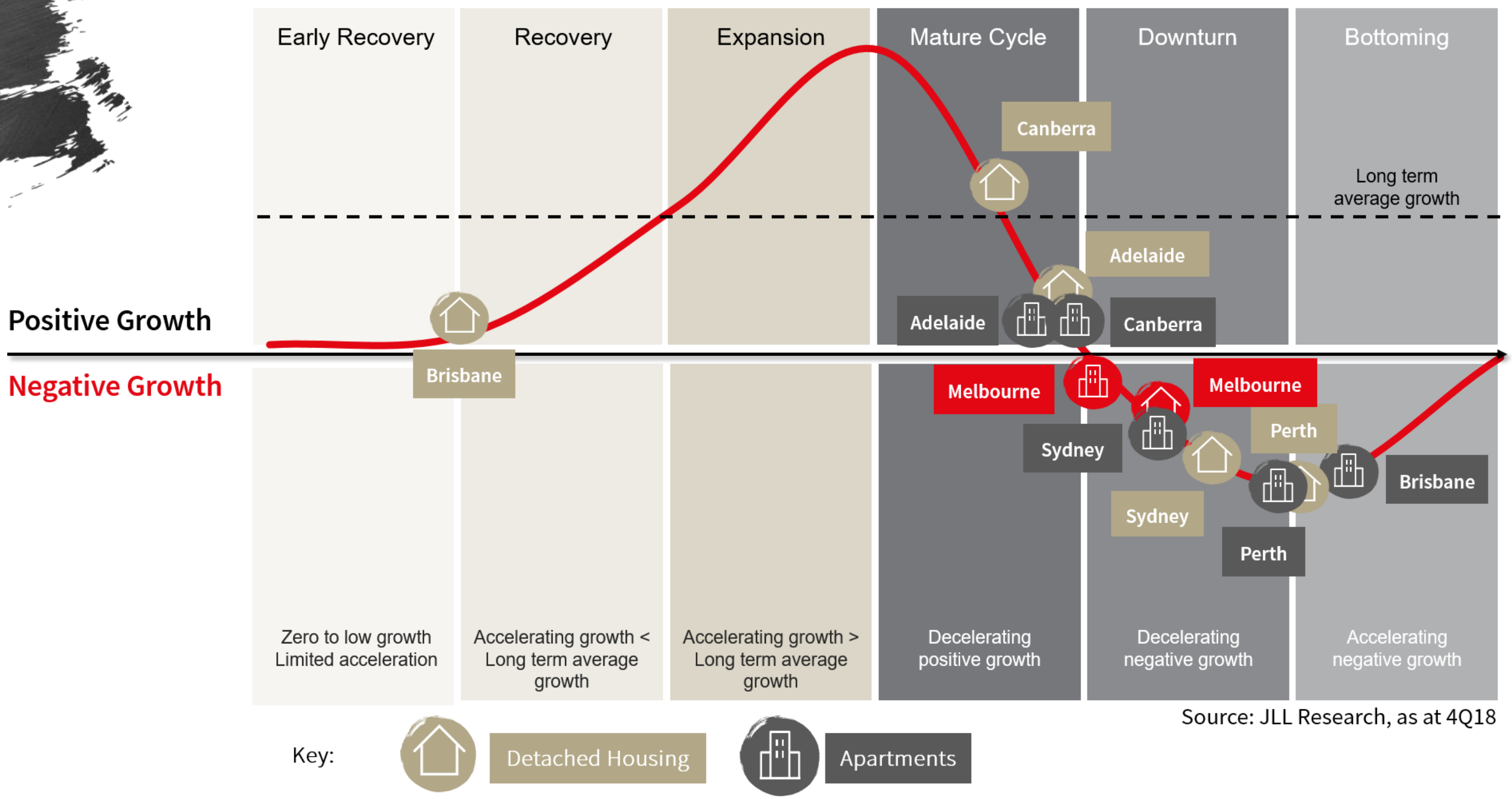
Overview

Prices continue to decline, as residential sales volumes fall and average days on market grow

Demand indicators are worsening and prices are declining, even in previously strong performing suburbs and the premium market. This comes despite overall positive economic conditions in Victoria.

