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News release

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Demand for inner Melbourne apartments showing some signs of life but it's not rosy yet

The global financial crisis is setting the scene for the next upturn in the inner Melbourne apartment market[1], according to leading industry analyst and economic forecaster, BIS Shrapnel. The company says low interest rates and very low vacancy rates, which are driving rising rents and high rental yields, will entice investors back into the market from late 2009.

According to BIS Shrapnel's *Inner Melbourne Apartments, 2009 to 2016* report, sharp reductions in interest rates over 2008/09 to well below six per cent has seen the gap between rental income and mortgage repayments narrow dramatically, which has significantly improved the equation for investors.

BIS Shrapnel senior project manager and report author, Mr Angie Zigomanis says a deficiency of rental apartments has rapidly emerged since the apartment boom from the start of the decade levelled out in 2006. The vacancy rate is now hovering at around one per cent, which has underpinned rental growth of, on average, 10 per cent per annum over the past three years, outpacing price growth and resulting in improved yields for investors.

"Despite these conditions, an upturn in prices and construction is being delayed," he says. "Investors currently remain reluctant to re-enter the market and purchase off-the-plan apartments. "Residential prices declined over 2008 and, although there have been signs of stabilisation in 2009, we believe that investors need to be confident that prices have bottomed out and growth is returning before they dip their toe into the apartment pool."

In the mean time, BIS Shrapnel forecasts strong rental growth will continue. New apartment completions fell from a peak of just under 4,000 in 2005/06, to less than 1,000 in 2007/08. The credit crisis has constrained the availability of funds for developers to start new projects, which will limit any quick turnaround in apartment construction.

"We are forecasting an average of 1,500 apartments per annum to be completed over the three years to 2010/11," says Zigomanis. "This is well below the previous ten year average of 2,650 apartments per annum, with the shortfall likely to lock in further rises in rents of between five and ten per cent per annum."

BIS Shrapnel expects price growth in the short-term will be limited due to the current economic downturn. However, this will underpin increasingly attractive rental yields stemming from strong rental growth.

1 The inner Melbourne area includes the following areas: the CBD precinct, the University precinct, Southbank, the Docklands, St Kilda Road, Port Melbourne and the St Kilda precinct

"While interest rates remain low the purchase equation is becoming more appealing to investors," says Zigomanis. "Low rates and rising rents are closing the gap between rental income and mortgage repayments. For investors buying a new apartment, the additional tax deductions available will likely result in some apartments being cash flow positive on an after tax basis."

As a result, BIS Shrapnel believes that investor demand and apartment pre-sales will show some signs of life towards the end of 2009, when it becomes evident that residential prices have bottomed. Yield-seeking investors will lead the upturn. Demand will pick up in 2010 as the economic outlook becomes more positive. It will then gather momentum in 2011 as the improvement in demand results in stronger capital growth.

Ultimately, investor demand will continue to increase on the back of stronger price growth over the following two to three years, with BIS Shrapnel forecasting total growth in apartment values of around 30 per cent over the 2009 to 2014 period. Given the current weakness in the market, and the time taken for demand to pick up, price growth will be limited in the short term, and most of this growth will occur over the latter part of this period.

"Unlike the past few years, it will be investment-grade apartments that will lead the upturn, as demand for these apartments benefits from improved rental returns and lower interest rates," says Zigomanis. "Stronger price growth for higher priced apartments will come through later in the cycle.

"The key driver of the more expensive apartment market segment is empty nesters who trade down from their current house to a smaller dwelling. Demand from this group will accelerate later in the cycle when they become more confident about the market into which they will be selling their existing house."

The CBD and Southbank precincts are expected to receive the bulk of new apartment supply during the five years to 2015/16, while the St Kilda precinct will receive the least amount of new apartment development. While strong price growth will be expected across the board, BIS Shrapnel anticipates those precincts with higher owner-occupiers and less potential for new supply – Port Melbourne, St Kilda road, and St Kilda – will perform better over the next five years.

The CBD, University, Docklands and Southbank precincts will not perform as well due to the high proportion of investor-grade apartments creating rental competition, and the potential for significant additional construction to take place in these areas.

By June 2016, BIS Shrapnel estimates inner Melbourne apartment stock will equal 68,000 apartments, which represents the construction of approximately 2,600 apartments per annum during the next seven years – roughly equivalent to the average construction levels seen during the last 10 years.

"Due to the time lag for off-the-plan sales to completion of apartments, the forecast recovery in investor demand from 2009/10 will not be reflected in a significant increase in new apartment completions until 2011/12, with strong growth in supply occurring over the following years," concludes Zigomanis. "This will ensure the continued deficiency of rental stock and solid rental gains for landlords."

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 45-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting.

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