RESIDENTIAL PROPERTY OUTLOOK

BANK OF MELBOURNE ECONOMICS

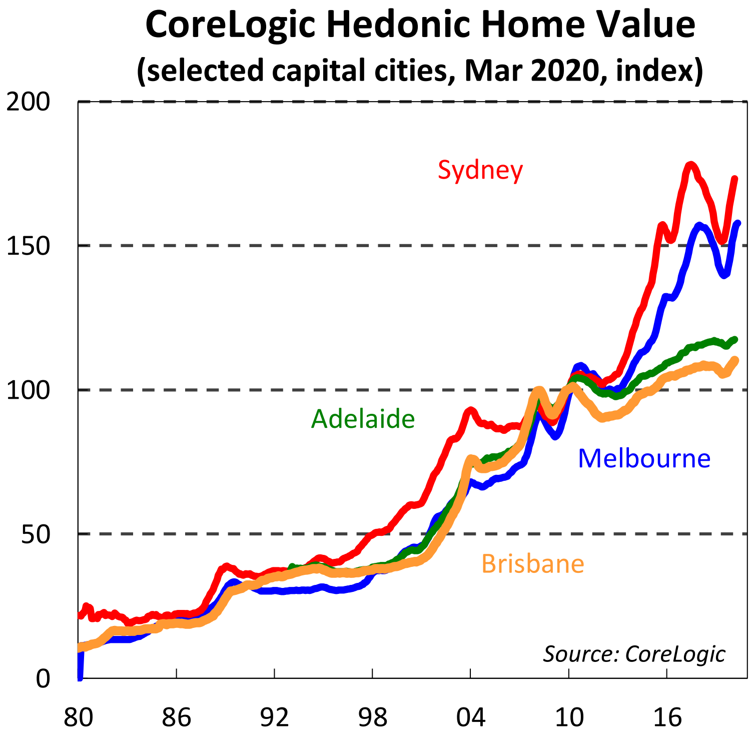
22 April, 2020

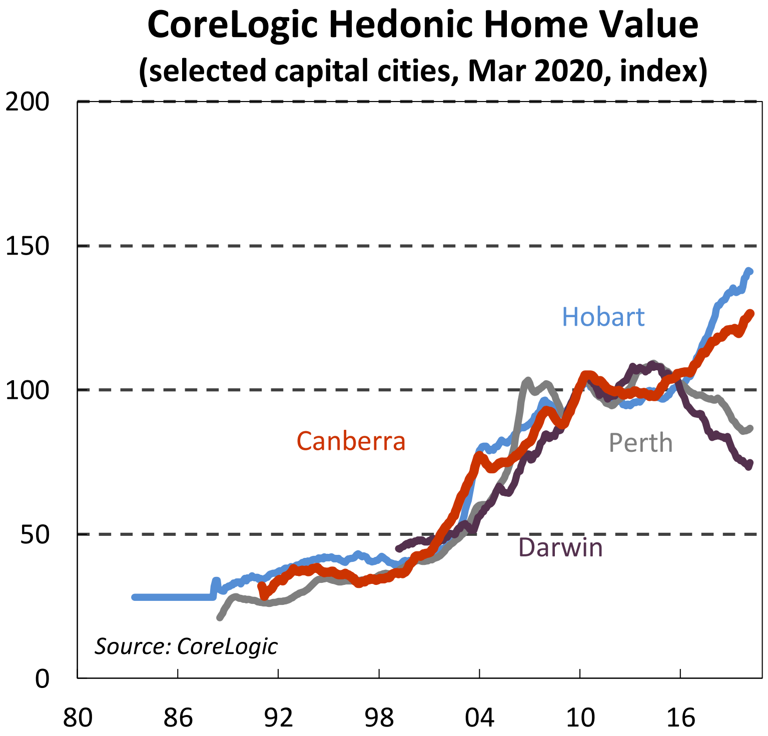
CONTENTS

OVERVIEW

- The COVID-19 pandemic and the measures in place aimed at stopping the spread are curtailing economic activity significantly.
- Some of these measures are hitting activity in the housing and construction sectors directly. With the social distancing measures now in place, transacting for property has become more difficult and some construction projects have been extended, delayed or cancelled.
- However, the sharp drop in demand and incomes is what will be felt most acutely across the sector.
- Dwelling prices are expected to fall this calendar year, as the loss of incomes, rising unemployment and a sharp population slowdown curb demand. Auction clearance rates have collapsed in recent weeks, suggesting softer dwelling prices are likely in the period ahead.
- A modest recovery in dwelling prices next year should prevail, provided the economy recovers later this year as we anticipate. Low interest rates and an improving jobs market will be key supports to housing next year.
- New home sales has dropped sharply in March and should continue to fall in the near term, driven by the impact of COVID-19.
- Our preliminary forecast is for dwelling prices to fall by 7-10% this calendar year and then return to modest growth of 2% in 2021.
- The weakness in overall demand this year is set to flow through to the construction sector.
- Residential vacancies are expected to rise, reflecting weaker incomes, slower population growth and as owners of short-term accommodation look to secure longer-term stays. Downward pressure on rents is likely over the year ahead as a result.
- However, there is unprecedented assistance which will cushion the downturn. Deferrals on mortgage payments for those who have lost income due to COVID-19 could limit forced sales.
- Stimulus measures will provide fuel for rapid housing price growth once the broader economic recovery begins. Interest rates are set to remain low while the substantial level of additional liquidity provided from both fiscal and monetary authorities will take time to unwind. But this crisis will cast a shadow on the economy for some time.
- New guidelines from the Federal Government implemented for tenancies have put limits on evictions for both commercial and residential properties. Landlords and tenants are expected to work together “in good faith”.
- State governments have issued a range of rental support packages, including land tax deductions to landlords who pass on benefits to tenants.

