

News Release

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New housing market to improve after stalling in 2010/11

Stable interest rates and improved economic conditions will support the land market, but lot production in Melbourne and Adelaide expected to weaken

Leading industry analyst and economic forecaster, BIS Shrapnel, expects the beginning of a recovery in new lot production from 2011/12 across Sydney, south-east Queensland and Perth over 2011/12, while lot production in Melbourne and Adelaide will continue to weaken.

According to BIS Shrapnel's *Outlook for Residential Land, 2011 to 2016* report series, new house and land activity softened or fell in all major markets in 2010/11, due to the expiry of the First Home Owner's Grant Boost Scheme, the sharp interest rate rises in 2009/10 (and further rise in November 2010), and slowing economic growth through the year.

However, this decline is creating a rising undersupply in a number of markets, and with an improved interest rate outlook and strengthening economic conditions expected over 2011/12, new house and land activity will begin to recover in those markets where the deficiency will be most pronounced.

Senior project manager and report series author, Mr Angie Zigomanis, says the expiry of the First Home Owner's Grant Boost Scheme had a significant impact on new lot production during 2010/11 – not only directly through the decline in demand from first-home purchasers themselves, but also indirectly as weaker demand for entry level dwellings prevented upgraders from selling their dwellings to purchase a new house.

"Following the expiry of the Boost Scheme, first-home buyer demand in 2010/11 was around half that of the stimulus-induced peak of calendar 2009, reflecting the pulling forward of demand to take advantage of the incentive," says Zigomanis.

The report series found that, with the exception of Sydney and Perth – where activity is still modest – all capital city and south-east Queensland markets reported a fall in lot production in 2010/11. After record lot production in Melbourne and new record levels in Adelaide in 2009/10, any pent up demand pressures have now well and truly eased, and activity is slowing. Lot production in the south-east Queensland markets of Brisbane, the Gold Coast and Sunshine Coast has collapsed to long term lows, reflecting the underlying oversupply of dwellings across the region.

"However, there is light at the end of the tunnel," says Zigomanis. "A rising deficiency is developing in a number of markets, while a benign interest rate outlook will see purchaser confidence begin to return, particularly with the flow on effects from rising resource investment forecast to permeate through the rest of the economy from 2012.

"First home buyer demand also appears to have bottomed out, with the 'pull forward' effect created by the First Home Owner's Grant Boost Scheme having been largely worked through. We expect a slow recovery in first-home buyer demand through 2012, which will help to underpin upgrader demand for new houses and land."

BIS Shrapnel says this should see the residential land market pick up nationally over 2011/12, and accelerate over 2012/13 as economic growth also strengthens. The upturn will be focused in Sydney,

Perth and south-east Queensland, which are building new dwellings well below the level required by population growth and where the underlying dwelling deficiency is increasing or, in the case of south-east Queensland, will emerge.

In contrast, new dwelling construction in Melbourne and Adelaide has been at, or close to, record levels, resulting in their dwelling deficiency shrinking, and moving into a possible oversupply. In these markets, lot production will continue to decline from their extremely high levels, although will remain relatively high in a long term sense.

“Pent up demand in those markets where there is a rising deficiency will be supported by a stable interest rate environment as well as rising employment and income growth from a recovery in economic conditions, which will help confidence return to the market through 2011/12,” says Zigomanis. “This will stimulate activity in housing markets and consequently land markets. Nevertheless, new house and land activity will vary nationally, depending on overall affordability in each market, and the level of pent up demand.”

However, BIS Shrapnel warns the environment for new house demand, and therefore the demand for land, will begin to deteriorate over 2013/14 as interest rate rises eventually have an impact across all markets. The gains in employment and income growth up until then will overcome some of the initial rises and will continue to support activity. But as inflationary pressures become more acute as the resource investment boom peaks and creates skills shortages and wages pressure, a sharp tightening in interest rates is expected, taking the standard variable rate to a forecast peak of 8.75 per cent in the first half of 2014. This will have a negative impact not only on residential demand, but the economy as well, with residential activity forecast to enter a downturn over 2014/15.

Outlook for lot production by region

Sydney

After falling to a low of around 1,500 lots in 2008/09, lot production in outer Sydney has picked up to be closer to 3,000 lots per annum over the two years to 2010/11. Still, this is well down from the peak of nearly 9,000 lots in 1999/2000.

Despite low levels of new construction creating a significant underlying undersupply of dwellings, lot production in Sydney has been stymied by the high cost of purchasing a new house relative to purchasing an established dwelling. However, affordability in Sydney has improved in Sydney after prices have generally stagnated since peaking in real terms in 2004. Prices for established houses in outer Sydney have also shown recent growth (partly supported by the First Home Owner’s Grant Boost Scheme, although price levels have since been sustained despite the expiry of the Boost), which has underpinned an improvement in upgrader demand and with it demand for new houses and land.

