

## Property Market Report – May 2008

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### Maybe now the RBA will leave us alone

The Reserve Bank of Australia likes to see misery in the community. There is mounting evidence that its wish is coming true. Its interest rate rises, coupled with a staggering stockmarket and high petrol prices, are really starting to hurt.

The March rise was, I believe, the tipping point. The community, by and large, has absorbed the 11 previous increases (I'm not forgetting those who couldn't and have lost their homes) but the latest one came with us inundated by bad news.

We're now being fed a daily diet of negative news events: the faltering sharemarket, the credit squeeze, the global economy, falling demand in the Australian economy, employment declining, consumer confidence at a 15-year low, and business confidence down as well.

Adding to the growing sense of glumness has been the actions of the banks, which have lifted interest rates independent of the Reserve Bank moves. When the National Australia Bank lifted its mortgage rates late in March, it was the NAB's third rate rise in less than seven weeks, giving the bank a standard variable rate of 9.36%. All the major lenders now have standard variable rates above 9.2%, compared with the RBA's official cash rate of 7.25%.

Mortgage stress has been around for a while but now we're hearing of "affluent stress". According to the JPMorgan/Fujitsu Mortgage Industry Report, interest rate rises have combined with margin calls on share holdings and rises in private school fees to draw more affluent households into the web of those struggling to make ends meet.

So what does all this mean for property investors? The answer to that question lies in the "National Overview" section of this report. But, for now, it's likely we can get on with life without fear of further interest rate rises. If the RBA acts again soon, it is truly sadistic.

### **National Overview: When you extrapolate the past to predict the future, you often get it wrong**

Already we're seeing evidence that the predictions of many pundits for 2008 are unlikely to be fulfilled.

As I commented in the previous quarterly report, most analysts have been predicting more of the same for 2008 i.e. the "better" areas will continue to thrive and the poorer areas will again struggle with rising interest rates. In other words, for want of an original thought they were predicting the recent past.

There are strong indications that things will be different this year. The popular view that the top end of the market will just keep on rocking is rapidly evaporating.

The industry cliché that the prime areas always perform and always hold their value is just so much nonsense. The outstanding characteristic of the blue chip suburbs is their volatility. The typical pattern for a Top End suburb in any capital city is a roller coaster ride: sharp peaks and troughs. A couple of years of big growth are often followed by a few years of declining values. The past two years have been big for prime residential property but this year will see the heat dissipating and values falling in many areas.

There are other signs of change this year. Some of the cities which have been doing well are facing corrections. Canberra has been a very strong performer for a couple of years but is headed for a backslide. Darwin is headed for a hiccup too.

There are signs that the market generally will not be as buoyant this year as last year. There is evidence trickling in from various sources: Residex sees evidence of prices falling, RP Data says the market is being flooded with homes for sale, APM says auction clearances rates are contracting, while various measures of consumer and business confidence indicate it's heading rapidly south. The *Australian Financial Review* reports: "Residential property analysts agree the market has quickly slowed nationwide, but are split over whether prices have fallen."

Amid all of this, it's a time of opportunity for property investors. It may not feel much like it, but I believe the current climate of rising interest rates benefits property investors. Higher rates are bad news for home owners and even worse news for renting households which aspire to home ownership. But for investors who already own property and want to own more, the current environment tips the balance in their favour.

Each rise makes it harder for renters to become owners. Each rise turns owners into renters (those who lose their homes because they can't meet the repayments any longer). Over time there are fewer home owners and more renters. Investor owners can raise rents to cover (or partly cover) the higher interest costs because vacancies are low everywhere.

This is likely to continue for some years. Economic forecaster BIS Shrapnel sees home prices and rents rising significantly in the next five years because the existing shortage of housing is expected to worsen considerably.

BIS Shrapnel predicts house prices will rise as much as 40% across the nation in the next five years, because of a growing shortage in housing. The firm's chief economist Frank Gelber says housing affordability is already at record lows but will go even lower because demand is much higher than supply.