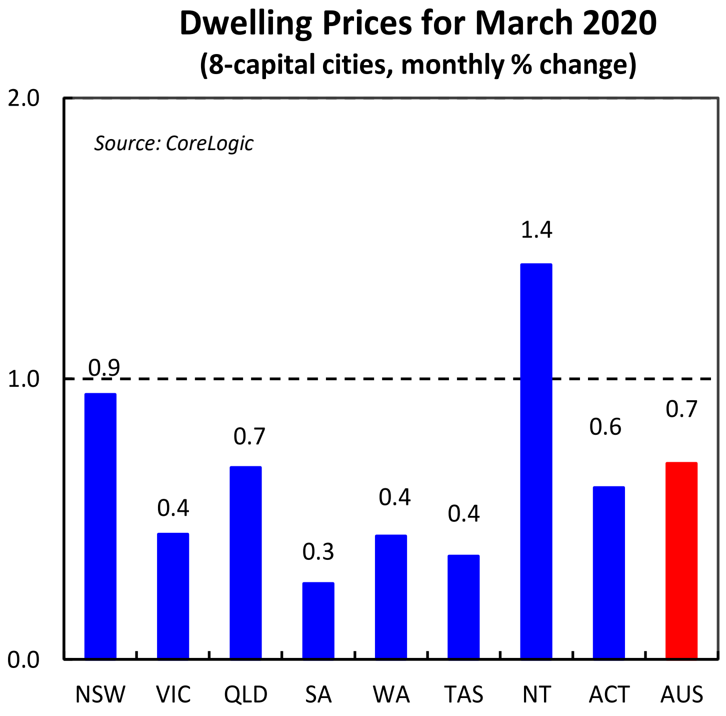
UPSWING IN DWELLING PRICES - SET TO CEASE

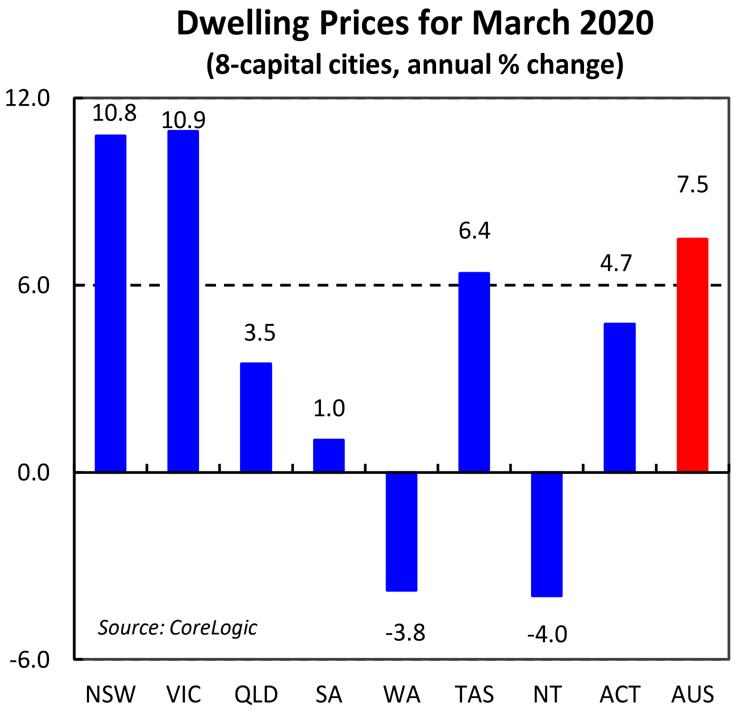




- Data revealed the upswing in housing prices that began around the middle of last year continued into March. Sydney and Melbourne led the gains in annual terms. Modest gains occurred across Adelaide, Brisbane, Canberra and Hobart. Perth and Darwin witnessed some stabilisation in housing prices. However, dwelling prices have yet to fully reflect the impact of stricter social distancing measures, which took effect from March 23. Anecdotes from the housing industry suggest demand was still firm in the first half of March, but fell away in the second half of March. We expect April data out in early May will reveal a more telling story.

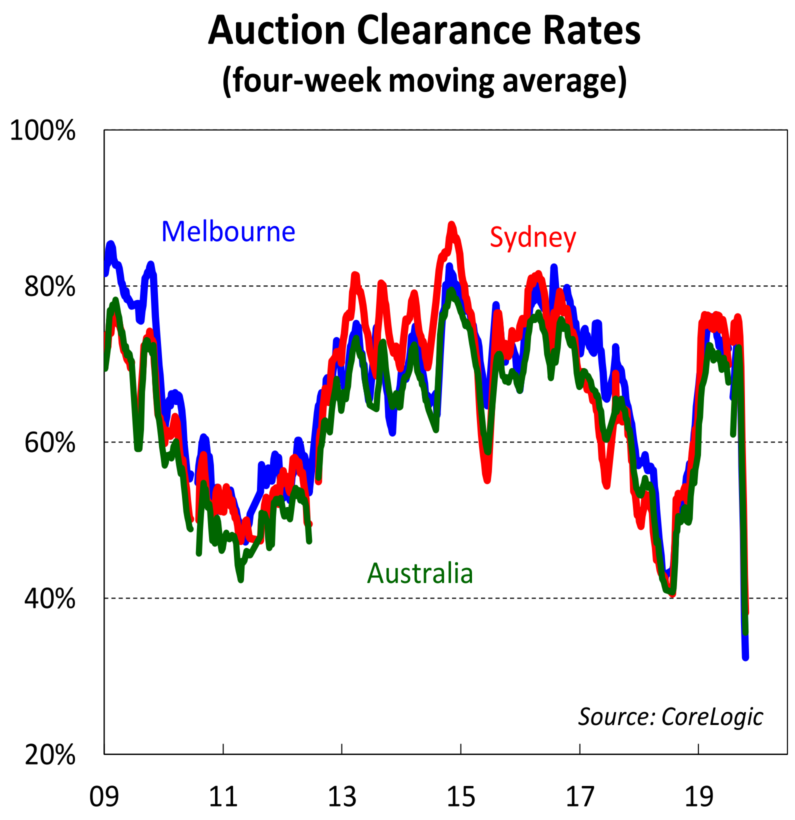
DWELLING PRICES ACROSS STATES & TERRITORIES





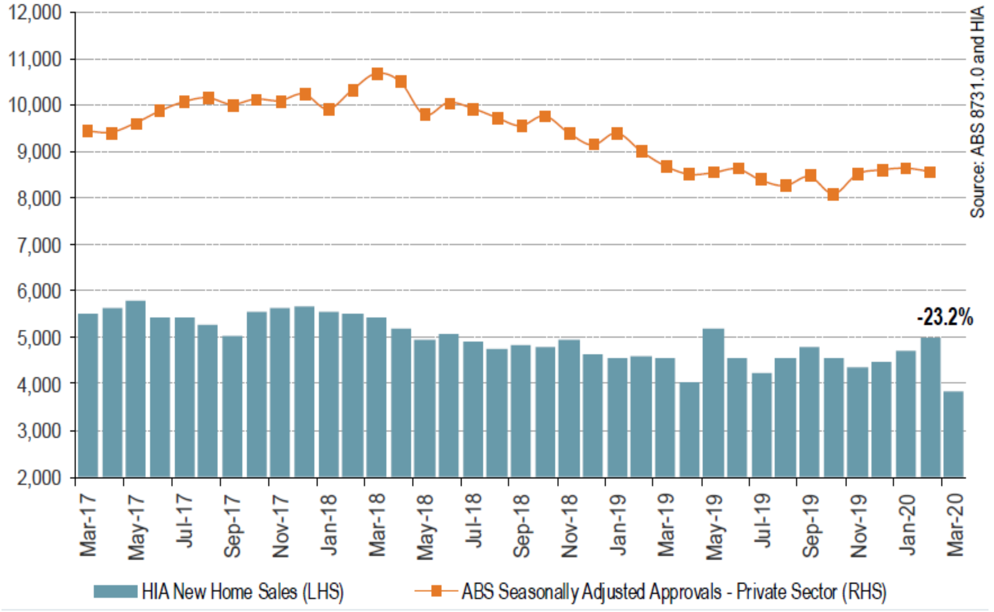
- The most recent data shows price changes for dwellings across States and territories have been uneven.
- The mining States were slower to see house prices recover, but prices have turned quickly in recent months.
- We expect all States and territories to record declines in dwelling prices over the next few months while COVID-19 engenders uncertainty and restrictions on consumer and business activities limit activity.

