Welcome to CoreLogic’s update on housing market conditions for August 2018. Last month we saw our national index move through the tenth straight month of falling home values. Since peaking in September last year, the Australian housing market has recorded a cumulative 1.9% fall in value; a relatively mild downturn to date, especially when you consider that values remain 31% higher than they were five years ago.

The month of July saw the housing downturn gathering some momentum; on a national basis, the 0.6% month on month fall was the largest decline since September 2011 and the rolling quarterly change, at -0.9%, hasn’t been this low since January 2012. Five of the eight capital cities saw values slip lower over the past three months and trends across the regional housing markets, where conditions have generally been more resilient to falls, have also turned negative.

The weakness in dwelling values is being driven by the long running declines in Perth and Darwin along with an acceleration in the rate of decline across Sydney and Melbourne. Outside of these cities, growth rates are generally slowing as tighter credit conditions broadly dampen housing market activity.

Across the capital cities, Melbourne has been leading the downturn, with the quarterly rate of decline outpacing Sydney since May this year. Melbourne dwelling values were down 1.8% over the past three months, followed by Perth at -1.5% and Sydney where the market was down -1.1%. Melbourne’s decline phase commenced five months later than Sydney’s, with the market peaking in November last year. Since that time, Melbourne dwelling values have fallen by 2.9%, while in Sydney, where values peaked twelve months ago, the market is down 5.4%.

Those cities where values continue to trend higher have also seen a sharp reduction in their rate of capital gain. In Brisbane and Adelaide, where housing values were rising at a more sustainable pace over the past five years, the annual rate of capital gains has weakened. In Brisbane, the annual rate of growth has eased from 2.9% a year ago to 1.2% over the past twelve months and in Adelaide the annual growth rate has dropped from 5.4% a year ago to just 0.7% over the most recent twelve month period.

Even the Hobart market, where the annual pace of capital gains has held in double digit growth territory since January 2017, is starting to slow down. Dwelling values were steady over the month and the annual rate of growth slowed to 11.5%; still strong but the slowest annual growth rate since February 2017. Over the past three months, Hobart dwelling values have increased by just 1.1% which is their slowest rate of increase over a three month period since July 2016.

Focusing on the regional markets, dwelling values were down 0.2% across the combined regionals index over the three months ending July, driven by falls across regional NSW where the market was 0.2% lower. Values were also down -0.6% across regional Qld and regional WA which recorded the largest decline over the quarter, down -3.5%. While three of the seven ‘rest of state’ regions saw a fall in values over the three month period, the pace of growth across the remaining regional areas has clearly decelerated, contributing to the overall softer national result.

Settled sales numbers highlight the market weakness, with the number of dwelling sales falling by almost 10% over the twelve months ending July 2018. Every capital city except Adelaide has seen a reduction in the number of settled sales, with the largest annual declines recorded in Sydney and Melbourne, where sales over the past twelve months were down 17% and 15% respectively.

As activity in the market slows, inventory levels have risen and vendors have lost some leverage. Total advertised stock levels are almost 8% higher than a year ago, reaching the highest level for this time of the year since 2012. With more properties to choose from, buyers are negotiating harder resulting in higher vendor discounting rates and longer selling times for private treaty sales.

Of course conditions are very different from city to city and region to region.

In Sydney, the housing downturn marked its one year anniversary, with the market peaking in July last year. Since that time Sydney house values have reduced by 7.0% while unit values have been somewhat more resilient, falling by 2.2% since peaking. There has been an ongoing divergence in the performance across different price points, with the most expensive quarter of Sydney’s market down by 8% over the past twelve months while the most affordable quarter of the market has seen values fall by only 1.8%. A rise in the number of first home buyers and more focus on debt to income ratios from lenders is likely skewing market activity towards the middle and lower end of the market.

Melbourne’s downturn accelerated in July, with dwelling values falling almost 1% over the month to be 1.8% lower over the past three months; the largest quarterly decline amongst the capitals and the most significant drop in values since January 2012. Since peaking in November last year, Melbourne house values are down 3.7%, while the unit values have been trending lower since April this year and are down only 1.1%. There has been a material divergence in growth rates between higher priced properties and the lower end of the market, with Melbourne’s top quartile values falling by 4.1% over the past twelve months while the least expensive quarter of the market is up 7.5%. The stronger growth conditions across the more affordable end of the market can be attributed to first home buyers propping up demand as well as borrowing capacity for more expensive properties being impacted by tighter debt to income ratios from lenders.

Brisbane has become one of the best performing capital city housing markets, not because growth rates have accelerated, but simply because most other cities have slowed down at a faster rate. The first seven months of the year have seen Brisbane dwelling values rise by 0.4% - a fairly mild result, but it’s the second highest growth rate after Hobart where values are 5.8% higher over the same time frame. Importantly, the local unit market has been the main driver of year to date growth, with Brisbane unit values up 1.1% over the first seven months of the year while house values are up a lower 0.3%. While the recovery in Brisbane unit values seems to be in an early stage, the construction cycle peaked almost two years ago. With supply winding down and population growth ramping up, we may see the local unit market staging a gradual improvement, however unit values need to rise almost 11% before returning to the previous nominal high which was more than a decade ago.