- Across Australia, all residential markets are feeling the effect of tight lending conditions, mainly for investors. This is particularly the case for cities such as Melbourne that enjoyed a strong period of price growth over recent years driven by investor activity.
- Residential indicators held up better than expected in Melbourne for a prolonged period. However, the current downturn is gaining momentum with prices declining further over 4Q18.
- Sales volumes have fallen, properties are spending greater time on the market and vendor discounting has risen reflecting the current slowdown in demand.
- Potential supply is still relatively strong as approvals continue to grow, which poses some risk considering the lower demand environment. However, strict development lending criteria and the high cost of alternative financing should regulate the number of projects that commence construction.
- Economic indicators are overwhelmingly positive for Victoria, which bodes well for underlying dwelling demand. This should soften the impact and length of the current residential downturn.

Figure 1: Australian Residential Property Market: Capital Value Cycle



Source: JLL Research, as at 4Q18

Economic and Regulatory Environment

Victoria continues to outperform national growth in key economic indicators.

Despite price falls in the housing market, economic conditions remain strong. Victorian population, retail spending and employment growth continue to outpace national trends.

- Victoria's economic growth continues to outpace national growth, with 5.2% state final demand (SFD) growth recorded in the year to 4Q18.
- Despite a low wage growth environment, retail turnover growth has accelerated in Victoria. Victoria remains one of Australia's best performing retail markets, with 5.2% growth (y-y) to December 2018, above the national average of 3.0 % y-y.
- In the year to 2Q18, the state's population grew by approximately 138,000 residents. This represents a very strong 2.2% annual growth. Just behind NSW, Victoria recorded the second highest net overseas migration. Solid interstate migration also remains a strong driver of population growth.
- Labour market conditions remain positive. Victoria's unemployment rate declined from 5.6% in January 2018 to 4.5% at January 2019. This remains below the national rate of 5.0%. Victorian employment growth (y-y) continues to outpace national growth.
- An improved infrastructure pipeline bodes well for the Victorian economy. A key project is the West Gate Tunnel that will assist in connecting residents in Melbourne's western growth corridor to the CBD. Additionally, the Metro Rail Tunnel and Level Crossing Removal Project are well underway.
- Low interest rates have fuelled the housing market in recent years. The target cash rate remains at the historic low level of 1.50% and is likely to remain steady in the near term.
- Although owner-occupier lending growth has moderated, mortgage rates remain competitive. However, rising bank funding costs may result in mortgage interest rates rising out of line with cash rate movements.

Figure 2: Key Economic Indicators

Australia		Victoria
2.5%	**State Final Demand Growth** Year-ended 4Q18	5.2%
3.0%	**Retail Turnover Growth** Year-on-year to December 2018	5.2%
1.6%	**Population Growth** Year-ended 2Q18	2.2%
2.2%	**Employment Growth** Year-ended January 2019	3.5%

Source: ABS, JLL Research

Demand

Sentiment has softened as Melbourne residential property becomes increasingly difficult to sell

- Residential demand indicators worsened in 4Q18. Annual sales volumes for houses and units (new and existing) fell 14.5% and 34.1% respectively over the 12-months to November 2018.
- Weighted average time on the market and vendor discounts for both houses and units have risen across Melbourne. This reflects the disparity between initial vendor and purchaser price expectations.
- Housing finance data also reflects the lower demand environment. Nationally, investor lending commitments continued to decline on an annual basis and owner-occupier lending growth has significantly moderated.
- While overall demand has cooled largely on the back of declining investor demand, the lower end of the market remains stimulated by First Home Buyers. First home buyer incentives and favorable new-customer lending rates by the big banks continue to drive demand at the lower end of the market.