EXPECT WEAKNESS IN DWELLING PRICES AHEAD



- On-site public auctions have been banned since Wednesday, 25 March. Auctions have moved online.
- The number of auctions lifted in that week (week ending March 29), as agents likely pulled forward auctions ahead of the ban.
- Many agents have enhanced or developed their digital offering, but the number of auctions and clearance rates have fallen dramatically in the past few weeks.
- Clearance rates fell to 31% in the week ending 12 April and the number of auctions fell by 80% compared with the week before.
- According to preliminary data, the clearance rate improved to 39% in the week ending 19 April and the number of auctions recovered slightly, but remained at historically low levels.
- However, in the week ending 19 April approximately 25% of auctions were withdrawn (460 withdrawals from a total of 1,848 auctions).
- Auction rates are a forward-looking indicator of dwelling prices. Falling auction clearance rates are a signal that there is weakness in dwelling prices ahead.
- The number auctions are likely to remain extremely low over coming weeks and months, so clearance rates may be representing a smaller share of the overall market.

NEW HOME SALES DROPPING SHARPLY

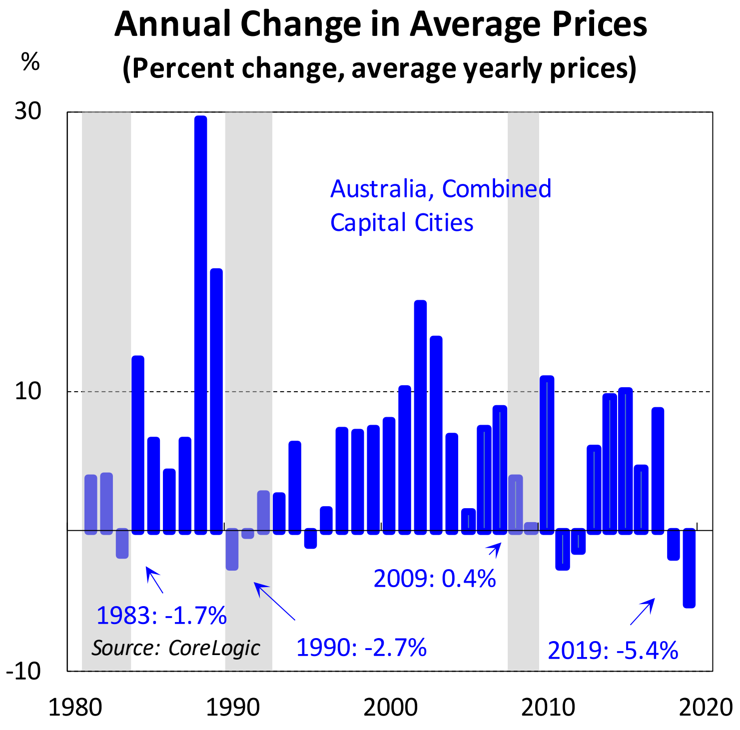


- New home sales dropped by 23.2% in March, according to new data published by the Housing Industry Association (HIA) today.
- The drop in sales likely reflects the softening in demand for housing once Stage 1 restrictions became effective in late March and as uncertainty around the virus heightened. It is clear households are choosing to delay some home purchases while employment uncertainty also lingers.
- The sample from HIA captured 18% of Australia's new detached home building sector.
- We would surmise that the drop off in sales for multi-density dwellings could be greater given ongoing concerns around cladding and the structural quality of apartments.
- The monthly decline in new home sales was experienced across all States.
- The worst hit State in March according to the HIA data was WA. WA new home sales fell by 31.6% in the month. NSW recorded a drop of 26.1%, QLD a fall of 24.1%, SA a decline of 21.1% and VIC a decline of 16.9%.

HOW FAR COULD DWELLING PRICES FALL?

- While we expect some decline in prices, there is significant uncertainty around how far they can fall.
- Economic activity is weakening and job losses are rising. This causes housing demand to decline even while interest rates are very low.
- Moreover, uncertainty about the outlook means that households and investors are less likely to make big decisions to purchase a home.
- Significant job losses will dent incomes, and limit demand for homes. Large spikes in the unemployment rate have been associated with price declines in the past.
- With migration grinding to a halt, slower population growth will also limit demand for housing, although this could be mitigated by a smaller net outflow of Australians moving overseas.
- There is, however, significant support for mortgage holders, including low interest rates, and range of support measures from banks and the government for those who have lost income due to COVID-19 which is not a usual characteristic of past recessions.
- Furthermore, sellers may wait for a better time to sell if their financial situation allows them to. This occurred during the global financial crisis and led to a reduction in housing stock available for sale. A reduction in available stock can limit the extent of the price declines.
- We expect dwelling prices could fall 7-10% this calendar year and then increase very modestly by 2% over 2021. The recovery in demand for dwellings will be supported by a gradual improvement in confidence as the economy turns around and as low interest rates underpin demand. We stress that forecasts have a greater degree of variability attached to them than usual due to the nature of the external shock. As the Reserve Bank Governor stressed yesterday, forecasting is difficult at the best of times.
- The RBA in its board meeting minutes today said that the economic contraction, uncertainty and social distancing measures were likely to result in very little turnover in the housing market and that “it remained unclear how this would affect residential property prices”.

LESSONS FROM THE PAST?



- Dwelling prices have had small annual declines in prices in past recessions and downturns.
- The current recession is very different, and we caution placing too much emphasis on past experiences.
- In downturns, the withdrawal of sellers usually helps prevent sharper falls in prices.

History of annual change in dwelling prices

(Percentage change of average annual median house prices)

