HONNER

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MELBOURNE MELTDOWN?

The rise and rise of new Melbourne units has continued unabated for the best part of five years but now that it's valuation time, many aren't stacking up price-wise. NICOLA MCDOUGALL

Developers seem to have a habit of getting overexcited and pushing out unit product until the market is saturated and suffers price falls. It's happened before in Melbourne and it will happen again, but the big difference today is many overseas buyers have reportedly done a disappearing act on their contracts.

THE CYCLE

The experts agree there's nothing overly unusual about what's happening in Melbourne's off-the-plan market at the moment – albeit with the new variable of foreign investors.

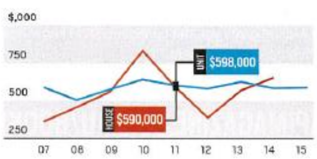
Melbourne-based chair of the Property Investment Professionals of Australia (PIPA) Ben Kingsley has been watching the booming new unit sector and waiting for the inevitable slide because he's seen it before.

"It's not uncommon for this to be occurring at the top of the cycle. If we look at historical cycles, we've seen significant price growth, which then leads to lots of pre-approval, building, getting the critical pre-sales, to get them under way in a moving market," he says.

ALL ABOUT DOCKLANDS[1]

	House	Unit
Median price Jul 16	SNR	$595,000
12-month growth	SNR	2.6%
Median rent Jul 16	$600	$530
Rent growth Jul 16 (YoY)	13.2%	3.9%
Gross rental yield Jul 16	SNR	4.6%
Properties sold Jul 16	7	30
Properties sold Jul 15	461	626
Average vendor discount Aug 16	17.0%	1.0%
Average vendor discount Aug 15	3.4%	1.7%

DOCKLANDS MEDIAN SALE PRICES[2]



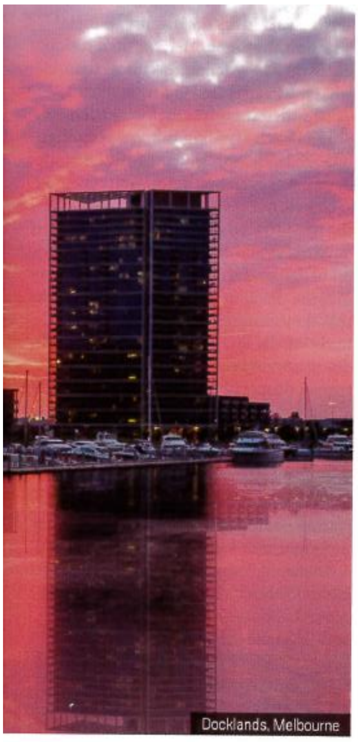
But with reports of valuations regularly coming in 20 per cent under contract price, it's clear that some buyers have bought into an unrealistically upbeat market.

"In general, it's something that can probably happen about 10 per cent of the time where people have been sold into an artificially inflated valuation," he says.

"That would happen in a balanced market but now we're starting to see up to 50 per cent, so this is a real indicator that these developers have taken advantage of market conditions… but the valuers acting on behalf of the banks are being more conservative and that's why we're seeing these results starting to come through."

A similar thing happened in Docklands in Melbourne about 20 years ago and in that circumstance, investors had to wait years to achieve any capital growth.

Today, however, they're probably



Docklands, Melbourne

happy owners of a desirable piece of real estate that has matured nicely over the years.

VALUATION WOE

There are rumours circulating among Melbourne's property people that up to 50 per cent of all new units aren't achieving valuations that match their original contract prices.

What this means is that many investors – both local and foreign – are having to tip in more of their cash to settle or some are even forfeiting their deposits altogether and walking away.

Such a strategy, however, may not always work as investors still have a legal responsibility to settle and some cash-strapped developers may take action to recover any additional costs relating to a settlement default, including if they have to on-sell the unit for a lower price than what was originally agreed.

Herron Todd White Melbourne managing director Tony Kelly spoke to API and admitted that valuations were coming in lower but that it's nothing new. He says, in fact, it's been happening for a few years.

"Valuations have been coming in under contract prices for the last four years. That hasn't changed," he says.

"The banks are asking us: 'What price can you get for it in the secondary market when your Ray Whites go and sell it?' and it's a different number and the evidence shows that there's that discount being applied and that discount is becoming a little bit more evident and a little bit deeper."

Kelly says that the new unit market has been "unnatural" for a while now because of the additional influence of foreign investors. Developers have been creating and promoting product for overseas buyers because they understand that demand remains strong offshore.

And even though Australian banks have tightened up their lending criteria for foreign and local investors of off-the-plan units, he says that the majority have still been settling.

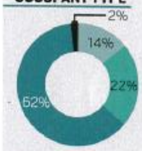
That may be about to change, however. "They've hardly ever fallen over.

DOCKLANDS FACT SHEET

Docklands has a mixed supply to demand situation. There are adequate rental properties available to tenants, however there's an oversupply of for-sale listings. Discounting is heavy. Incomes in Docklands are growing slightly slower than the Victoria average. The proportion of renters to owner-occupiers is above average for Victoria. Stock for sale levels are down by 6.6 per cent year on year.

