Welcome to CoreLogic’s update on Australian housing market conditions for July 2018. With data now available through to the end of June, we can provide an overview of the housing market performance over the financial year and our views on where the market is likely to be heading from here.

CoreLogic’s national housing market index showed a remarkable reversal in housing market conditions over the past year. A year ago, national dwelling values were up 10.2%, largely driven by surging values in Sydney where the market was up 16% and Melbourne where values had tracked 13% higher over the year. The most recent financial year has seen the national index slide 0.8% lower, with Sydney values down 4.5% and Melbourne values edging only 1% higher.

Although most of the focus has been on slowing conditions in Sydney and Melbourne over the past year, every capital city apart from Perth has shown a weaker performance over the most recent financial year relative to 2016-17, although there are some variances across the product types and valuation segments.

Across the broad product types, the detached housing sector has underperformed relative to the unit market, with capital city house values down 2.2% over the financial year while unit values managed to eke out growth of 0.4%. This stronger performance from the unit sector was heavily influenced by the Sydney and Melbourne housing markets where the unit sector has been more resilient to a downturn, likely to due to the more affordable price points available within the unit market and the surge in first home buyers where demand is focused on more affordable housing stock. Every other capital city, where housing affordability constraints are less challenging, has seen the detached housing sector outperform the apartment market.

We have also seen some divergence in housing market conditions across the broad valuation segments. The combined capital cities index is showing clear weakness at the most expensive end of the market, with the most expensive quarter of housing recording a 3.6% fall in dwelling values over the year while the most affordable quarter of properties have seen values rise by 1.4%.

Once again, this headline trend is heavily influenced by Sydney and Melbourne, where the most expensive quarter of the market has seen values fall by 7.4% and 2.5% over the financial year respectively. Most other cities have seen relatively little difference in the performance of properties across the broad valuation spectrums.

Another sign of diverging performance can be seen in advertised stock levels. The number of properties advertised for sale in June 2018 was 22% higher than a year ago in Sydney and 10% higher in Melbourne while every other capital city has seen a reduction in overall advertised stock levels. A rise in inventory levels implies buyers have more choice, more ability to negotiate with vendors and less urgency in their decision making which helps to alleviate any upwards pressure on prices. Demonstrating the impact of low advertised stock levels, the strongest capital city housing market, Hobart, has almost 30% fewer homes currently on the market compared with a year ago.

The change in housing market conditions can also be seen across CoreLogic vendor metrics, including auction clearance rates, median selling time and vendor discounting rates. Across the combined capitals, auction clearance rates have reduced from 67% at the end of the previous financial year to finish 2017-18 about ten basis points lower, at 55%. The two largest auction markets, Melbourne and Sydney, have seen clearance rates reduce from 71% to 60% and from 68% to 50% over the year.

Median selling time has increased by 3 days over the year across the combined capitals to reach 43 days. The Sydney housing market has recorded the largest increase, with the median selling time increasing by 20 days over the year to reach a median of 46 days. Conversely, homes in Hobart are typically selling 20 days quicker, averaging just 29 days based on the most recent data.

As always, there are substantial differences in the housing markets performance across each of the capital cities.

Sydney dwelling values fell by -4.5% over the 2017-18 financial year. This was the largest financial year fall on record. The reversal in Sydney’s housing market performance is stark when considering that a year earlier values had increased by 16.4% over the financial year. Despite the recent year on year fall, Sydney dwelling values remain 54% higher than they were five years ago. The weakest conditions are confined to the premium sector of the Sydney housing market where values across the upper quartile of the market are down 7.4% over the year while the most affordable quarter of the market has seen values fall by a less significant 1%.

Over the financial year, Melbourne dwelling values increased by 1%, which was the slowest rate of growth in six years and well down on the 13.0% increase over the 2016-17 financial year. Digging below the surface, it’s clear that more affordable housing markets are showing much stronger conditions; likely the result of more first home buyer activity and more broadly, affordability constraints. The most affordable quarter of the Melbourne market has seen dwelling values rise by 9.3% over the past twelve months while the most expensive quarter of the market has recorded a fall of 2.5%

Growth in Brisbane dwelling values has slowed over each of the past two financial years with an increase of 1.1% over the past twelve months. The past year has been the weakest financial year performance since values fell by -3.6% over the 2011-12 financial year. Although the rate of growth slowed, Brisbane housing values have increased over each of the past six financial years. In a sign the Brisbane unit market is emerging from a period of sustained weakness, unit values were up 1.7% over the June quarter while house values rose by only 0.1% over the past three months. If this is the start of a recovery trend, the local unit market needs to see values rise by a further 11% before recovering to their 2008 high.

Adelaide dwelling values increased by 1.1% over the financial year, marking the 5th consecutive year in which values have increased. Although values trended higher over the year, it was the slowest rate of change for the city since values fell -0.4% in 2012-13. Despite the relatively soft rate of growth, settled sales are 1.0% higher across Adelaide over the past twelve months and advertised stock levels are 5.5% lower than a year ago, suggesting vendors are starting to get some leverage back over buyers.