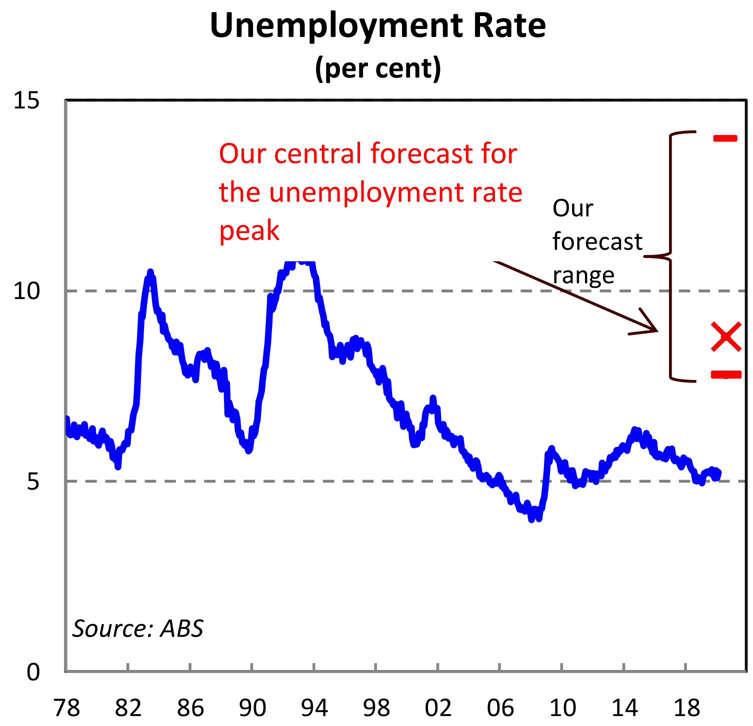
	Sydney	Melbourne	Combined Capital Cities		Sydney	Melbourne	Combined Capital Cities
1981	-3.8	11.0	3.7	**2001**	10.8	14.0	10.1
1982	-2.0	4.3	3.9	**2002**	17.8	14.0	16.2
1983	-8.4	6.8	-1.7	**2003**	11.5	9.4	13.7
1984	9.1	21.3	12.3	**2004**	3.5	3.9	6.8
1985	0.6	13.5	6.5	**2005**	-3.4	3.0	1.4
1986	3.9	6.1	4.2	**2006**	-0.1	4.5	7.3
1987	7.4	8.2	6.5	**2007**	4.3	13.2	8.7
1988	39.8	20.9	29.5	**2008**	1.5	8.0	3.8
1989	12.2	18.8	18.6	**2009**	1.6	2.4	0.4
1990	-5.0	-3.5	-2.7	**2010**	11.2	18.0	10.8
1991	1.0	-3.9	-0.3	**2011**	-0.4	-2.4	-2.7
1992	2.9	-0.1	2.6	**2012**	-0.2	-3.9	-1.5
1993	0.5	0.7	2.5	**2013**	7.9	5.0	5.9
1994	8.3	2.3	6.1	**2014**	14.7	8.4	9.6
1995	0.1	-1.5	-1.0	**2015**	16.1	11.0	10.0
1996	3.7	1.2	1.4	**2016**	5.8	7.3	4.4
1997	11.4	9.2	7.1	**2017**	11.6	12.3	8.6
1998	8.3	10.4	7.0	**2018**	-4.8	0.3	-2.0
1999	8.5	10.6	7.3	**2019**	-6.7	-5.8	-5.4
2000	8.8	9.4	7.9				

Source: CoreLogic. Recessions & large economic shocks are shaded.

DRIVERS OF HOUSING DEMAND

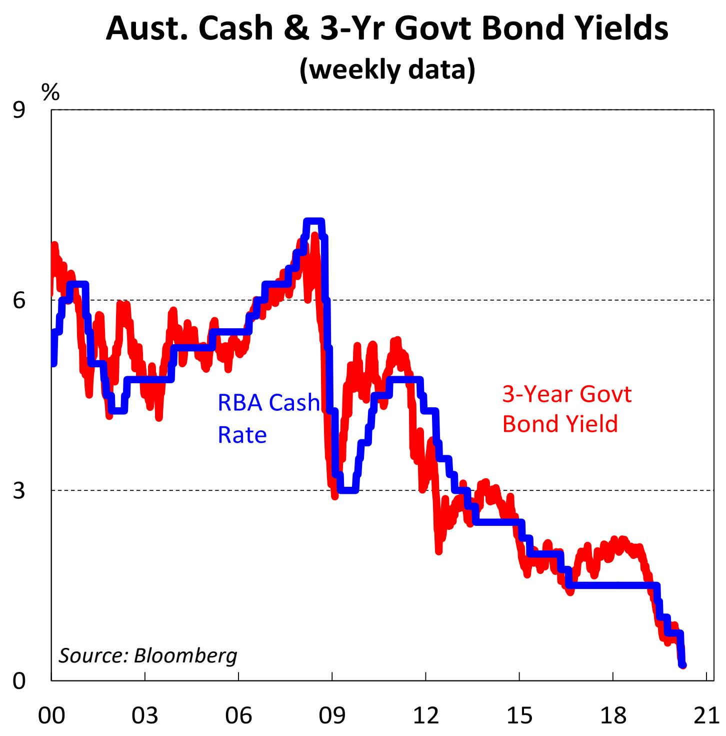
- Incomes, employment and interest rates are key determinants that drive housing demand and affordability.
- Falling incomes and/or rising unemployment constrains housing demand.
- In contrast, lower interest rates provide support to housing demand and dwelling prices.
- Economic downturns are typically associated with rising unemployment and lower official interest rates.
- This downturn is no different. We expect the unemployment rate to rise from 5.2% in March to a peak of around 9% later this year. The survey of households published by the Australian Bureau of Statistics yesterday suggests the risks are the peak could be higher; we cannot rule out a peak in the unemployment rate approaching the mid teens.
- The Reserve Bank Governor delivered a speech and outlined the RBA's key forecasts. They included the unemployment rate rising to around 10% by June this year and warned the unemployment would likely remain above 6% over the next couple of years.
- The Reserve Bank's cash rate was cut to 0.25% on March 19, which is its effective lower bound. Many variable and fixed home loan mortgage rates are at historical low levels.
- This current downturn is expected to be much deeper than during the global financial crisis. The RBA expects national economic output to fall by around 10% over the first half of 2020 with most of the decline taking place in the current June quarter. It will be the biggest contraction since the 1930s. Total hours worked are likely to decline by around 20% over the first half of this year. Lowe highlights that these very large numbers speak to the "immense challenge" faced by society to contain the virus. In Lowe's question and answers session, he described the downturn as a "once in a century event of marked economic contraction".
- Lowe also underscored that this period will pass and that a bridge has been built to get us to the other side. That bridge has been partly built with the help of Australia's strong balance sheets and the waves of stimulus measures from the various forms of government and the RBA.
- Regardless of the timing of the recovery, Lowe says it will not be a quick return to business as usual. Rather, "the twin health and economic emergencies that we are experiencing now will cast a shadow over our economy for some time to come".