Source: SQM Research, www.sqmresearch.com.au (accurate to August, 2016).

OCCUPANT TYPE[3]



- Owner-occupiers
- Mortgage holders
- Renters
- Other

Source: Australian Bureau of Statistics 2011 Census

HOUSING MAKE-UP[4]

- Separate house (0)
- Semi-detached row or terrace house, townhouse etc (45)
- Flat, unit or apartment (2456)
- Other dwelling (9)

VACANCY RATES[2]

3.0% DOCKLANDS

1.9% MELBOURNE

10-YEAR AVERAGE ANNUAL GROWTH[5]

SNR HOUSES

1.8% UNITS

KEY DRIVERS

- Central location
- Lifestyle facilities.

POPULATION[4]

5791

WALK SCORE[6]**: 86**

Docklands has a Walk Score of 86 and most errands can be accomplished on foot. There are about 605 restaurants, bars and coffee shops in the suburb and residents can walk to an average of 35 of these in five minutes.

[1]Source: APM and SQM Research. [2]Source: realestate.com.au. [3]Source: ABS 2011 Census. [4]Source ABS 2011 Census. [5]Source: APM. [6]Source: www.walkscore.com.au. H = houses U = units. YoY = year on year. SNR = statistically not reliable

Apartment buildings at Port Melbourne

"It just means that the foreigners… they just don't care because they still see it as getting their money out of the country and that's a lot safer than leaving it in the country," Kelly says.

"We're definitely hearing and seeing that settlement dates have been pushed out… Developers are happy to give them longer and longer to settle, as they see it as a better outcome than having to try to put product back on the market.

"They're better off to persist with someone they've got on the line rather than take the risk of going back into the market. They're giving them more and more time to find the money."

> "Valuations have been coming in under contract prices for the last four years."
> TONY KELLY

The unusually strong demand from foreign investors means that the final outcome is difficult to call.

What is likely to happen, if overseas investors don't settle and do simply disappear, is that the local inner-city new unit market will be even more exposed than it needed to be. Eventually, local investors will soak up the supply, but that could take a while.

And that will likely leave investors who could settle, and developers with any financial troubles, exposed.

The impact of potentially AWOL foreign investors is likely to drive unit prices down further, Kingsley says, which will make it difficult for investors to recover their position if they find they need to sell.

He says if investors dispose of their new units in the short-term then it's likely they may sell for even less than what the valuers had conservatively valued the property at before settlement.

The key to avoiding this unappealing financial situation is to do your research before you even buy a new unit.

"It's very concerning and it highlights the need to – when you are working with developers and sales agents who work on behalf of the developers – drill down into the detail in terms of other projects that they've done and to approach it traditionally like you would approach doing any comparable analysis on any type of property that you buy," he says.

"So you identify comparable properties and you look at what they've been selling for. Not just by the developer, but you're also looking at other properties located close by of a similar quality of build, and if there's any uniqueness or lack thereof."

The word "oversupply" has been bandied about a lot, especially in media reports about the Melbourne, Sydney and Brisbane inner-city new unit markets. But it's a term that may not mean what you think it does.

According to Kelly, the Melbourne off-the-plan sector is not oversupplied. That's because properties have been settling, even with conservative valuations.

Of course, there may well be an oversupply of new unit product in the rental sector, but the sales market has kept its head above water.

WHAT'S AHEAD?

That positive status is likely to change, Kelly says, with 2017 looking like the year that the new unit market tips well past the equilibrium point into oversupply territory.

"Right here as we sit, there's not an oversupply.

"We can look on the horizon and we're pretty sure there's a problem on the horizon, there's storm clouds. How soon will they get here? We're not sure but there are signs that it's starting to sprinkle or to rain and the storm is likely to hit next year, unless something corrects itself," he says.

The intensity of the storm, however, will be dependent on foreign investors and whether the Chinese cash machine that's been firing on all cylinders is abruptly switched off.

If that happens, Kelly says, that storm could easily turn into a cyclone and we should run for shelter.

"That's the real risk, that we'll see significant drops in values because the local buyers aren't there to fill that void… particularly in this environment," he says.

So, it appears that a rough ride is ahead for the Melbourne new unit market but investors can take heart in the fact that it has (kind of) happened before.

Supply runs ahead of demand, but then the market catches up. It's the period of time between those two market ups and downs that can be tricky to navigate.

Kingsley says investors can protect themselves by being realistic about the returns they're likely to achieve between now and then, and remembering that property is always about the long-term horizon, not the temporary impact of approaching storm clouds.

> "In general, it's something that can probably happen about 10 per cent of the time where people have been sold into an artificially inflated valuation."
>
> BEN KINGSLEY

"They're going to have provision in their calculations, potentially, for some higher levels of vacancy that they wouldn't have done in the past," Kingsley says.

"When you bring on high levels of stock, it's not just automatic that they're going to be consumed by tenants very quickly. There's always a lag period and they should factor that into their calculations. Property is a long-term investment – that's true.

"Doing your homework to see the level of supply, and future supply, coming into those markets is also something [you] have to consider." API