Underlying demand is 182,000 new dwellings per year but only 150,000 are being built. NSW has the biggest shortfall, but Victoria is only slightly better. Gelber's says there will be a national shortfall of 60,000 dwellings by June and 129,000 by mid-2009. "We need to build more houses," he says.

Rising interest rates are compounding the problem by discouraging new home construction. "When interest rates stop rising or eventually start to fall, it's likely there will be a surge in demand for housing that could result in a price explosion," Gelber says.

The ANZ Bank, in its latest *Australian Property Outlook* report, tends to agree with that assessment. It says: "A dramatic tightening of the housing market will force already-soaring house prices and rents sharply higher. By 2010 we project a record housing shortage of nearly 200,000 homes which risks becoming an intractable imbalance as renters and first home buyers become collateral damage in the Reserve Bank's ongoing war on inflation.

"A flight to quality will add to the weight of money that is driving residential (and other) property markets higher.

"This is extremely bad news for both first home buyers and renters, as houses are no different to bananas - in that, when there is a shortage, prices are likely to rise. However, unlike bananas, the necessary rebound in housing supply will be far more difficult to achieve and house prices are therefore unlikely to fall."

### **You don't make money buying in peak markets**

"Whyalla is the best place to buy an investment property!" shouted *The Advertiser* newspaper on 23 March. In making this bold statement, it encapsulated everything that is wrong with the way property investors receive information and make decisions about where to buy.

If the newspaper had said "Whyalla was a great place to buy an investment property a year ago" it would have been closer to the mark - and less likely to cause harm to readers.

The newspaper's statement was based on historical information. It was making the mistake media makes daily in reporting real estate. It receives data from research companies and real estate institutes which identify the places which have shown the highest price growth in the recent past - and then makes the monumental mistake of telling readers that this means they are the best places to buy in the coming year.

The newspaper report was based on a press release from Australian Property Monitors. The research company rated locations on their long-term capital growth, rental returns and days on the market - and concluded, using this highly-flawed technique, that Whyalla was the top place to buy in South Australia.

There are so many things wrong with this approach it's difficult to know where to start. Long-term growth in median prices is a factor worth considering because it may indicate a good track record, but it's riddled with uncertainty because of the unreliability of median price data. You can seek long-term price growth from three different research sources and be presented with three widely-variant answers.

Another problem is that one or two abnormal years can give a location a very healthy 10-year average which can be misleading. It depends when you do your sums. Whyalla would have a healthy 10-year average right now because the last two years have been boom years. If you'd done your calculation three years ago it would have had a poor long-term average because the town had been in long-term decline - before the resources boom turned things around.

Similar problems exist in data on median rental returns. They're probably the most flawed statistics of all those presented by property research companies. I could fill a book with examples where research companies have quoted a 6.5% gross rental return as typical for a location - but when I've looked at homes currently for sale I've been unable to find a single instance of a tenanted property showing a return that high - or anything remotely close to it.

After long experience investigating these statistics - including speaking to property managers and other market professionals - I can tell you that most of these numbers are nonsense.

Also reeking inconsistency and unreliability is the data on "days on the market". I've seen examples where one research company claims houses in an area typically sell in 25 days while a rival firm says 130 days. I've seen locations where the research firm's data suggests the market is booming, with values soaring, but says average time on the market is 150 days. The two pieces of information are contradictory.

So if your equation comprises three sets of statistics, each of which is flawed, you're going to end up with a nonsense answer.

The truth about Whyalla is that it was a good place to buy 1-2 years ago. I had in on my Top Ten lists for South Australia and National Boom Towns. I've taken it off both lists because it's no longer a future hotspot. There's little point telling people to buy there now because it's already had exceptional price growth.