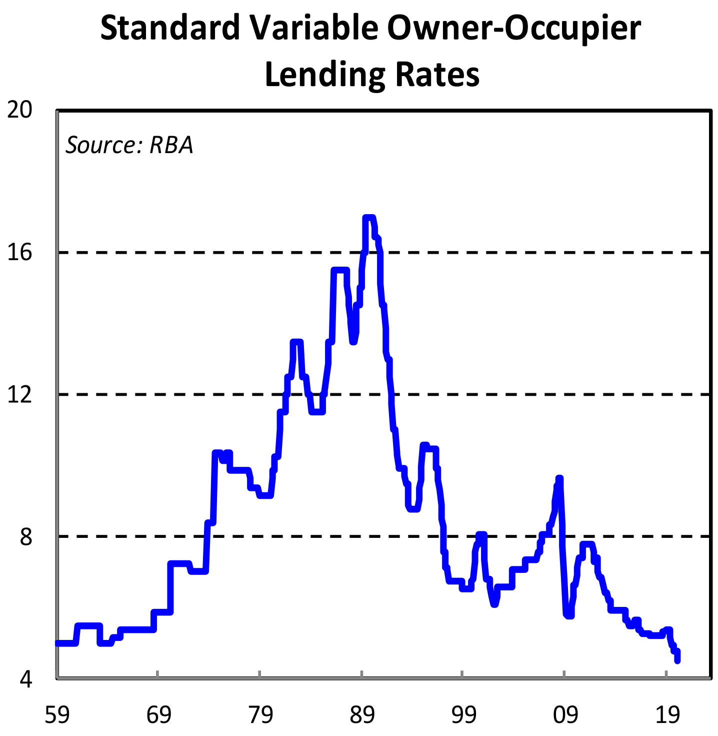
UNEMPLOYMENT RATE TO SPIKE



- There is considerable uncertainty surrounding the growth and employment outlook in Australia.
- However, we are expecting a deep recession and a significant number of job losses.
- Potential job losses would be unprecedented in recent history.
- The Australian Bureau of Statistics (ABS) yesterday released the first edition of a new fortnightly series of statistics covering weekly wage and employment data submitted to the Australian Tax Office (ATO). Employment fell by 6.0% in the two weeks to 4 April 2020, which included a 5.5% drop over the most recent week. This is a large fall in a short amount of time.
- In March, the separate Labour Force Survey showed that there were around 13 million Australians employed. A 6.0% decline in employment would result in approximately 780k job losses if this survey is representative more broadly.
- The Reserve Bank is anticipating the unemployment rate to rise to around 10% by June this year and warned the unemployment would likely remain above 6% over the next couple of years.
- We see the unemployment rising to 9% by June and would not rule out the unemployment rate rising to as high as 14% this year; our best-case scenario has the unemployment rising to just under 8% this year.
- The uncertainty around job security lowers demand for housing.
- The loss in incomes will deter potential buyers from making home purchases.

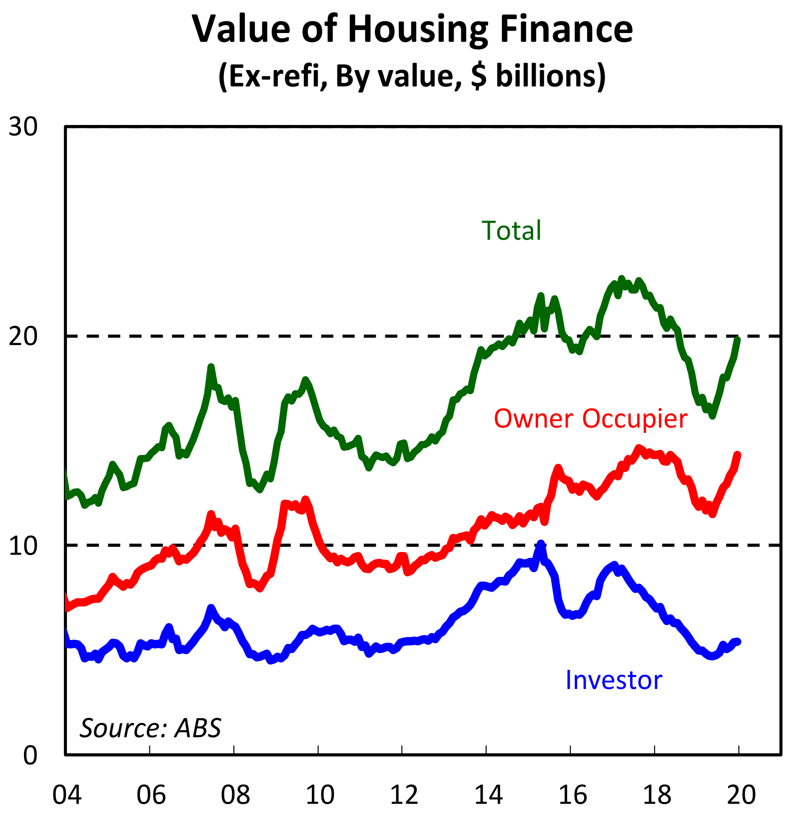
INTEREST RATES





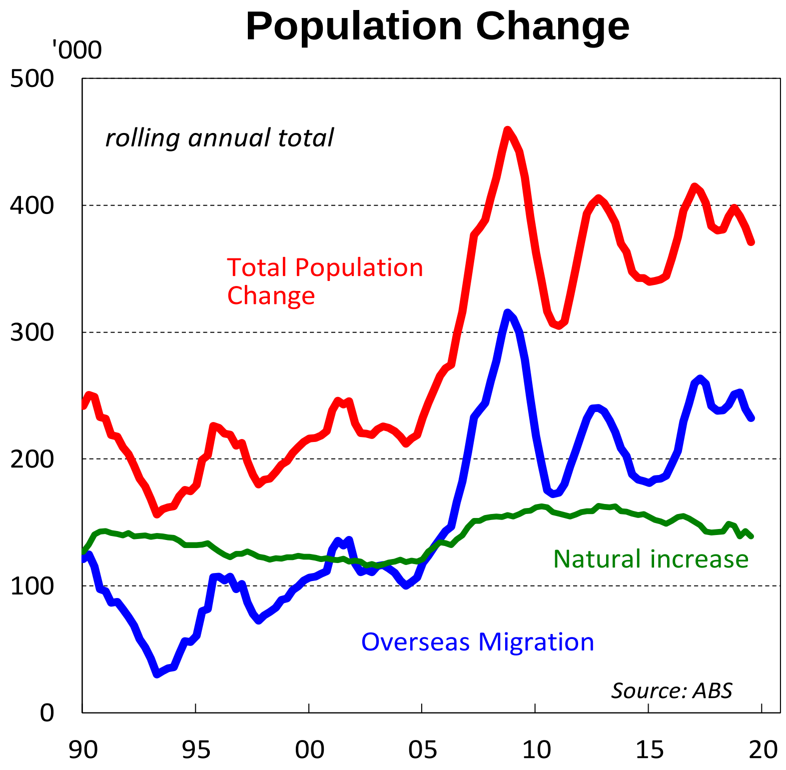
- The RBA lowered the official cash rate to 0.25% on March 19. It has also adopted a target of around 0.25% for the 3-year government bond yield (i.e. quantitative easing) and set up a term funding facility for authorised deposit-taking institutions (ADIs). These policies are intended to help lower lending rates for businesses and households. The lower borrowing costs help provide support to home lending. Indeed, the RBA Governor said that the cash rate will not be raised before he lifts quantitative easing and he will not be lifting quantitative easing until there is evidence of inflation and employment data moving towards the RBA's goals. Low interest rates are here to stay for an extended time. The ability for loan repayment deferrals for those who have lost income due to COVID-19 could limit forced sales.