“The rise in prices for established houses in outer Sydney has meant the premium required to purchase a new house compared to an established house has narrowed,” says Zigomanis. “Consequently, upgraders have become more willing to sell their current dwelling to purchase a brand new house on a new subdivision.”

As a result, BIS Shrapnel estimates land production has increased to around 3,000 lots per annum over the last two years. As well as increased demand, developer activity has also been assisted by a reduction in State Government levies, which has allowed developers to proceed with some of those developments that were made marginal when these imposts were introduced. The upturn in lot production initially emerged in north-west Sydney – where incomes are higher and the premium to purchase a new house over an established house in the region is narrower – and is now expanding to the other new home region of south-west Sydney. Lot production on the Central Coast has only shown a mild pick up.

The overall Sydney upturn is forecast to continue to gain momentum, with forecast price growth for established dwellings, underpinned by a significant deficiency of dwellings and further strengthening of economic conditions and income growth, improving the relative affordability of new housing. Lot production is expected to rise to a peak of 6,100 lots by 2013/14 as outer Sydney accommodates much of the upturn in new house activity. This is still below the 7,600 lots per annum average over the five years to 2001 and reflects the still-high cost of land, which will maintain the shift to less expensive medium and high-density dwellings and infill and knockdown development in established areas.

Perth

Lot production in outer Perth peaked at 12,300 lots in 2005/06, and has since fallen to well below this level. This peak was underpinned by a booming local economy, which drove increased migration inflows and strong wages growth. BIS Shrapnel estimates that this took the land market into oversupply, driven by a 143 per cent increase in the median house price and a 205 per cent increase in the median land price from 2002 to 2007. Combined with the impact of rising interest rates, which peaked in 2008, affordability for housing and land also deteriorated significantly, causing lot production to move into a downturn from 2006/07.

The impact of the GFC and constraints on finance also had a negative impact and lot production more than halved to less than 6,000 lots in 2008/09 and 2009/10.

“This period of weak lot construction has resulted in excess land on the ground now being largely absorbed,” says Zigomanis. “As a result, lot production is estimated to have increased to over 7,000 lots in 2010/11, despite a decline in new house commencements during the year”

Land affordability in Perth is also slowly improving. Similar to the Sydney market, land prices in Perth also overshot the mark at their peak. However, in contrast to Sydney, where high government charges meant that developers could not reduce prices to ‘meet the market’, median land prices in outer Perth and Peel are now six per cent below their peak (and 14% lower in real terms), and with incomes rising, new housing is slowly becoming more affordable.

The combination of more affordable land and an improved interest rate outlook should see concerns about affordability in Perth somewhat ease. At the same time, strengthening population growth on the back of strong state economic growth is seeing a rising underlying deficiency of dwellings emerge, as evidenced by tightening vacancy rates. These factors will drive an upturn in house prices and new dwelling demand in Perth from 2011/12, translating into rising demand for land.

Lot production is consequently forecast to rise and peak at 11,800 lots in 2012/13 and remain high in 2013/14 – just below the 2005/06 peak – as population and income growth in Perth is driven by the return to booming conditions in the resource sector. Nevertheless, a forecast peak in interest rates in 2014 will weaken affordability, resulting in demand for new houses and land decreasing more sharply over 2014/15.

Brisbane

New house activity and lot production in Brisbane has fallen considerably since peaking during 2007 and 2008. The affordability issues that had emerged after strong price growth up to 2008 have persisted, while weak economic conditions in Queensland are also impacting on confidence and population growth.

“Compared to the other capital cities, the low interest rates of 2008/09 and the introduction of the First Home Owner’s Grant Boost Scheme had little impact on new house activity, and housing starts and lot production in 2010/11 in Outer Brisbane was at its lowest level since 2001,” says Zigomanis. “The Brisbane market has been dampened by a combination of excess dwelling supply, weak state economic conditions, declines in overseas and interstate migration inflows, and some strains on land price affordability.”

BIS Shrapnel says any upturn in the Brisbane market is expected to lag, with new house and land activity remaining subdued in 2011/12. However, this weakness will also result in the excess dwelling stock being absorbed and a rising deficiency emerging. This deficiency will drive greater demand for new dwellings which will strengthen more considerably from 2012/13 as the next round of big investment in resource projects ramps up and begins to contribute more significantly to the Queensland economy.

However, a forecast peak in the standard variable rate of 8.75% in the first half of 2014 will curtail the upturn before it can gain too much momentum, with lot production in outer Brisbane forecast to rise to a peak of 6,800 lots in 2013/14; still below the peak in lot production in 2003/04 and other peaks in the mid-1990s.

