HOME TRUTH

SEPTEMBER 2016

Welcome to HOME TRUTH, a monthly synopsis of Brisbane's quality property sales and leasing markets.

++

MARKET BRIEF

SALES:

~ Enquiry Levels – Low to Moderate
~ On Show Attendances – Low to Moderate
~ Listing Activity – Low to Moderate
~ Negotiating Activity – Low to Moderate
~ Conversion Index – Low to Moderate
~ Auction Success Rate – Low to Moderate
~ Disparity Index* - Very High 15%+

* The Disparity Index is the broad percentage difference between what buyers and sellers feel property is worth

LEASING:

~ Enquiry Levels – Moderate
~ Listing Activity – Low
~ Take-up Rate – Low to Moderate

MARKET DETAIL

SALES:

As we formally enter the peak Spring Selling Season there are a lot of positive fundamentals in place for the market but as yet seller confidence isn't fully one of them. As such, we look like entering this traditionally halcyon sales period undercooked on (quality) stock.

Looking back over recent weeks, the market that had an encouraging real post-election spring in its step has lost some traction as it has become clearer publicly that post poll Australia economically may not be better than pre, or perhaps worse.

The mood could still change obviously as spring has only just formally sprung but from a historic perspective spring listings this year are slower than usual coming on (particularly so when we consider that spring sprung so early post the election induced winter market hiatus).

The RBA went a little ways towards giving confidence a boost over the last month by 'belatedly' cutting rates again, though true to form totally inadequately as became clear when the currency went up instead of down almost immediately after the announcement. From that we can very safely bet that more cuts are on the way.

What will need a lot more than interest rate cuts to remedy is the investment apartment market which now appears on the edge of a yawning precipice with quarter on quarter sales reportedly down by 50% (a half), a shift of immense proportion if not indeed one totally unprecedented in Brisbane's history.

The even bigger worry that developers have presently than selling investment apartment product is getting already sold off the plan product to settle. As the banks have retreated from the market (including from contracts where they had granted finance approval), developers have had to line up alternative 'mezzanine' finance at rates some 2 to 3 times (200 – 300%) higher than bank lending rates.

Trying to get some clarity on the risk profile, according to one senior economic forecaster, Melbourne with its population of roughly 4 million people or more than twice ours has about the same number of apartments planned to be built as we do over the next 3 years. If those numbers are correct and anywhere near that number come out of the ground, we had better become at least equally fashionable to the Chinese as Melbourne (was) in a real hurry.

Whether or not or just how badly the investment apartment sector of the market ultimately unravels will of course greatly depend on what the mainland Chinese investor (as principal buyers) does short to medium term.

Inasmuch as it is out of character for the Chinese to walk away from a deposit or an agreed property purchase given how sacrosanct property is to them, there are limits to everything. If the dominoes really start to fall, habitual behaviour regardless of how engrained can evolve.

Digressing slightly from the core residential scene, an unusual phenomenon has washed through commercial (retail and industrial) property where a yield starved world combined with record high vacancies is seeing prices for tenanted property being sold on record low yields but untenanted property same size, same area going cheap.

AUCTIONS:

Auction action in Brisbane broadly remains relatively subdued, not unusual for the time of year but disappointing given the early start to the spring selling season the market enjoyed in the first few weeks that followed the federal election result being decided.

Whilst still early Spring, from our perspective (with only 3 auctions locked in thus far and all for September), it must be said given the prevailing level of buyer activity that we are likely to soon find ourselves in supply deficit.

NATIONAL PICTURE:

Sydney – Fresh lease of life in housing sales and only subdued softness across apartments
Canberra – Like its geography, placed somewhere between Sydney and Melbourne
Hobart – Cyclical affordability driven mainland to island migration growth spurt
Melbourne – Slowing on all fronts with apartments leading the charge
Adelaide – Flat-lining despite all the electoral cash splash promises
Perth – Mining downturn driven contraction continues at pace
Darwin - Perth situation writ large

LEASING:

The market has eased to be at levels more typical of the time of year which is a change from the unseasonal demand (particularly for housing) that we had been experiencing. Contributing to the seasonal quietening is the reality that with each interest rate cut, housing affordability improves which can put rental prices under further pressure.