The same foggy logic led APM to nominate Parramatta as the top investment location in Sydney. Parramatta! I've just completed my list of the No Go Zones - the worst places to invest in property in Australia - and the Parramatta precinct is right at the top of the list: prices are still falling, the long-term growth record is poor, there's a high rate of home re-possession, serious crime is rife and it's at the leading edge of social disadvantage. You just don't want to invest in these sorts of places.

Based on the research company's logic one of the best places to buy would be Mount Isa in Queensland. This highly buoyant mining town of 20,000 has suburbs where prices grew 50%

last year. The rationale proposed by *The Advertiser* and other newspapers dictates that we should all rush out and buy a house in Mount Isa.

The truth is that investors should avoid Mount Isa. Two years ago I had the western Queensland icon on my Top Ten list for national Boom Towns. Not any more. Today it's close to the top of my national list of No Go Zones. Mount Isa is no longer a good buy. It's had 2-3 years of phenomenal price growth and it no longer represents good value. A couple of years ago you could buy cheaply and enjoy an 8% income return as well as high capital growth. Today you'd be lucky to get a 4.5% return, not much better than a capital city.

The other turn-off with Mount Isa is that it is attracting the wrong kind of publicity with growing pollution and health problems. Like Port Pirie in South Australia and Esperance in Western Australia, there's alarming news about blood lead levels among kids in Mount Isa. The health consequences of lead poisoning are serious, sometimes fatal, and this is not conducive to capital growth. In Esperance the lead pollution issues almost shut the town down. But the equations used by media, and the research sources they use, make no allowance for these critical issues.

There's a moral in this story. The lesson is to ignore newspaper headlines that label places as hotspots because their prices grew a lot last year. As investors, we're interested in what happens next year, not last year. Investing is about the future, not history.

The headlines that should grab investors' attention are the ones that inform readers about, say, a major new industrial project which will create 2,000 jobs. Or one that says the State Government is going to sweep through a nominated city suburb with an urban renewal program. Or one that reveals plans to improve access to an area with a new highway or rail link.

*The Advertiser* headline, based on a research company's flawed analysis, is likely to induce investors to buy at the peak of the Whyalla cycle, whereas investors should be buying when the cycle is starting to rise - long before the peak.

### **Melbourne: Record good, fundamentals strong, prospects healthy**

Did Melbourne have a boom year in 2007 or merely a good year? It depends on whose figures you accept. Different data sources provide different answers.

According to the ABS House Price Indexes, Melbourne had a very good year with its price index rising 18%. RP Data, which says its median house price rose 17%, comes close to agreeing.

But the people at the Real Estate Institute of Victoria, bless their black hearts, say prices rose 23% in Melbourne last year - and, that, in my estimate would constitute a boom year.

However, if I'm going to believe anyone here it won't be the REIV, which often struggles to identify the truth among a stack of numbers. I think the ABS is the most reliable source - so I'll stick with my assessment in the last quarterly report: Melbourne last year maintained its record of never having had an outright boom (20% plus) year - it had another of those very solid creditable years in which good old dependable Melbourne specialises.

And it's been doing the same thing with residential rentals recently. Solid growth, but nothing spectacular. It confirms my view that Melbourne continually under-values itself, bearing in mind its status as one of our two most important cities and as the No.1 city for population growth.

So I think the prospects for further good growth in the next couple of years are good.

Louis Christopher, head of property research at Adviser Edge, tends to agree. He expects Melbourne to be the star performer among the eight capital cities this year. He predicts house values will grow 15% and units 12%.

Paul Braddick of ANZ Bank says strong economic conditions and a tightening labour market have created solid growth in household incomes and attracted increasing numbers of international migrants (who are the main reason that Melbourne is Australia's No.1 population growth city). He expects this to continue but doesn't expect price growth to be as high in 2008 as last year because of interest rate rises.

He also notes that vacancies fell to 25-year lows late in 2007 and advertised rents represented an annual rise of 27%. "The Melbourne housing market balance will continue to tighten and there is little relief in prospect for embattled renters," Braddick says.