Gold Coast

Demand for land on the Gold Coast has collapsed after a peak of 3,500 lots was recorded in 2006/07. It is estimated that less than 1,000 lots were produced on the Gold Coast in 2010/11, which is the lowest level of lot production on the Gold Coast for at least the past 20 years.

Demand on the Gold Coast has also been impacted by strong house price rises up to 2008, which not only underpinned an excess of dwelling stock, but also reduced the region's affordability advantage over the eastern state capitals, and consequently resulted in a slowdown in interstate migration. Weak local economic conditions have also impacted on demand. The insertion of infrastructure charges has also affected the viability of developments that were bought at the peak of the market, and has stopped production of some subdivisions.

BIS Shrapnel expects minimal improvement in activity in 2011/12 while an excess dwelling stock remains in place and developers are still affected by the constrained financial environment. Although the very low level of new dwelling activity is resulting in excess stock being absorbed, a deficiency is not expected to emerge until 2012/13, slowing the pace of any upturn despite improving economic conditions across the state. As a result, lot production is forecast to experience only a moderate increase to a forecast peak of 2,200 lots in 2013/14, well below the peak in 2006/07. While recent price declines on the Gold Coast have seen affordability improve, it remains an issue and a forecast peak in interest rates in 2014 will cut off any upturn before it can fully play out.

Sunshine Coast

Sunshine Coast lot production fell to an estimated 1,600 lots in 2010/11, below the peak of 2,300 lots in 2007/08, which in turn was well below the previous high of 3,700 lots in 2003/04. BIS Shrapnel notes a key component of demand in the Sunshine Coast market is empty nesters aged 55 and over who sell their existing homes and embark on a sea change. However, after the substantial price rises on the Sunshine Coast up to 2003/04, the trade down value of the region had been somewhat reduced. Consequently, although house price growth and turnover improved in 2007, the recovery in lot production was more moderate in 2007/08.

The decline in lot production since 2007/08 has been driven by a combination of factors – weaker purchaser demand is resulting from reduced interstate migration, local economic conditions are depressed, and there have been constraints on funding for development since the GFC. New stock is also being added to the market via the sale of holiday home dwellings for occupation, or the return of holiday homes to the residential rental market as owners seek to obtain a return from their underutilised dwellings.

Growth in new housing activity is expected to be minimal in 2011/12, while lot production is forecast to slightly fall. A moderate upturn is forecast from 2012/13 as population growth on the Sunshine Coast begins to improve. The recovery in the Queensland economy in this period is expected underpin greater residential turnover in Brisbane, while the residential upturn in Sydney is also expected to gain momentum. This will again encourage empty nesters to sell up and migrate to the Sunshine Coast. Lot production is forecast to peak at 2,300 lots in 2013/14, similar to the levels in 2007/08, although still well below previous peaks.

Melbourne

Lot production in Melbourne's outer suburbs peaked at a record 18,900 lots in 2009/10, after the previous high of 18,700 lots in 2008/09. New housing demand in Melbourne was driven by record levels of population growth stemming from a peak in net overseas migration inflows and a net inflow from interstate migration. Together with relatively solid local economic conditions through the GFC, this has fuelled a high level of new housing activity. Compared to the other eastern state capitals, affordable land played a part in promoting demand for new housing.

"However, demand for new houses and land in Melbourne is now in decline, with around 17,700 lots estimated to have been produced in 2010/11," says Zigomanis. "Pent up demand from the record level of population growth is being satiated, while strong rises in land prices is resulting in some purchasers seeking more affordable established stock."

Lot production is forecast to continue to weaken. Improving economic conditions driving solid underlying demand, together with some lingering dwelling deficiency, will slow the decline to around 16,000 lots by 2012/13. However, a forecast peak in interest rates in 2014 will underpin a stronger downturn from 2013/14, with lot production in the 13,000–15,000 lots per annum range over the subsequent three years. While this is well down on the level of lot production in recent years, it reflects the unsustainable level of activity that has taken place and is more reflective of the level of underlying demand anticipated in the future.

Adelaide

In line with the improvement in residential construction activity, lot production in outer Adelaide has increased from around 3,000 lots in 2004/05, to an average of nearly 4,000 lots per annum over 2008/09 and 2009/10. This increase was underpinned by strengthening underlying demand in the Adelaide market due to significant increases in overseas migration inflows. This sustained period of strong activity has resulted in a mild excess of dwellings emerging in Adelaide, and together with the weaker economic environment over 2010/11, lot production has fallen to an estimated 2,500 lots during the year.

The improved interest rate outlook and strengthening economic growth nationally should maintain lot production at this lower level through to 2013/14. This level of activity translates to new supply running just below the estimated level of underlying demand, and by this time an underlying dwelling deficiency is expected to be re-emerging, which should underpin the following upturn. The subdued environment over the next few years is also expected to result in only minimal increases in land prices.

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

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