HOUSING FINANCE – BORROWED TIME



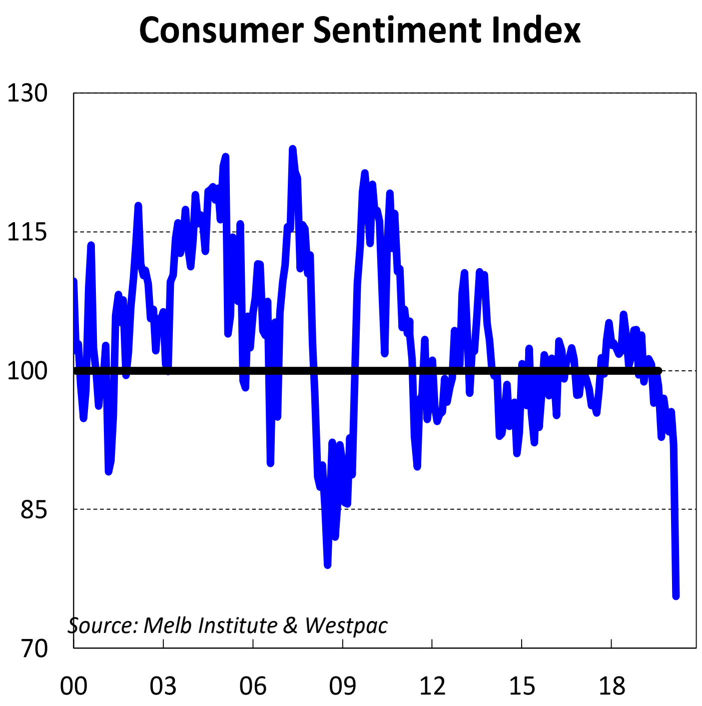
- The value of home lending declined in February for the first time in nine months, despite separate data showing that house prices rose in February and March.
- This slowing in housing finance could be providing an early signal of slowing housing demand .
- Housing finance had been on an upward trajectory until then, in line with the house price recovery that began in the middle of last year.
- Before the coronavirus pandemic, housing transactions were also showing signs of increasing.
- Stay-at-home restrictions, banning of on-site public auctions and public open inspections will deter potential buyers.
- Uncertainty about the economy and substantial job losses will also further dent demand to buy dwellings and further reduce new borrowing.
- The stimulus package implemented by the RBA was not specifically targeted at housing lending. However, it will ensure that lending rates remain very low for some time, which could encourage borrowing once the economic recovery sets in.
- Temporary mortgage repayment holidays implemented by some large financial institutions may also put some upward pressure on existing loan balances. Typically, these policies add the interest payable to the total balance, but extend the term of the loan.

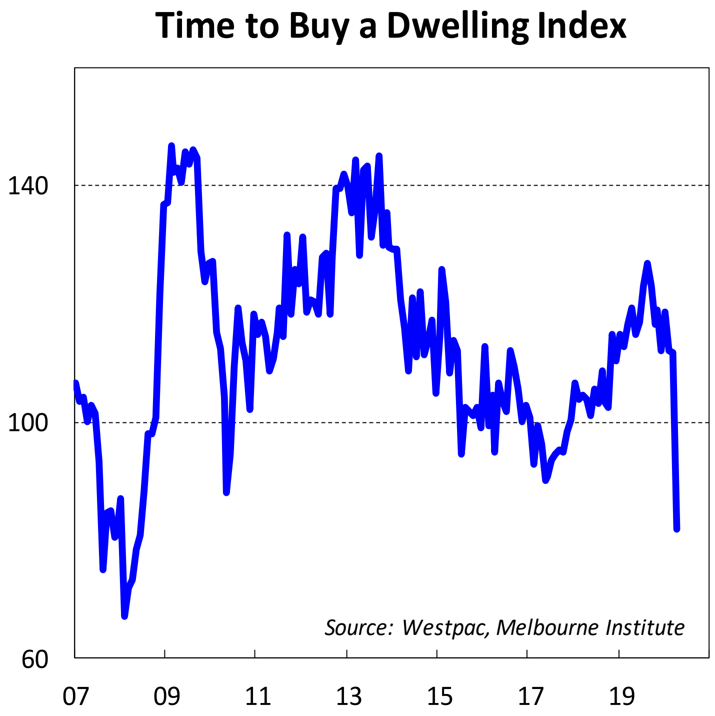
MIGRATION INFLOWS SET TO GRIND TO A HALT



- Strength in Australia's population growth has been mostly driven by overseas migration inflows.
- Strong population growth has helped underpin housing demand over the past few housing cycles.
- The annual growth in population due to net overseas migration was 230,000 people in 2019.
- Based on an average household size of 2.6 people (from the last Census), this equates to underlying demand of 89,000 dwellings per year.
- Inbound migration will be significantly lower in the near term due to containment measures. The policy debate once the health crisis passes will be whether or not migration intake should be increased to make up for the deficit.
- Demand for dwellings will slow significantly, as migration inflows are halted.

