Melbourne Housing Market 2017 - A Snapshot

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Industry Update

Executive Summary

Melbourne has witnessed price growth of 15.9% for FY 2016-17 and quarterly growth of 1.8% QoQ till Aug’17. The market continues to grow at a rapid pace and will perform better than Sydney in the short term.

Resilient housing market

The Melbourne housing market continues to expand and is being resilient to the slowdown of the Australian housing market. The last year has seen rising prices at a rapid pace of 15.9% and by 9.7% YTD. This is primarily due to low levels of housing stock and no affordability concerns. Although there will be some correction in prices over the next few months in the wake of stricter regulations and lesser foreign demand, the prices will not stop rising. Since the prices are much lower and the supply – demand gap not as wide as Sydney, the price correction will not be much.

Better affordability than other Australian cities

A key difference between the Sydney & Melbourne markets is affordability. Sydney has a higher cost of living index than Melbourne and hence the average population of Melbourne has greater disposable income. Coupled with it is the higher average wage rise of 2.6% in Melbourne in the last five years and a strong State Final Demand growth of 4.5% in the last year.

Cheaper market to enter than Sydney

Melbourne has an avg. per sq. ft. price of ~550 AUD, which is cheaper than Sydney and Canberra, the two most expensive markets. This makes it an attractive option to invest at a lower risk.
The Macro Outlook

**Increasing mortgage rate & stricter rules for foreign investors**

A rising mortgage rate and tightening of government laws, especially for foreign investors should see a slight reduction in foreign demand, especially Chinese investment.

A **50 per cent** cap on the number of new developments sold to foreign investors included in May’s federal budget is also a discouragement, alongside tightening currency controls in China, which is the primary source of foreign investment in Australia’s housing market.

The nation’s biggest banks have this year raised minimum deposits, tightened eligibility requirements and increased rates on interest-only mortgages -- a form of financing favoured by people buying homes to rent out or hold as an investment.

**Changes in taxation & incentives by government**

In the past two years alone, the Victorian government introduced a **3 %** stamp duty surcharge for foreign buyers and then more than doubled it to **7 %**. The axing of stamp duty concession for off-the-plan properties from July 1 for investors have increased taxes further.

**Chinese government tightens money transfer rules & restricts overseas investment in real estate**

Banks are cautious in lending money to first time buyers and at the same time Chinese banks are tightening money transfer rules so Chinese investors are finding it difficult to get their money out of China. The Chinese government announced sometime in mid-August that it will restrict foreign investments in sports clubs, real estate and entertainment and other areas.

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**Industry at a Glance**

**Key Statistics**

<table>
<thead>
<tr>
<th>Housing Market Size (Till Q2'17)</th>
<th>Annual Growth</th>
<th>Average Price Per Sq. Ft.</th>
</tr>
</thead>
<tbody>
<tr>
<td>65.4 ($B)</td>
<td>-13%</td>
<td>550 USD</td>
</tr>
</tbody>
</table>

**Capital Appreciation**

<table>
<thead>
<tr>
<th>Capital Appreciation (Annual)</th>
<th>Capital Appreciation (Quarterly)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.9%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

**Investment Returns & Risk**

*Size of bubble indicates current price per sq. ft.*
Melbourne Micro-Markets

Melbourne Outer Ring Suburbs-
Shire of Cardinia, City of Casey, City of Frankston, City of Greater Dandenong, City of Hume, City of Knox, City of Marrickville, City of Melton, Shire of Mornington Peninsula, Shire of Nillumbik, City of Whittlesea, City of Wyndham, Shire of Yarra Ranges

Melbourne Middle-Ring Suburbs-
City of Banyule, City of Bayside, City of Barwon, City of Brimbank, City of Darebin, City of Glen Eira, City of Hobsons Bay, City of Kingston, City of Manningham, City of Maribyrnong, City of Monash, City of Moonee Valley, City of Moreland, City of Whitehorse

Melbourne Inner-Ring Suburbs
City of Melbourne, City of Port Phillip, City of Yarra, City of Stonnington
Top Locations for Investment

A number of factors play a crucial role in deciding which location to choose for housing investment. Below are the most important ones:

1. New building approvals
2. Infrastructure development

Melbourne ranks no. 1 in the most liveable cities list and is primarily because of the extensive road & rail networks linked to airports & seaports coupled with comparatively lower cost of living index.

The Victorian Government has committed to improving Melbourne’s world-class transport system. The new ‘Melbourne Metro Rail’ will include a nine-kilometre twin rail tunnel from Melbourne’s south, under the city centre, through to the university and health precinct in the city’s north.

The inner ring suburbs have witnessed the maximum returns over the last three years and will continue to be a safe investment. However, to diversify the investment portfolio some of the upcoming areas are the ones with maximum new buildings either approved or forecasted to be constructed over the next 6-12 months.