Contributing to this understandably is the still building wave of investment apartments competing for a tenant pool which is not just not growing but indeed may be contracting as more and more people realise that maybe it is not so bad back at home with mom and dad after all (now that my pay and / or my hours have been cut).

Also influencing the market as previously touched on here, whilst someone wanting to rent a house would generally prefer to rent a house, if apartments offering similar or greater living space become available at much lower prices, a rethink becomes likely.

To summarise the current leasing market; for apartments we are seeing weakening demand at the lower ends of the market, demand more steady around the middle, and the upper end ($1,000 pw plus) performing best due to lower inventories.

For housing, the lower end of the market is softer because of the apartment competition, the middle up to $1,000 pw is down on a year ago thanks to diminishing job security but is holding up much better than the bottom, and the top end is mixed with reasonable demand in the $1,000 - $2,000 per week market but much less above that (again for principally economic reasons, which ever bottom line careful corporations are contributing to).

PROPERTY ECONOMICS

HOMEFILE – The national economy continues to misfire on most cylinders and our state economy..., well there even a misfire would be welcome. That would at least indicate life.

But if you think things are crook here, spare a thought for Perth and Darwin whose economies are almost totally reliant on resources. They think we've got it good (which of course we haven't, we're also going backwards, just not at the speed they are).

Things look likely to get worse for at least the latter because typical of democracies that have a habit of shooting the messenger in downturns, the NT has just voted for a government that is clearly infinitely less credentialed for the huge task of getting the state back on an even keel than the one it is replacing.

WA may soon commit the same economic harakiri for the same reasons and get to endure the same consequences. You have got to pity any state or territory that has to go through what we have these past two years, and particularly one(s) that don't have any real secondary strings to their bow to fall back on.

More nationally, as property markets and state and federal economies are as we know inextricably linked (with some lag time), what the failed election afterglow has done is made it ever clearer that our interest rates will have to follow the rest of the developed world to (at least) zero, and probably sooner rather than later.

Bank Bill Swap Rates clearly reflect that with all three key indices, the 90 day, 2 year and 10 year, plumbing new depths to record all-time record lows recently (including as recently as this morning). As of this morning, the 10 year rate looks like breaking under the 2% mark having dropped by more than 2/3 since 2011.

Incredibly this pivotal index has given up more than 4% in just the last 24 hours (from 2.12% to 2.03%), good news for borrowers but not good news for retirees with money in cash.

The RBA has moved a few millimetres close to accepting that the tsunami of negative economic data is real by rather reluctantly allowing through another piddling, grossly inadequate .25% cut this month, a concession small enough to ensure their terribly misguided approach to rate setting where cuts are only contemplated as a last resort stays intact.

The RBA can continue with its economically debilitating reactive water torture approach to monetary policy but given how totally ineffective such policy folly has proved, they really need to give some serious thought and preferable very soon to something a little more effective and appropriate, a cut suitably bold enough to shock, say at least .5% but ideally 1% or more. The imminent departure of its intransigent governor may be an ideal opportunity to do that.

The RBA can still do this now but won't be able to do it if we get to zero in the current manner. Make the pre-emptive cut strike now while we still can and the whole world takes note, the currency falls, and the economy is stimulated. Don't and continue with the failed trickle down approach and we will find that when we hit ground zero, we will arrive there with no ammunition, no stimulation possible for the economy, and a currency still way too uncomfortably and non-competitively high. Then we'll have a real problem and will seriously have to borrow (which with a sovereign risk downgrade, will be at much higher interest rates, assuming we can find someone foolhardy enough to lend to us).

Perhaps partly supporting the RBA's intransigence and disappointing generally, the government continues derelict in its duty by not fully and candidly laying all the economic cards on the table, not coming totally clean with the nation just what an incredible economic mess we are in and how without urgent corrective surgery, how bad things will get.

The closest they have come is the recent admission that they now have both an earnings and a spending problem, where previously they only acknowledged the latter (not that either should be news to anyone with an IQ greater than their shoe size).

They've also flagged that if the status quo remained unchecked (which in the private sector is called operating while insolvent), the country will be in hock to the tune of $10trillion inside 10 years (this 5 times current annual GDP).

The government still has time to turn the economy around and a government 'encouraged' shock rate cut by the RBA would be a very good start. It may already be too late to prevent a recession but action now may at least prevent something far worse and enduring. Let's hope democracy allows it to happen.