Residential

Houses			Indicator	Units		
↓			Sales Volumes	↓		
↓			Total Listings	↓		
5.6%			% Stock on Market	5.4%		
Overall[1]	Affordable[2]	Prestige[3]	Weighted Average Time on Market	Overall[1]	Affordable[2]	Prestige[3]
29	28	50		40	48	52
Overall[1]			Vendor Discount	Overall[1]		
-5.0%				-4.2%		

Figure 4: Demand Indicators - Melbourne

Hot Suburbs (Average Days on Market)

	Houses	Units
Overall[1]	1. Ormond 2. Upwey 3. Fairfield 4. Skye 5. Kurunjang	1. Kensington 2. Hampton Park 3. Mill Park 4. Werribee 5. Northcote
Affordable[2]	1. Millgrove 2. Frankston North 3. Woori Yallock 4. Kurunjang 5. Warburton	1. Hampton Park 2. Mill Park 3. Werribee 4. Pakenham 5. Sydenham
Prestige[3]	1. Malvern 2. Hawthorn East 3. Surrey Hills 4. Brighton 5. Armadale	1. East Melbourne 2. Toorak 3. Ivanhoe 4. South Yarra 5. Kew

Sources: CoreLogic, JLL Research, as at November 2018

Supply

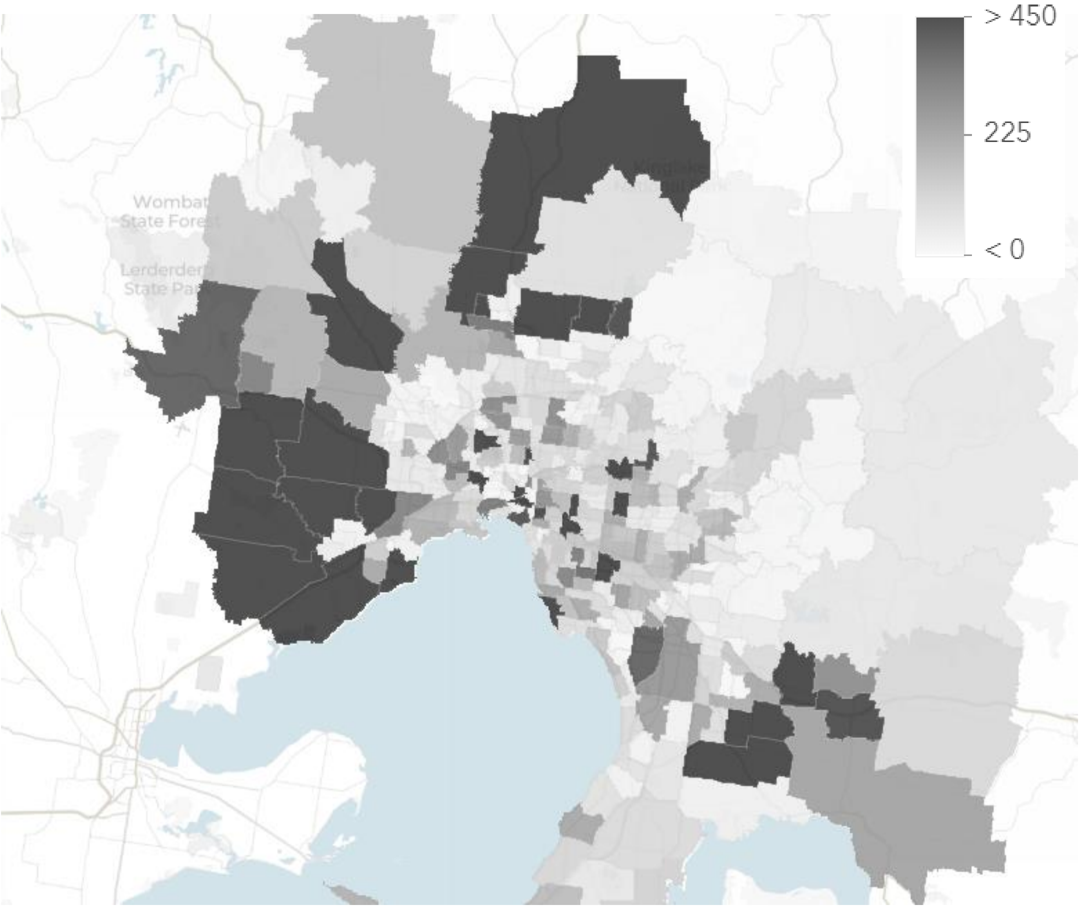
Development funding hurdles are likely to limit the number of projects that commence construction