As per the latest numbers published by the Australian Bureau of Statistics, the following locations have seen the most number of building approvals in the last 6 months and have a similar outlook in the next few months.

Prices are likely to increase further over the short-term but at a much slower pace.

The returns for the micro-markets within Greater Melbourne would be around 11.74% for the city, 22.68% for Inner Ring, 11.54% for the Middle Ring and 4.88% for the Inner Ring for the next 3 years.

Industry Performance

Industry Outlook

Price to stabilize in next 4-6 months and then rise

The outlook for Melbourne is similar to Sydney with a slight correction expected in prices over the next 4-6 months to bring the prices to equilibrium. Post that growth will be moderate and the property market will be at the bottom of the cycle, followed by declining prices in 2018. The housing prices in Melbourne have moved up by 0.5% compared to 0% in Sydney in the last month. However, there would be modest price reductions in the next few months.

Chinese buyer demand up in Melbourne, but down nationally

Melbourne holds the biggest share of Chinese investments in the last year followed by Sydney. While the other Australian cities are seeing decline in Chinese investments, Melbourne seems to have stolen away the demand. What works for the Melbourne market is the lifestyle advancements and educational opportunities prevalent in the city. Hence, the price correction will not be huge.
Although Melbourne does not have a supply crisis per se, the population growth per annum is highest amongst the other major cities in Australia. Hence To ensure ongoing supply, the Victorian Planning Authority will work with councils to **complete 17 precinct structure plans** by December 2018.

**Key Statistics**

**Price & Rental Yields (% pa)**

<table>
<thead>
<tr>
<th>Market</th>
<th>Rental Yields (+)</th>
<th>3 year capital appreciation (+)</th>
<th>1 year capital appreciation (+)</th>
<th>Vacancy(-)</th>
<th>GDP (factored)</th>
<th>Transaction Cost(-)</th>
<th>LTV(+)</th>
<th>Cost of Capital(-)</th>
<th>Capital Gain Tax (-)</th>
<th>Rental income Tax (-)</th>
<th>PSF (-) (USD)</th>
<th>Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inner Ring</td>
<td>2.60%</td>
<td>18.50%</td>
<td>20.00%</td>
<td>2.00%</td>
<td>4.50%</td>
<td>7%</td>
<td>70%</td>
<td>4.35%</td>
<td>32.50%</td>
<td>32.50%</td>
<td>680.84</td>
<td>22.68%</td>
</tr>
<tr>
<td>Middle Ring</td>
<td>2.00%</td>
<td>13.60%</td>
<td>14.00%</td>
<td>3.00%</td>
<td>4.50%</td>
<td>7%</td>
<td>70%</td>
<td>4.35%</td>
<td>32.50%</td>
<td>32.50%</td>
<td>412.34</td>
<td>11.54%</td>
</tr>
<tr>
<td>Outer Ring</td>
<td>4.00%</td>
<td>8.30%</td>
<td>8%</td>
<td>1.80%</td>
<td>4.50%</td>
<td>7%</td>
<td>70%</td>
<td>4.35%</td>
<td>32.50%</td>
<td>32.50%</td>
<td>228.04</td>
<td>4.86%</td>
</tr>
<tr>
<td>Melbourne City</td>
<td>2.70%</td>
<td>13%</td>
<td>15.90%</td>
<td>1.70%</td>
<td>4.50%</td>
<td>7%</td>
<td>70%</td>
<td>4.35%</td>
<td>32.50%</td>
<td>32.50%</td>
<td>550</td>
<td>11.74%</td>
</tr>
</tbody>
</table>

**The Inner-Ring will witness maximum returns**

From an investor point of view, assuming the pricing, rental yield and vacancy rate fluctuations remain at their last 3 years average value, rate of returns from investing in Sydney’s key micro-markets are forecasted to be **11.74%** for the city, **22.68%** for Inner Ring, **11.54%** for the Middle Ring and **4.86%** for the Inner Ring for the next 3 years.
Conclusion

The prices in the short to medium term will stagnate and will then witness single digit growth by mid-2019. The pricing correction will be of a lesser magnitude than Sydney in the wake of reducing vacancy rates, better affordability and a slightly higher foreign demand in the recent months. **Mid to end 2018** will be a good time to invest in Melbourne property as they say that its always advisable to buy at the bottom of the cycle.

Chinese buyers account for around 80% of total foreign investment with Melbourne being the top destination for these investors. Although the recent regulatory changes have restricted Chinese investment, resulting in price correction, Melbourne is still seeing increased Chinese demand. This also brings an element of risk and needs to be monitored.

Melbourne is turning into a favored housing investment destination in Australia overthrowing Sydney. It is a cheaper market to enter with good returns and a brighter short to medium term prospect.

**Sources:** CBRE, NSW Housing, M3Property, Knight Frank, JLL