Economic forecaster BIS Shrapnel, which sees a serious nationwide shortage of housing and therefore big rises in prices over the next five years, says one of the biggest shortages is in Victoria. It says underlying demand is for 46,000 new dwellings a year but only 38,000 are being built. It suggests a deficiency of 14,000 homes by June and 33,000 by the middle of next year.

Melbourne has had solid rental growth in recent years but it has been unexceptional (9.5% average growth for house rents and 11% for apartments). Given all the factors in play I think there's plenty of scope for further rent rises in Melbourne. If the RP Data figures are correct, Melbourne is the cheapest mainland capital for tenant, outside of Adelaide.

#### **Adelaide: Another example that the future matters more than the present or the past**

Strictly speaking Adelaide shouldn't be doing as well as it is. Its economy isn't pumping like Queensland's or Western Australia's and it's a net loser on interstate migration.

But it's the looming positives that have everyone excited. South Australia has big resources projects in the pipeline, it has major defence contracts and the state is grabbing an increasing share of overseas migration, all of which will lift housing demand.

Last Adelaide's median house price rose 11%, 18%, 20% or 23%, according to various research sources. We'll go with the ABS Housing Index figure of 20%. Whichever figure you believe, it was a pretty good year - and apartment prices leapt as well.

Louis Christopher, head of property research at Adviser Edge, expects - as I do - that Adelaide will have another good year in 2008, though less spectacular than 2007. He suggests prices for both houses and units will increase 10-11%, with only Melbourne and Sydney doing better.

Investors can expect further good growth in rentals in Adelaide. House rents have risen an average 7.5% a year over the past three years and only about 6% in the past 12 months, according to RP Data figures. There have been greater rises in apartment rentals, which have averaged 12% a year over the past three years.

Valuer Herron Todd White says: "There is still a good deal of activity in the market ... It appears to have enough momentum to continue rolling along, albeit at a less frantic pace. Property also retains its position as the trusted friend to investors jittery at the daily stockmarket report."

Adelaide rentals remain by far the cheapest of the mainland capital cities and its low vacancies suggest scope for further rental growth.

The ANZ Bank's *Australian Property Outlook* says the tightness of the rental market has pushed up advertised rents by 22% recently. "With rental vacancies forecast to reach record lows in the years ahead, strong upward pressure on rents will be maintained," it says.

Adelaide's residential vacancy rate eased a little in February, almost reaching the giddy heights of 2%. The Real Estate Institute of South Australia says this is despite February being traditionally one of the busiest months for the rental market.

The REISA says some owners have asked rents above market levels and that has caused a small rise in the vacancy factor to 1.9%. "Properties with higher prices are staying vacant longer, but those advertising a reasonable price, especially within the \$200-to-\$300 range, are letting readily," it says.

The City precinct, including the CBD and North Adelaide, has the highest vacancy factor, reaching almost 4% in February. Most other precincts of Adelaide remain below 2%.

### **Brisbane: Fundamentally strong though some slowdown is expected**

The Queensland State Government wants us to regard 2008 as "The year of infrastructure delivery". The Queensland public is more likely to see it as "The year of better-late-than-never".

Whatever, it is certainly a time of enormous spending on infrastructure, particularly on transport, water supply and health services. Projects costing \$5 billion will be completed this year and another \$15 billion's worth is under way.

They are all desperately needed developments as Queensland struggles to cope with its population growth. Water is a good example: a desalination plant is almost completed, there are pipelines criss-crossing South East Queensland, new dams are in planning and a project to recycle effluent water is well advanced. It all adds up to many billions of dollars washing through the economy.

So while Queensland has many problems to deal with, its government has lots of money thanks to the resources boom and the property market, and it's spending lots of it on bridges, busways, tunnels, roads, hospitals and pipes to carry water from A to B.