- 54,347 dwellings were approved in Greater Melbourne over 2018, reflecting a 7.0% decline in approvals. Although this number still remains relatively high, many of these projects will not proceed due to continued tight development funding conditions, particularly for high density apartment projects.
- Similar trends to previous quarters continued in terms of the location of residential approvals. Housing approvals increased 4.1 % y-y. The majority of these occurred in Melbourne's outer growth corridors, where a number of lots continue to be released in major greenfield developments.
- Semi-detached approvals declined 7.5%, but remain concentrated in middle ring areas, particularly in the North. This includes Braybrook, Sunshine North and Pascoe Vale. Townhouse development activity alongside apartment activity appears to have moderated due to similar constraints in achieving pre-sales and development funding in the current low demand environment.
- Apartment approvals declined 22.1% y-y. Melbourne and Southbank continue to have a high amount of apartment approvals. However a number of middle-ring suburbs (Footscray, Doncaster and Oakleigh) have had a high number of approvals as many developers turn their attention here after a prolonged period of extensive inner-city apartment development activity.

Figure 5: Building approvals (last 12 months): Greater Melbourne

	Houses	Semi-detached	Apartments
Building Approvals (Greater Melbourne)	27,921 (4.1% y-y)	11,357 (-7.5% y-y)	15,069 (-22.1 y-y)
Hot Suburbs (Building Approvals)	Cranbourne East Mickleham – Yuroke Tarneit Cranbourne South Rockbank	Braybrook Sunshine North Pakenham – South Pascoe Vale Noble Park - West	Melbourne Footscray Southbank Doncaster Oakleigh-Huntingdale

Figure 6: Greater Melbourne SA2's Residential Building approvals (last 12 months)



Source: ABS, JLL Research, as at December 2018

Pricing

Apartment and detached house prices continue to decline across Melbourne

Melbourne property prices continued to fall in 4Q18. The prestige market and a number of previously high-growth suburbs have come under pressure.

- Melbourne house prices fell 11.5% in the 12-months to November 2018 according to Core Logic's Home Value Index. Over this period, apartments fell a more moderate 3.7%.
- Prices have fallen in a number of prestige suburbs where sales activity has become relatively stagnant as vendors re-assess price expectations.
- Prices have also come under pressure in a number of established middle-ring suburbs that experienced strong growth earlier in the cycle such as Box Hill and Mitcham.
- While a number of growth area suburbs are still recording strong annual growth, other indicators are showing pressure in these markets. This includes increased discounting on house and land packages and purchasers seeking to re-sell contracts pre-settlement in greenfield estates.
- Investor activity remains low across the market, largely on the back of tightened lending and the absence of foreign investors .

Figure 7: Annual Median Price Growth (As at February 2019)

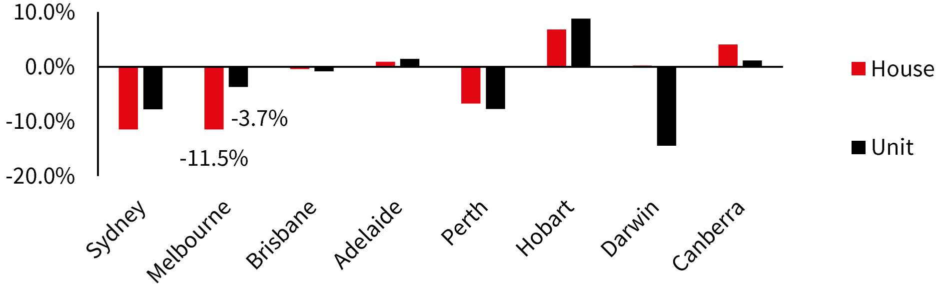


Figure 8: Annual Median Price Growth – Greater Melbourne (As at November 2018)

