GLOBAL MARKETS

Facts And Fallacies About Melbourne Residential Market

June 2015

I know something is up when I suddenly get multiple calls from friends or contacts who know about what I do here at RunningStream. These days, the calls are enquiring about Melbourne properties, which is fine. Specifically, about investing in Melbourne Central Business District (CBD) apartments, is not fine.

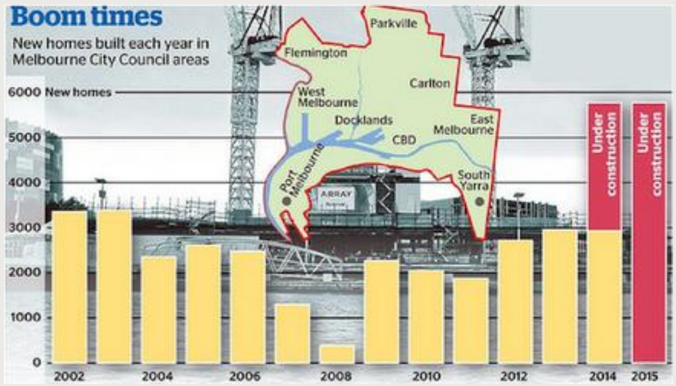
I know then that my friends must have seen the news about the cut in the Australian interest rate, cheap AUD, the inherent stability of the Australian housing and the accelerating growth in home prices. Everyone wants to jump onto the bandwagon of owning an Australian property these days.

Many agencies here in Singapore are selling Melbourne inner-city properties in Southbank, Docklands, Queen Victoria Market or Flinders and Spencer Street in the CBD. Go to any website and you will likely see advertisements on a property fair featuring these CBD properties. Many local investors buy into the advertisements without fully understanding the situation on the ground.

Now, I am not saying that it is bad to buy Melbourne CBD properties. Especially if your intent is to stay close to the city as an owner occupier. But if one is thinking of investing then my view is that buying an inner city apartment is a really bad idea with the oversupply situation and shrinking apartment sizes.

There are a lot of better opportunities in the middle ring suburbs where local Australians prefer to live and buy homes as owner-occupiers. Given the regulations that foreigners can only sell their property to locals and Permanent Residents (PR), it would make sense then to buy in an area that Australians favour instead of following the conventional Asian mindset to buy in the CBD.

It is all the more important for buyers to select the right area to invest in especially since foreign buyers are now subjected to additional stamp duties. The appreciation potential of the area must be factored in against the additional costs.



Oversupply Risks

I will just go ahead with one important reason to avoid this area. There are 2 types of suburbs we look at in deciding whether to bring a project in. Is the suburb in an owner-occupier market or is it an investor market?

Investor markets are areas where the majority of homes are owned by property investors and vice versa for owner occupier markets. The logic is very simple. In the Melbourne CBD and surroundings, the majority of apartments are owned by investors and foreigners which means that the supply of rental stock is high.

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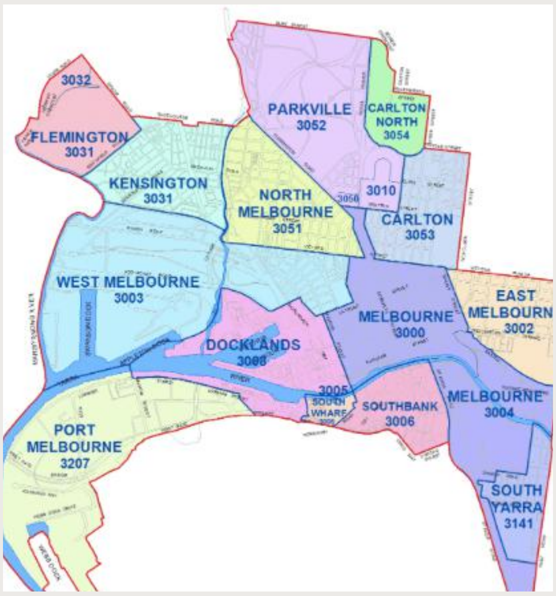
This is not a problem as long as the demand from tenants is high as well. However, given the recent glut of developments, there will be a huge spike in the supply of properties, giving tenants more leverage to fight for a lower rent. There is already an oversupply of apartments in the CBD and rental yield compression at 4.2% (lower if you are buying at today's inflated developer prices).

The problem comes when distressed landlords who are unable to take the pain of being cash-flow negative sell their properties at distressed prices. The effect of this will be to adversely affect valuations of all properties in the vicinity and cause a knock-on effect on other landlords that were barely holding on before.

This type of scenario only happens in an investor market where people care very much about rental yields and property valuations. In owner occupier markets, prices are resilient as people usually do not care too much about valuations given that they live in their homes. The small number of investors means that there is a reduced supply of rental stock, which also means landlords retain more negotiating power.

It is not rocket science. Just a bit of common sense and knowledge of the market. But unfortunately, many people are blinded by ignorance, charming salespeople and herd mentality.



Locations Supported By Fundamentals

Now then, you would be asking: "If not the CBD, then where?" That would be the purpose of this article. When not meeting and servicing our clients, my fellow portfolio managers and I are usually engaged in our passion, which is researching and understanding the different markets. For us, in asset selection, we look at several fundamental factors including the following:

-Owner Occupier Market

-Good Infrastructure & Amenities

-Nearby Job Nodes

-Future Development

-Price Point / Valuation

Examples of such locations are the South Eastern suburbs of Melbourne stretching from Caulfield all the way south-east towards Dandenong. Inner North suburbs from Maribyrnong to Reservoir as well as East from Richmond all the way to Chirnside Park. Not to forget the lovely suburbs near the bayside like Moorabbin, Bentleigh, Hampton and Cheltenham. These are great locations with excellent infrastructure and amenities with easy transportation and access to the workplace be it in the city or in suburban job nodes.

These are areas where most Australians aspire to live in (depending on affordability). But then again, the caveat for us is that the property might be in the right area. But it also has to be at the right price point.

Some of you might have also seen land estate offerings in Western suburbs such as Point Cook, Werribee or way North towards Doreen and Mernda. Would those be good investments? The answer would depend on your time frame.

If you are expecting to refinance from equity growth in a few years to expand your portfolio, those landed properties in the West or far North would probably not work for you as their growth performance is anaemic to below average at best. Salespeople would tell you that it is a no-brainer to buy a landed property in Point Cook for $400,000 when you compare a similar property in the East with the same distance to the CBD costing almost $1M. They will have you believe that it will be just a matter of time before you have that explosive growth.

However, everything goes back to fundamentals. While these are also owner-occupier suburbs, infrastructure is not as well developed in the West than in the East or South-East and that land is immensely abundant in these areas. Also, there is a local perception that living in the West is less desirable than the East. (Think about driving to the city and back home with the summer scorching sun in your face every day.)

For investors thinking of going West, I would say go no further than Altona or Laverton if you are hoping for some capital growth in the near term.

The truth is that a serious investor will still have to go deeper still to be certain about their investment decision. Data like resale numbers, demand/supply ratio and auction results can help in clarifying the picture of market for investors.

Conclusion

I hope this article would have given readers a better understanding of how sensible asset selection works. In property investments, the ultimate bottom line is striking a balance between returns and risks. While Australian property remains a great investment vehicle to grow wealth, one must remain selective to achieve maximum returns with minimum pain.

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