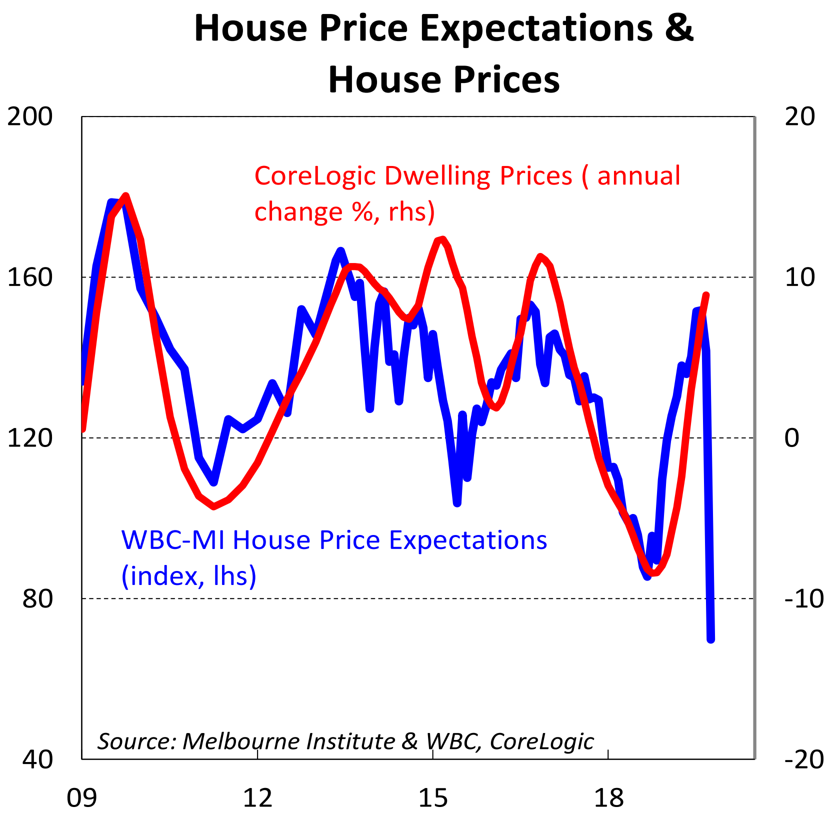
CONSUMERS ARE CRAWLING INTO THEIR SHELLS





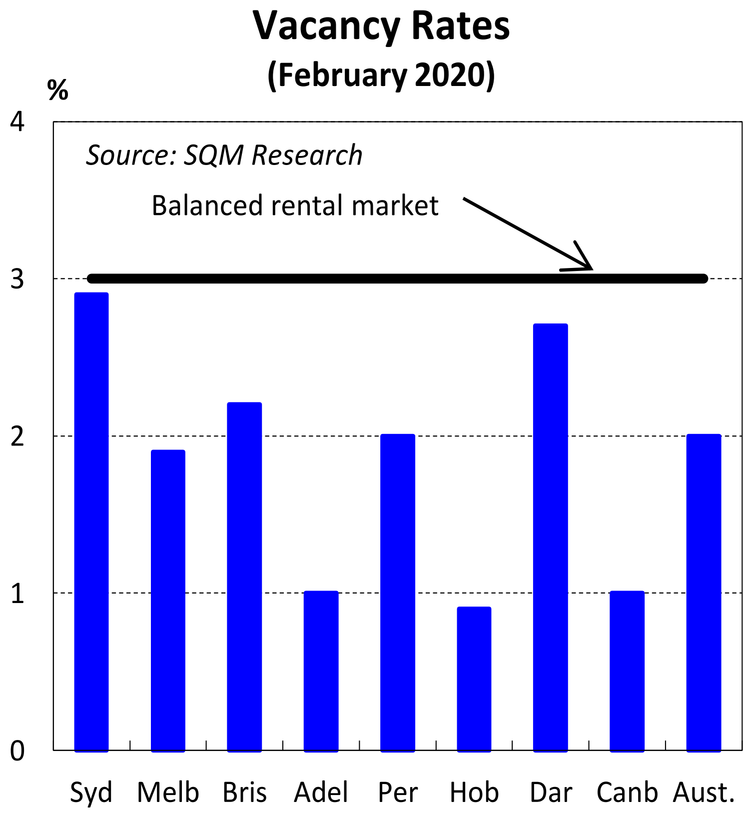
- The Westpac-Melbourne Institute consumer sentiment index recorded its sharpest fall ever in the 47-year history of the series in March. The level is at its lowest since the 1990s, when the economy was last in recession.
- The “good time to buy a dwelling” sub index fell to its lowest outcome since 2008 during the GFC, indicating the vast majority of consumers currently view buying conditions as unfavourable.

HOUSING EXPECTATIONS HAVE DETERIORATED SHARPLY



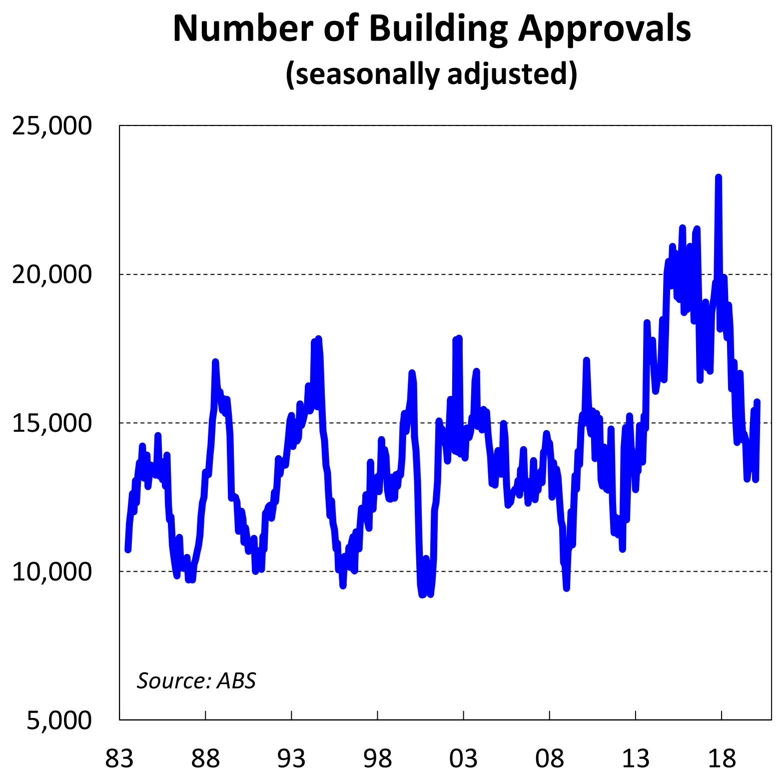
- The Westpac-Melbourne Institute House Price Expectations Index in April was at its lowest in the series history which dates back to 2009.
- March was also the sharpest fall ever recorded in the index.
- Survey respondents are asked whether they expect house prices to rise or fall – the lower the index, the more respondents expect house prices to fall.
- It would suggest that dwelling prices are set for a sizeable fall.
- However, it is worth noting the house price expectations index measures sentiment, which can turn around quickly. There have been ‘V’ shaped recoveries in the past.

VACANCY RATES AND RENTS



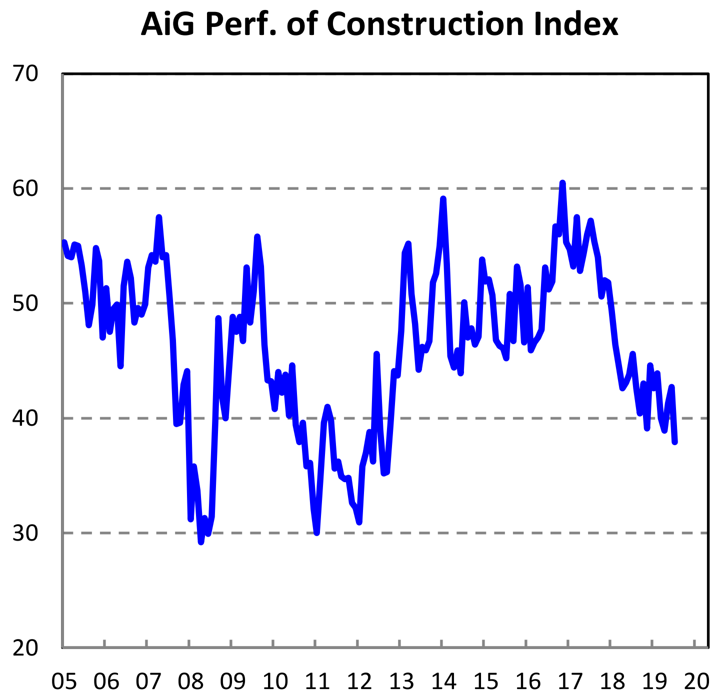
- Vacancy rates were low across most capital cities in February.
- Vacancy rates are set to lift as job losses limit the ability to pay rent, and as migration inflows slow significantly.
- We expect downward pressure on rents over the year ahead.
- Owners of holiday rentals may also look to secure longer-term stays, adding to supply.
- The 3% threshold is what is considered to divide a tight rental market from a loose rental market. Sydney and Darwin's vacancy rate in February were near 3%.