Adelaide dwelling values are generally trending upwards, but on a subtle trajectory. Values nudged 0.1% lower in July but were 0.7% higher over the rolling quarter. A year ago, the annual growth rate across Adelaide was tracking at 5.4%, however the annual trend has moderated to just 0.7% at the end of July, highlighting a sharp slowdown in the pace of capital gains. Despite the slower growth conditions, settled sales activity has held firm, in fact, ticking 0.2% higher year on year. Adelaide was the only capital city to record a rise in settled sales activity over the year. While the past five years has seen the strongest growth conditions skewed towards the most expensive end of the market, the latest data shows annual growth has transitioned towards the lower end and middle of the market where the annual change in dwelling values has been 1.5%.

The Perth housing market has slipped a little over the past three months, after recording several consecutive months of positive growth. The three months ending July saw Perth values fall by 1.5%, which was the largest quarterly fall since August 2017. While we remain of the view that the Perth housing market is either at the bottom of its downturn or very close to it, the recent negative movements highlight that this market remains fragile and growth drivers are scarce. The apartment market has been the weakest, dragging the quarterly reading down by 3.3% while house values were down a smaller 1.1% over the past three months.

Hobart’s stunning rate of double digit annual growth has shown some cracks over the past few months, with the annual trend in capital gains reducing to 11.5%; still reflecting strong conditions, but the annual trend has been reducing since September last year. In another sign the Hobart market has moved through a peak rate of growth, the July results showed Hobart dwelling values were unchanged over the month and house values tracked 0.2% lower, the first month on month fall since January 2016.

Darwin has been the hardest hit capital city, with dwelling values down a cumulative 21.9% since peaking in 2014. With some recent positive month on month results, the annual trend has started to improve, driven by a better performance across the detached housing market where values are 5.5% higher over the first seven months of the year. The local unit market is still experiencing depressed conditions with values down 12.0% over the same time frame.

Canberra’s housing market has continued to hold reasonably firm with dwelling values ticking 0.2% higher over the year to date. The subtle rise in values is attributable to a 0.7% lift in house values which has helped to offset a 1.1% fall in unit values over the same time frame. Inventory levels remain roughly on par with a year ago, however the median selling time has reduced by four days relative to a year ago and vendor discounting has contracted, suggesting selling conditions remain relatively strong.

Overall, we can’t see any factors that may halt or reverse the housing markets trajectory of subtle declines over the second half of 2018. The availability of housing credit has been a significant factor contributing to this slowdown, however there are a variety of hurdles contributing to slower conditions.

From a credit perspective, the latest credit aggregates from the Reserve Bank of Australia highlight that owner occupier lending has continued to grow at a relatively strong pace; up almost 8% over the twelve months to June. The same data highlights that the slowdown in credit growth is attributable almost entirely to less investment lending, where growth is tracking at a record low of 1.6% annually.

Sydney and Melbourne have recorded the most substantial concentration of investment activity, and despite the tighter lending conditions for this segment and weaker housing markets in Sydney and Melbourne, somewhat surprisingly, New South Wales and Victoria continue to show higher investment concentrations relative to other states.

Although the 10% speed limit on investor credit growth has been removed for eligible lenders, we aren’t expecting a rebound in credit availability for investment purposes. Mortgage rate premiums for investment loans remain in place and the limits on interest only lending continue to provide disincentives to housing market investment. Additionally, market factors such as low rental yields and dim prospects for short to medium term capital gains are also likely to quell investment demand.

Higher housing supply is another factor that is likely to weigh on some sectors of the market. Unit construction remains well above average across most states, and is at record highs across Victoria and South Australia and only marginally below the record high in New South Wales.

Coupled with high supply, key segments of demand, including domestic investors and foreign buyers, have thinned out which could see downwards pressure on prices in those areas where new ‘investment grade’ projects are numerous.

Migration trends have also changed which is likely to have both positive and negative impacts on housing demand. Although ABS demographic data is only current to December last year, it is clear that New South Wales is seeing a growing exodus of residents to other states, while interstate migration rates to Victoria appear to have peaked as well. The reduction in migration implies reduced housing demand in these locations. Queensland is the major beneficiary of cross border resident flows, which should help to support housing demand, especially across the South East corner of the state.

Despite the reduction in dwelling values in Sydney and Melbourne, housing affordability remains a pressing issue in these cities. The ratio of dwelling prices to incomes was tracking at 9.1 in Sydney and 8.1 in Melbourne at the end of June. Although these ratios are likely to improve as incomes edge higher and housing prices reduce, prices would need to fall a lot further to see this measure of affordability return to more adequate levels, especially when you consider where these ratios are relative to the other capital cities.

While dampening factors are at play, consistently low mortgage rates will continue to provide a support buffer which should help to keep a floor under housing demand.

Owner occupiers continue to enjoy mortgage rates at the lowest level since the 1960’s, and, although investors are paying around a 60 basis point premium on their home loans, interest rates remain low for this segment of the market as well.

Higher funding costs could see mortgage rates edge higher, however we would need to see mortgage rates rise by more than 150 basis points before returning to the 20 year average of 6.8%. Even though smaller lenders have increased owner occupier mortgage rates, some larger lenders have recently reduced interest rates for certain owner occupier mortgages.

Considering the 30% limit on interest only loan originations and the stiff interest rate premiums for interest only loans, it’s likely we will see owner occupiers gradually consume a greater share of market activity relative to investors going forward.

With the housing market changing rapidly, it’s become even more important to stay across the trends as well as the key economic and demographic factors at play. The CoreLogic research pages are maintained with a frequent updates on the key issues. Stay up to date at www.corelogic.com.au

**Short version**

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