	Hot Suburbs (Annual Price Growth)		Cold Suburbs (Annual Price Growth)	
	Houses	Units	Houses	Units
Overall[1]	1. Warburton	1. Thornbury	1. Malvern	1. Malvern East
	2. Kurunjang	2. Sydenham	2. Armadale	2. Caulfield South
	3. Sunbury	3. Northcote	3. Malvern East	3. Caulfield North
	4. Whittlesea	4. Maidstone	4. Hawthorn	4. Mitcham
	5. Melton	5. Pakenham	5. Box Hill	5. Carnegie
Affordable[2]	1. Warburton	1. Sydenham	1. Delahey	1. Prahran
	2. Kurunjang	2. Pakenham	2. Albanvale	2. Springvale
	3. Sunbury	3. Sunbury	3. Deer Park	3. Windsor
	4. Melton	4. Thomastown	4. Hastings	4. Travancore
	5. Melton South	5. Werribee	5. Cranbourne East	5. Box Hill
Prestige[3]		1. East Melbourne	1. Malvern	1. Balwyn
			2. Armadale	2. South Yarra
			3. Malvern East	3. Toorak
			4. Hawthorn	4. Ivanhoe
			5. Brighton	5. Camberwell

Source: Corelogic, JLL Research

Rental Market

Rental yields are beginning to show signs of softening

Rental growth has slightly moderated on the back of a slight increase in vacancy. However, rents are still growing as prices decline, resulting in a slight softening in yields.

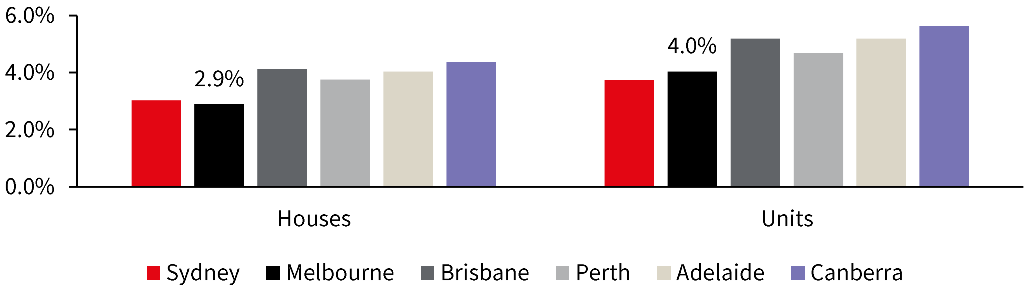
- Greater Melbourne rental vacancy increased slightly from 2.1% in January 2018 to 2.2% in January 2019. In this same period, Inner Melbourne vacancy has also increased from 1.9% to 2.1% reflecting increased pressures from strong supply in this area.
- Greater Melbourne median weekly rents grew 2.3% and 2.5% y-y for houses and apartments respectively over the year to February 2019.
- Most of the strong performing suburbs are middle-ring suburbs such as Balwyn, Mont Albert and Elsternwick.
- A number of traditionally high demand suburbs (many of which fall into the prestige category) saw declines in rents in the past 12 months. For houses this includes Toorak and Caulfield. For units, this includes Alphington and Cremorne.
- So far, the introduction of the Vacant Residential Property Tax (VRPT) in January 2018 has had little impact to date. The purpose of the tax is to encourage more investors to put their properties on the rental market. Enforcement has so far been unclear, but may be improved this financial year, leading to a potential increase in rental stock. Conversely, as investor purchasers decline, the amount of future rental supply entering the market is likely to be limited, which may balance the potential impact of this tax.
- Rental yields marginally increased 1 bps for houses to 2.9% and remained stable at 4.0% for units over the quarter. In the medium term, yields are likely to rise largely on the back of price declines.

Figure 9: Median Weekly Rental Rates and Vacancy (all dwellings)

	Hot Suburbs (Annual Rental Growth)		Cold Suburbs (Annual Rental Growth)	
	Houses	Units	Houses	Units
Overall[1]	1. Mont Albert	1. Ashburton	1. Hampton East	1. Blackburn South
	2. Patterson Lakes	2. Williamstown	2. Toorak	2. Alphington
	3. Balwyn	3. Edithvale	3. Caulfield South	3. Black Rock
	4. Diggers Rest	4. Macleod	4. Caulfield	4. Cremorne
	5. Elsternwick	5. Laverton	5. Black Rock	5. Strathmore
	Greater Melbourne (2.3%)	Greater Melbourne (2.5%)	Greater Melbourne (2.3%)	Greater Melbourne (2.5%)