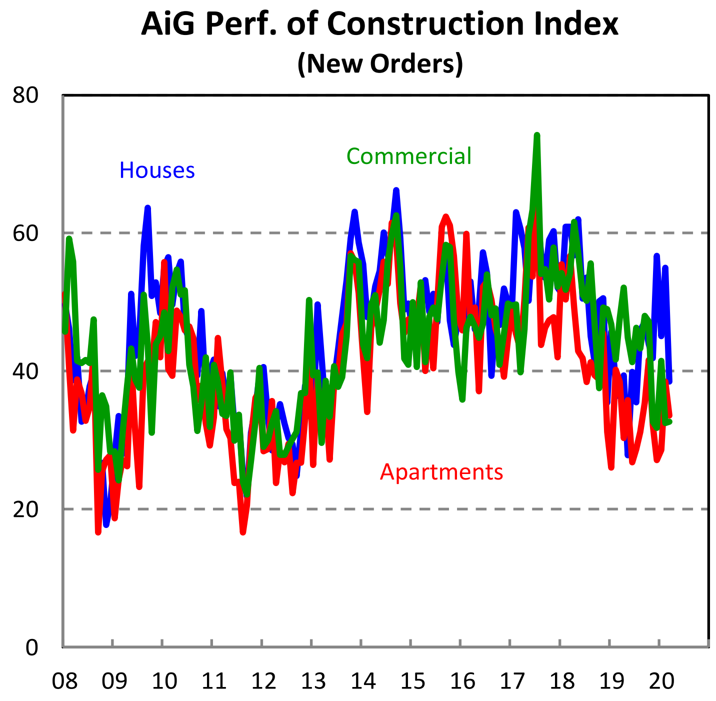
RESIDENTIAL CONSTRUCTION – RECOVERY SET TO STALL



- Residential construction was stabilising following a renewed upswing in dwelling prices.
- The stabilisation was led by detached and low-rise apartments. The high-rise segment had been under downward pressure due to uncertainty following building quality and cladding concerns, as well as pockets of oversupply in some regions. Debt coverage requirements were also providing a constraint for multi-rise developments greater than 4 stories.
- With housing demand and economic activity dropping off sharply, construction is likely to weaken considerably.
- The latest NAB business survey points to confidence in the construction industry dropping sharply in March, although conditions have yet to deteriorate significantly as yet.
- In a survey conducted by the ABS over 16-23 March, the construction industry reported one of the highest proportion of businesses expecting an adverse impact from COVID-19, well over 90%.
- Social distancing measures are likely to delay and extend project times, but the main impact on the industry will come from the downturn in the economy, which will hit demand for the sector.

WARNING SIGNS





- The AiG performance of construction index fell to its lowest since 2013 in March and is in deep contraction territory.
- All key sectors of construction were in contraction.
- New orders have fallen sharply for houses. There was a weaker starting point for apartment construction.
- New orders in commercial construction are the near the weakest since 2012, and conditions are set to worsen.

COMMERCIAL TENANT SUPPORT PACKAGE – FEDERAL GOVT

- The Federal government announced a new mandatory code of conduct to support small to medium enterprises (SMEs) who have experienced financial distress due to the coronavirus outbreak on April 7 (flagged on April 3).
- Its central idea is that landlords and tenants should work together “in good faith” to get through the temporary shock of COVID-19.
- The code is to be administered by the individual governments of the States and territories.

Criteria:

- Tenants with a turnover less than $50 million and tenants eligible for the JobKeeper payment (effectively requiring the revenue of tenants to have declined at least 30% due to COVID-19 compared with a comparable period a year ago).

Key measures:

- Hold on evictions for renters over the next 6 months.
- Private landlords must agree to waive or defer a proportion of rent in accordance with the decline in trade due to COVID-19 suffered by their tenants.
- Tenants must stay committed to their lease terms (subject to amendments).
- Any benefits that owners get for their properties must be passed on to tenants (for example, reduced charges or deferred loan payments).
- Under the new leasing principles, if a landlord has agreed to defer rent, at least 50% of that total amount must be waived. This principle includes a clause that the landlord’s financial ability to offer that waiver must be taken into account and the tenant has the option to relax this obligation on the landlord.
- The Commonwealth Government is waiving rents for all its small and medium-sized businesses (SMEs) and not-for-profit tenants within its government properties, under its Rent Relief Policy.

COMMERCIAL TENANT SUPPORT PACKAGE – STATES

- Several State and territory governments have responded to the new mandatory code of conduct with rental support packages.
- Most of these packages include some sort of support for landlords, usually through land tax discounts or deferrals.
- The landlord must pass on the benefits to the tenants in order to receive these support packages, as outlined in the new code.

NSW

- As part of a broader rental support package, $220 million has been made available for commercial landlords in the form of land tax waivers or rebates (up to 25%) whose tenants have suffered due to the coronavirus.
- A total of $440 million has been made available for commercial and residential landlords under the scheme.

QLD

- 3-month waiver and 3 months deferral of land tax for commercial landlords whose tenants have suffered from the coronavirus.
- Landlords are not allowed to evict their tenants or require them to draw down on their superannuation or sell large assets like motor vehicles to meet rental obligations.
- A total of $400 million has been made available for commercial and residential landlords under the scheme.

VIC

- $420 million total in land tax relief for commercial and residential tenants.
- 6-month ban on evictions and rental increases.
- SMEs eligible for JobKeeper have access to a $80 million fund to be granted rental waivers or deferrals.

SA

- Businesses paying land tax on a quarterly basis are able to defer payment of their third and fourth quarter instalments for up to 6 months.

RESIDENTIAL RENTAL SUPPORT

- The Federal government announced a moratorium on evictions for tenants affected by the coronavirus on March 29. The moratorium is for 6 months. The implementation of this has been left to the States.
- State and Federal government has stressed that much of the support for renters is designed to be provided through the enhanced JobSeeker and the new JobKeeper payments.

NSW

- The NSW rental support package has allocated $220 million in land tax reductions (up to 25%) and deferrals for residential landlords who offer rent reductions to their tenants.
- There is a 60-day ban on evictions for tenants whose incomes have been affected by COVID-19.
- Landlords and tenants must engage in “good faith” negotiations to reduce rent.

QLD

- A total of $400 million has been made available for commercial and residential landlords in the form of land tax reductions (3 months deferral and 3 months waiver of the yearly land tax requirement).
- Landlords are not allowed to evict their tenants who have been affected by the coronavirus or require them to draw down on their superannuation or sell large assets like cars to meet rental obligations.
- $20 million has been made available in relief grants for affected tenants covering up to 4 weeks rent or a maximum of $2,000.

VIC

- $420 million total in land tax relief for commercial and residential tenants.
- 6-month ban on evictions and rental increases.
- Households affected by the coronavirus have access to a $80 million fund to be granted rental waivers or deferrals and will be able to negotiate a rent decrease with landlords in good faith.

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