So Queensland, as usual, is bristling with positive news: the economy continues to outperform, population influx continues to lead the nation and property prices are rising.

ANZ's *Australian Property Outlook* says: "Queensland continues to reap the benefits of the commodity boom and a buoyant labour market has boosted household incomes by a remarkable 11.5% over the year to September. A marked jump in infrastructure spending, solid investment intentions and healthy household cash flow suggest economic conditions will remain very supportive in 2008.

'Rentals markets have continued to tighten and advertised rents were up a solid 18% over the year to September. In stark contrast to other states, Queensland's home building industry is performing strongly. Residential building approvals have risen sharply since early 2006 and are currently at a 13-year high. Nonetheless, dwelling supply is still falling short of underlying housing demand and the market is expected to tighten further in 2008, increasing upward pressure on house prices and rents.'

Herron Todd White says in the March edition of *The Month in Review* that Brisbane's rental market has continued to rise "unabatedly skyward" for so long that many tenants appear to sigh in relief when they receive only a \$10/week rent rise. "The competitiveness of the market is played out daily in extended inspection queues for prospective tenants and ever-surprising rises in rent when leases come up or change over," it says.

But it also comments: "The growth in both rents and values is likely to run out of steam and a slowdown sits on the horizon around the mid-year point."

Louis Christopher, head of property research at Adviser Edge, is also less enthusiastic about Brisbane's prospects this year compared with Sydney, Melbourne and Adelaide. He predicts price growth around 8-9% for Brisbane homes this year.

Investors need to be careful with some regional Queensland markets which have, to date, been outstanding performers. There's no doubt that Mackay, which has shown exceptional capital growth for many years, has passed its peak - with virtually no price growth in 2007 and some suburbs showing price decline. Its short-term prospects haven't been helped by the extensive flooding in February.

Townsville, one of Australia's strongest regional economies, is starting to show signs of plateau-ing in its property market after three or four very strong years. HTW says: "The pressures Townsville has been experiencing in its residential market are starting to abate, but only very slowly. Investor demand is cooling, attributable to higher borrowing costs. Locals remain active in the market but are much more discriminating in their purchases and a touch more nervous given the interest rate climate. These conditions have led to some moderation of price growth and normal sale periods for sensibly-priced properties extending out to 6-8 weeks."

Gladstone has had two years of exceptional price rises, with many suburbs increasing 30% or 40% last year, and the best time to be buying there was two years ago - but because of the number of massive projects focused on Gladstone, the city will continue to show solid price growth.

#### **Canberra: More land, fewer public servants: the market is expected to slow a little**

Last time we told you Canberra had been nominated the "fastest market in the land". According to RP Data, the nation's fastest market among the capital cities was the Canberra apartment market, with properties typically selling within 17 days. APM gave Canberra another title: the most heated of Australian property markets.

Well, all that is likely to change. The omens suggest Canberra will come back to the pack this year.

RP Data says it's already starting to decelerate. The *RP Data Property Pulse* report says: "Canberra's short run of price growth slowed down over the last quarter of 2007. Houses and unit prices in Canberra increased 13.9% over the year but with only a 1.5% movement over the quarter."

The *Australian Property Outlook* report from ANZ says the ACT has been an exceptional economic performer recently, given that it's a non-resource region. "However, more recent data suggests the economy is coming off the boil, with state final demand experiencing its largest quarterly contraction in over 10 years, falling 1.9% in the September quarter. Employment growth has also stalled with the number of employed reduced by 0.5% in the year to November."

Among Canberra's problems are the cuts to the public sector planned by the Rudd Government. Another key change is the release of large of land for new residential development (land shortages have been blamed for rapid price growth recently). And, in the past year, the ACT has had the lowest economic growth and lowest employment growth among the states and territories.

Valuer Herron Todd White also sees contraction in the Canberra market. "Buyers are showing more caution and this has caused a general slowdown in sales, with marketing periods for selling properties on the increase," it says, adding that there is also a steady rise of supply of new properties on the market, including new land releases around the city.