Rental Vacancy (All Dwellings)			
Greater Melbourne	Inner (0-10km)	Middle (10-20km)	Outer Melbourne
2.2%	2.1%	3.3%	1.5%

Figure 10: Capital City Gross Rental Yields (as at November 2018)



Source: Corelogic (August 2018), REIV (October 2018), JLL Research,

Outlook

Strong economic fundamentals are likely to limit the severity of the current residential downturn.

Prices are anticipated to fall further before stabilising. However, growth is unlikely to reach the same high level as the previous peak of the market for an extended period of time

- Positive economic conditions will support underlying dwelling demand– Continued economic growth, declining unemployment and strong population growth suggest a positive outlook for the Victorian economy. A solid pipeline of infrastructure projects and strong performance in other sectors should somewhat alleviate the length and extent of the current downturn.
- Supply will be limited by development funding constraints - While there is a strong supply pipeline of projects, many of these will not eventuate as pre-sales remain difficult to obtain in the current low demand environment. Banks will also remain hesitant to fund residential projects considering current residential conditions.
- There is some uncertainty in the rental market, but moderate growth will continue– Rents will continue to rise as vacancy remains low. There is some concern over the vacant property tax which may slow growth. Rental demand is likely to continue on the back of job and education-driven population growth.
- Prices will decline further in 2019– Current credit conditions and negative sentiment are likely to persist over the next 12-months, which will continue to weigh on residential prices. Growth will return in the medium-term, but it is unlikely to reach the same strong levels of growth seen at the top of the recent cycle as investor demand is unlikely to come back to its previous levels.

Figure 11: Melbourne Residential Outlook (next 12 months)

Hot topic

Residential foreign investment has declined sharply

Recently released data by the Foreign Investment Review Board (FIRB) shows that foreign investment into Australian residential real estate fell 58% in FY2018. FIRB approvals for residential real estate peaked in FY2016 totalling $72.4 billion. Since then approvals have fallen around 83% with just $12.5 billion of residential investment recorded in FY2018.

Victoria and NSW remain the key residential markets for foreign capital (Figure 12). While both these markets previously experienced a long period of strong investor-driven growth, it is evident that this drop-off in foreign investment has contributed to recent price declines. NSW has seen a particularly pronounced decline in FIRB approvals. NSW accounted for 32% of residential real estate approvals (by volume) in FY2016, but only accounted for 23% in FY2018.

FIRB's recent report suggests that foreign resident land tax and stamp duty increases, FIRB application fees, domestic credit restrictions and capital outflow restrictions in home countries have all been factors in dampening foreign demand. Chinese investment into real estate has particularly slowed which reflects China's additional capital outflow controls on top of Australian foreign investment controls. Total Chinese real estate investment (including commercial real estate) declined from $39.9 billion in FY2016 to $12.7 billion in FY2018.

The report also highlights that there has been a large decrease in 'new dwelling' investment approvals. At the peak of the cycle, foreign buyers were recognised as the key purchasers in many new apartment developments. However, pre-sales activity has now cooled significantly, reflecting this drop in foreign investment activity.

It is unlikely that foreign investment into residential real estate will return to it's previous levels in the near future. Stamp duty decreases and FIRB application fee relief may stimulate foreign investment again, but it is unlikely that the Federal and State Government will make these changes for some time, if at all.