Perth dwelling values fell by -2.1% over the financial year which is an improvement on the rate of decline from the previous financial year when values were down 2.6%. Although values have now fallen for four consecutive financial years, declines over the most recent year were the most moderate of those four years. The first half of 2018 has seen Perth house values hold reasonably firm, slipping by just 0.1%, however unit values haven’t been quite as resilient, down 4.4% over the first half of the year. With dwelling values remaining 10.9% below their June 2014 peak, the recovery phase is likely to take some time across the Perth housing market.

Hobart dwelling values increased by 12.7% over the financial year – a high but steady rate of growth relative to the previous financial year when values rose 12.8%. Dwelling values in Hobart have now increased for five consecutive financial years however, the past two years have seen the strongest growth since the 2003-04 financial year. With values showing such strong capital gains, Hobart is no longer the most affordable capital city, handing the title to Darwin where dwelling values are now $3,600 less than Hobart prices. Hobart properties are selling in just 29 days on average and there remains a severe shortage of housing stock which is adding to the upwards pressure on housing prices.

Darwin dwelling values were down for the fifth consecutive financial year, falling -7.7% over the past twelve months to be 22.2% lower relative to the 2014 market peak. The rate of value decline over the past financial year was much greater than the -2.6% fall recorded in 2016-17 however, suggesting the long running downturn may have found a second wind as credit conditions tighten. Although homes are selling slightly faster than a year ago, the shifting of stock has come due to vendors substantially discounting their asking prices, with the median vendor discounting rate rising to 10.5%.

The annual pace of capital gains across Canberra has reduced from 7.8% in 2016-17 to 2.3% in 2017-18. Although value growth slowed over the past year, Canberra dwelling values have now increased over four consecutive years. Median selling time has increased by three days over the past year, to reach 46 days, however vendors continue to offer up little in the way of discounts on their asking prices, with the median vendor discount tracking at just 3.6% which is level with a year ago.

The weakening in housing market conditions should come as no surprise, considering the changed regulatory environment which has limited the availability of housing credit, especially for investors. Annual housing credit growth has slowed from 6.6% over the 2016-17 financial year to 5.8% over the twelve months ending May 2018. The slowdown in credit has been entirely driven by less lending for investment housing where the annual rate of growth has fallen from 5.1% a year ago to 2.0% which is an historic low.

Lending to owner occupiers has held reasonably firm, in fact showing a subtle rise from 7.5% a year ago to 7.9% over the twelve months ending May 2018. The improvement in owner occupier finance has been driven by a surge in first home buyer lending, mostly emanating out of New South Wales and Victoria, where stamp duty concessions have supported renewed demand from this sector of the market.

With APRA lifting the 10% cap on investment lending this month, there has been some speculation that this could see a rebound in investment lending, however we believe this is unlikely. The 10% speed limit has become largely redundant, with broader limits on interest only lending, more focus on debt to income ratios and greater scrutiny of borrower expenses and incomes likely to continue to muffle investment related credit growth. Additionally, investors continue to pay, on average, a 60 basis point premium on their mortgage rates.

While higher mortgage rates and more stringent lending criteria are having a clear effect on investor participation in the housing market, other barriers are also apparent.

Despite the slippage in home values across Sydney, and to a lesser extent Melbourne, dwelling values remain very high relative to other capital cities. With lenders now scrutinizing borrowers with a debt to income ratio of more than six times, housing markets where prices are high relative to incomes could see less activity as prospective buyers find their borrowing capacity reduced. This is certainly the case in Sydney and Melbourne where the dwelling price to income ratio is 9.3 and 8.0, while the remaining capital cities have recorded ratios below 6.5.

Additionally, with the federal election campaign imminent, we could see investor confidence impacted further if changes to taxation polices related to investment housing are debated. Rental yields are improving from a low base, however it’s likely that the majority of property investors are offsetting their cash flow losses against their taxable income. Changes to negative gearing would likely add a further material disincentive to investors.

Although the market expects official interest rates will remain on hold until 2020, there is growing pressure on lenders to lift mortgage rates due to higher funding costs being experienced overseas. Smaller banks and non-banks have more exposure to international funding markets, which has seen some of these lenders start to adjust their mortgage rates higher.

Considering households have become very sensitive to changes in interest rates due to record high indebtedness, higher interest rates, along with tight credit conditions could place additional downward pressure on housing market conditions. A weaker housing sector would likely show a flow on effect to economic conditions, creating some drag on consumer spending as the wealth effect reverses and dwelling construction winds down as well as creating challenges for those industries that are at least partially reliant on housing turnover.

Overall, we are expecting housing market conditions are likely to remain relatively soft over the second half of 2018. Of course there will be substantial variations in the performance of the sector, so make sure you are staying up to date with all the latest trends at the CoreLogic web site. www.corelogic.com.au

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