But that's not to say Canberra won't continue to provide growth. Prices are high in Canberra but so are incomes and affordability remains at manageable levels. "Repayments on the average mortgage are only 25% of disposable income in Canberra, much lower than the national average of 37%," the ANZ says. "This may give prices some further upside in the coming quarter."

House rents have risen an average 9% a year over the past three years and apartment rents by 13.5% a year, according to RP Data figures. So there's been healthy rental growth and that, plus the heat coming out of the demand side of the equation, suggests growth will be less in the next little while.

### **Darwin: Be advised: there are better places to park your money**

I was recently asked to nominate a coming hotspot in the Northern Territory property market and I had to decline. There is nowhere in the territory I would recommend to an investor.

Darwin is over-cooked, over-priced and over-rated. Alice Springs and Katherine are high on my list of No Go Zones. Steer clear.

Prices and rentals have reached the point of silliness in Darwin. The Northern Territory has been having an economic boom but so too have other parts of Australia without pushing property values beyond reason. Darwin houses cost more than Brisbane's or Adelaide's, with a median price above \$400,000. Darwin is our most expensive city for tenants: typical rental levels for three-bedroom houses include \$550 per week in inner Darwin, \$430 in the northern suburbs and \$380 in Palmerston. We now have the unusual situation of households buying homes because they can't afford the rents.

These levels are unsustainable, as there are signs of the economy coming off the boil. The Northern Territory had the lowest economic growth among the states and territories in the December quarter. Darwin has had a strong property cycle but it's come to the end of it. Its movement in house prices was among the lowest of the capital cities in both the September and December quarters.

Darwin has reached the point where affordability over-rides economic strength, as happened in Perth recently. The annual Demographia International Housing Affordability Survey has categorized Darwin as "severely unaffordable" and a report in *Your Investment Property* magazine suggests buyers are being spooked by the high cost of housing, causing the market to slow considerably. The report confirms that prices have fallen recently.

The other concerns for Darwin are the excessive level of unit construction and signs of an upcoming lull in the local economy, as major projects wind down. This is not a great time to buy in Darwin.

Valuer Herron Todd White's latest edition of *The Month in Review* confirms my view. It says the Darwin market has peaked and sales for houses and units are falling. "It appears the market has steadied and may now have reached its peak in specific sectors," it says. "This may be the case for the inner-city unit market in particular, which has seen a steady build-up in supply over the last three years. High construction costs and increasing land values are seeing first-home owners being pushed out of the Palmerston market towards the rental market and the expectation is that continued sustainable value growth will slow."

Louis Christopher, head of property research at Adviser Edge, expects nothing much in the way of value growth in Darwin for the next two years. His prediction for houses is 3% growth this year and 4% next, with a similar outlook for apartments.

Apartments rents have risen an average 21% a year for three years and, given the large amount of new supply plus prospects for reduced demand, I expect little further growth. Indeed, we may see apartment rents decline in Darwin.

## **Hobart: As usual, a series of contradictions**

The Hobart property market has done fairly well in recent years, despite the lack of any economic or population growth impetus. Now it appears it's going to get some.

The ANZ Bank, in the *Australian Property Outlook* report, says the Tasmanian economy may have "turned the corner". There was a marked improvement in State Final Demand towards the end of last year, boosted by a strong performance from manufacturers. Jobs prospects have also improved.

"These signs of recovery should be enough to maintain positive inward migration levels and underpin housing demand," he says. "The number of housing finance approvals actually increased in October, bucking the trend that saw falls across all other states except NSW. The tightness of the residential market in Tasmania is reflected in house prices rising 11.6%.

"Residential vacancy rates remain remarkably stable near long-term historical lows of around 2%. Consequently, median established and advertised rents have risen about 5% in the past year."