Figure 12: Foreign residential investment by state (FY2018)

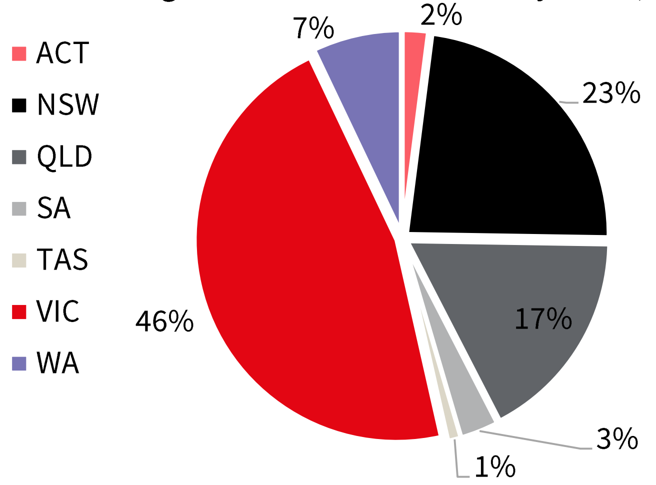
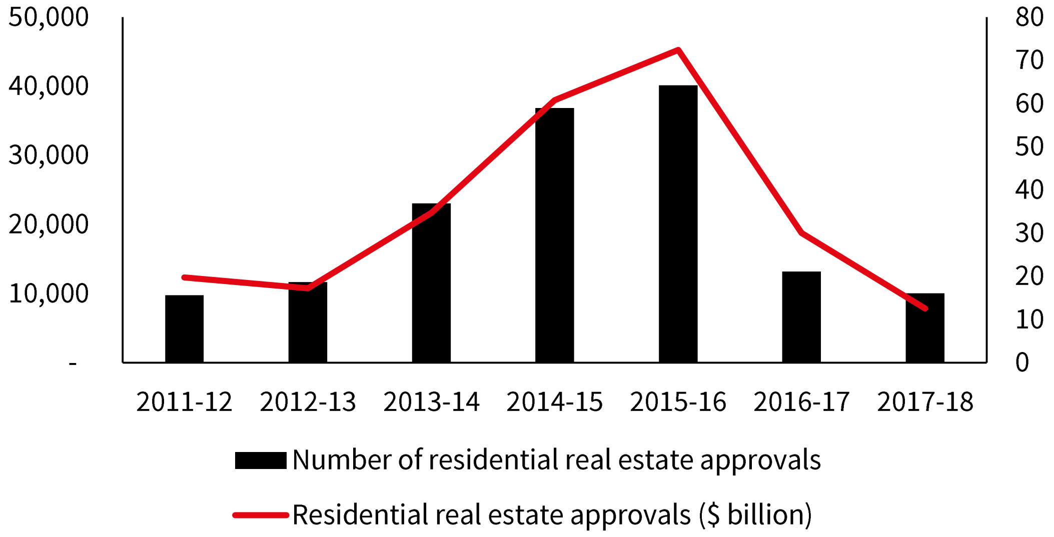


Figure 13: Foreign residential investment



Source: FIRB, JLL Research

Data Dictionary

Melbourne Residential Market

1. Overall – Refers to Greater Melbourne Residential Market.
2. Affordable – Refers to the bottom 10% of suburbs in Greater Melbourne as measured by the Median value.
3. Prestige – Refers to the following suburbs:
    - Houses – Albert Park, Armadale, Balwyn, Brighton, Camberwell, Canterbury, Deepdene, Eaglemont, East Melbourne, Hawthorn, Hawthorn East, Kew, Kew East, Kooyong, Malvern, Malvern East, Middle Park, Mont Albert, South Yarra, Surrey Hills, Toorak
    - Units - Albert Park, Balwyn, Brighton, Brighton East, Camberwell, Canterbury, Deepdene, East Melbourne, Hampton, Hawthorn East, Ivanhoe, Kew, Kew East, Kooyong, Middle Park, Mont Albert, Port Melbourne, Toorak
4. AVM – refers to CoreLogic's Automated Valuation model and refers the median value of all properties across the geography based on the AVM Model

Contact Us

Research

Leigh Warner
National Director
Head of Residential Research
leigh.warner@ap.jll.com
+61 7 3231 1445

Louise Burke
Analyst
Strategic Research
louise.burke@ap.jll.com
+61 3 9672 6433

Valuations and Advisory

Matthew Singleton
Senior Director
Head of Residential Valuations – Australia
Matthew.Singleton@ap.jll.com
+61 412 032 521

Jeremy Marsden
Director
Residential Valuations VIC
jeremy.Marsden@ap.jll.com
+61 419 366 381

Disclaimer