Research company Matusik Property Insights in a recent report says that Tasmania showed the second highest economic growth among the states and territories in 2007 (behind Western Australia) and the highest, by a wide margin, in the December quarter.

Ironically, given that Tasmania is finally showing some economic spark, most pundits are pessimistic about its property market.

Louis Christopher, head of property research at Adviser Edge, doesn't expect much joy for Hobart property owners this year. He predicts 5% capital growth for house and just 2% for units.

Christopher's sentiments tend to be confirmed by Residex, which found that Hobart's median house price dropped 2.2% in February, the biggest decline among the capital cities.

Valuer Herron Todd White is also a little pessimistic. "It appears the residential market in Hobart and surrounding regional localities has slowed," it says in the April edition of *The Month in Review*.

"The latest round of interest rate rises appears to be the culprit slowing the market. Buyer inquiry has diminished although stock levels have remained static. We have seen the first signs of mortgagee-in-possession properties to emerge in recent years. There is always a bust in a property cycle and we are yet to see it. This may indeed be the beginning of the slide backwards."

So Hobart retains its status as the most inexplicable of the nation's major property markets.

## **Perth: There's more to consider than the economy: Perth's falling market proves it**

Many analysts examine economic data and translate that directly into predictions about the housing market. Perth shows that you can't do that - not if you like to be proven right. There are other factors, chief among which is affordability.

General economic conditions in Western Australia remain the strongest in the nation. "The commodities boom is still providing significant economic momentum and real gross state product expanded a massive 6% in FY2007, while real gross state income grew at a remarkable 12%," says Paul Braddick of ANZ Bank.

Yet annual price growth has fallen away to nothing and the most recent data suggests prices are falling in many areas. The various sources of median price data don't agree on much, but one area of agreement is that Perth's median house price went virtually nowhere in 2007, with a growth range of 1% to 3% from four research sources.

According to RP Data figures, Perth median prices fell in the January quarter for both houses and units (including a 9% decline in the unit median).

No matter how prosperous the economy, prices can only go so high before the market chokes on them. As Braddick says: "In the wake of recent interest rate hikes, combined with a doubling of median house prices since late 2003, affordability has clearly become an issue and this will continue to cap prices in coming quarters.

"Housing approvals and commencements have continued to fall from the peaks reached in late 2005 as interest rates have climbed. With affordability putting home purchase out of the reach of many, rental vacancy rates have fallen to 20-year lows. Ongoing tightness in the rental market has seen rents skyrocket with increases in advertised rents in excess of 35%."

Yields aren't that flash either, despite major growth in rents recently. HTW says in the March edition of *The Month in Review*: "Yield is a word that has not been discussed openly in the residential property market in Perth over the last few years. As property values have gone on an exponential growth pattern, the average weekly rental return has not kept pace, which has resulted in generally poor yields at average values."

The most recent REIWA statistics indicate 3.5% for houses and 4% for units are standard gross rental yields.

Louis Christopher, head of property research at Adviser Edge, expects the slow market to continue this year and next. He expects annual price growth for both houses and units to be around 3-4% for the next two years.

But it may not be that good. When Residex detected a decrease in prices in the major cities in February, it found that Perth had led the decline. It suggested that more than half of Perth houses had dropped in value.

And mortgage broker AFG says mortgages in Western Australia fell in each of the first three months of 2008, compared with the same month a year ago. Overall, loans fell 14% in the March quarter in what AFG terms an "unprecedented sales contraction".

While price growth has stopped, rental growth has continued. House rents have risen an average 15% a year over the past three years and 17% in the past 12 months, according to RP Data figures. Apartments rents have averaged 17% annual growth.

The WA economy is still pumping so there's likely to be underlying demand in the rental market, particularly as large numbers have been priced out of the buying market, but the recent level of growth is likely to slow down in the next year or two.

### **Sydney: All the signs suggest recovery - but we've said that before**

We expect to see meaningful recovery in the NSW property market this year. No, seriously, we do. I know we've said this before, but this time we mean it.

All sorts of analyst are saying the same thing (which shows that the best way to be proved right as a forecaster is to keep predicting the same thing until it comes true).

For example, economic forecaster BIS Shrapnel, which sees a serious nationwide shortage of housing and therefore big rises in prices over the next five years, says the biggest shortfall is in NSW because construction collapsed in FY2005 to its worst levels in 30 years.

It says underlying demand is for 50,000 new dwellings a year but only 30,000 are being built. It suggests a deficiency of 22,000 homes by June and 58,000 by the middle of next year. This will place pressure on both prices and rentals.

Louis Christopher, head of property research at Adviser Edge, expects Sydney's growth to be among the best in the land this year. He predicts house prices to grow 12% and unit prices 13% and expects only Melbourne to do better. Christopher says: "Sydney is showing healthy signs of a recovery following a time of stagnant growth after the last boom abruptly ended with two successive rate rises in 2003."

ANZ's latest *Australian Property Outlook* also agrees with this general theme. "After languishing for much of the past three years, Sydney house prices and the NSW economy are finally showing signs of life," it says.

"The recovery has been buoyed by a marked tightening of housing market conditions with the vacancy rate falling to a 19-year low of 1.4%. In addition, the NSW economy accelerated in 2007 and is now once more growing at a respectable pace."

This is against a background of "extremely depressed" development activity. "NSW home building approvals have slumped to their lowest level on record ... and any recovery remains some way off," ANZ says. "Our projections suggest a critical and rapidly expanding shortage of housing in Sydney will provide significant support to house prices and rents."

ANZ notes a 24% rise in advertised rents and says: "With vacancies set to push even further below record low levels in the year ahead, ongoing rapid rental growth appears inevitable."

There's certainly scope for rental increases. Sydney house rents have risen only 4% a year on average over the past three years and there was little growth in the past 12 months, according to RP Data figures. Apartment rents have shown greater growth, but at 7.5% average per year is still lagging a long way behind other cities.

### **Conclusion: Ignore the negative sentiments and benefit from counter-cyclical investment**

Confidence is evaporating, according to all the usual survey measures. Business confidence is down and general consumer confidence is down. It's not so surprising - there's ample negative news lately, led by interest rates heading north and shares heading south.

If you're one of those inclined to defer decision-making about property investment amid the bad tidings, consider the following:-

Residential property has delivered vastly superior returns to all other broad asset classes over time and is expected to go on doing so.

The ANZ's head of financial system analysis Paul Braddick says in the latest edition of *Australian Property Outlook*: "As an asset class, housing has continued to deliver remarkably strong and relatively stable investment returns. Since 1984, residential property has enjoyed an extraordinary compound annual total return of 13.4%."

"Over the past 23 years at the national level, house prices have virtually never fallen with the greatest annual falls being just 0.3% in the depths of the early 1990s recession and 0.9% in 1996. In contrast, Australian equities fell 43% between September and December 1987, 15% in 1992, 17% in 1995 and 18% in 2003."

"In risk-adjusted terms since 1984, residential property returns have more than tripled those of equities and more than doubled those of commercial property and government bonds.

"More recently, total returns on residential property have accelerated, underpinned by a sharp tightening in the housing demand/supply balance that is driving both rents and house prices sharply higher."

Braddick says a "dramatic tightening" of the housing market will force already-soaring house prices and rents sharply higher. He says: "By 2010 we project a record housing shortage of nearly 200,000 homes which risks becoming an intractable imbalance as renters and first home buyers become collateral damage in the Reserve Bank's ongoing war on inflation.

"A flight to quality will add to the weight of money that is driving residential (and other) property markets higher."

If Braddick is right, the dark clouds gathering have numerous silver linings. So while many people are intimidated by the negative atmosphere into doing nothing, those with the foresight to be counter-cyclical investors will do well in a buyers' market.