As politically unpalatable as telling the whole truth may seem to the government, most Australians (of all persuasions) have come (at least privately) to accept that the government took one hell of a hospital pass with office 3 years ago. These same people though know at least equally that regardless of where the blame lay for creating the mess we are in (particularly the ridiculously, unjustifiably, and unsustainably high cost of running the nation), it is incumbent upon the government at hand to get on and clean it up.

That is going to require either winding the cost of running the country back to acceptable pre-Gillard | Rudd levels (deconstructing the 10,000's of extra government jobs they created for political purposes) which would be electorally uncomfortable or ramping up the tax take (despite the serious structural damage to the economy the latter would do).

Neither option is palatable but better to be doing either or both 3 years out from the next election than 3 months.

Doing nothing and hoping that somebody will come along and sprinkle some magic dust on the economy is not an option (if not just because governments have a perfect failure record when they choose to sit on their hands when even the blindest of the blind know that is dumb) but strangely may be what is chosen if only out of abject fear of the consequences of actually doing something.

The government's reluctance to show the required level of economic leadership is also encouraging the banks to do likewise with bad loans, which they are ignoring hoping they will go away. They won't of course, risking a repeat of post 1989 Japan where the failure of banks to bite the bullet made a bad situation infinitely worse (and enduring – the market still hasn't recovered and won't whilesoever the bad loans sit there festering). Spain is another example.

Sadly but unsurprisingly, when markets turn turtle, banks go after those they can, not always those they should.

This time around will be no different. One gang of 3 I know between them owes just one bank a cool $1billion (and counting). I say counting because $1bn was the 'blister' in 2008. Since then in step with the value of the properties the bank has security over plummeting (making it even less viable for them to call the loans in) the interest on the loans (assuming the bank is charging it and not just quietly writing it off) has been accumulating, compounding.

It also may not surprise you to know that the 3 continue to live a rather halcyon life; European supercars, yachts, grand homes, first class overseas holidays etc. When things go bad the clever ones lose everything but their money.

SINOFILE – Hard or Soft Landing for China or something in between, that is the question?

But what is the answer? It is doubtful that anyone knows or indeed could ever know.

Yes, China is a real Chinese Puzzle. The secrecy, lack of transparency, lack of recent capitalist experience, and general obfuscation behind the bamboo curtain is such that not only is it impossible for anyone outside to get a read on how well or even if China can weather its current economic challenges, for those inside its not much different.

This is seeing the government knee jerk react to just about every fiscal threat thrown at them, last decade's Asian Crisis and the current slowing seeing that saw them print money frenetically, and last year's share rout which had them take the unprecedented action of intervening directly in the market themselves cases in point.

All come with consequences but given the uncharted waters that is the world's largest population fresh out of abject poverty trying to make a real fist of capitalism, at speed, and within a communist framework, quite possibly no-one really knows what these might be. Even after the event, we may never know what they were. Who could have picked property prices doubling in Shenzhen and going up by more 50% in most other capitals this past year?

Some of that increased property wealth (if realised while the Yuan is as high as it is) could and likely will find its way here, though less for investment property purchases than in the past as politics has largely rendered that door shut, for better or for worse.

EUROFILE – The picture for Europe is not much clearer than China's (for different reasons) and is getting more opaque with the passage of time (and entry into the EU of each new less deserving state, Albania next in the queue).

Brexit hasn't helped though it's interesting to note right now that any actual departure time just doesn't seem a long way off in the distance, it seems to be moving away, not coming close. Many now question whether it will happen.

Germany is clearly in no hurry, nor London (who voted unanimously against it), and increasingly the other more influential EU states are holding their council on when it's to happen, in stark contrast to their indignation immediately post poll. Are both sides looking out (or holding out) for a way back in (or a way out of the way out, a Brexit Exit).

The recent stabilisation in the pound (albeit at a historically still quite subdued US$1.30) supports the underlying sentiment gathering pace that if a feasible exit strategy from Brexit presents itself, it may be roundly embraced.

It is too early to call the short to longer term effects of an actual Brexit (which is currently legislated to happen) should it happen but if share prices in some of the major public UK building companies pre and post the Brexit Poll are anything to go by, a post (physical) Brexit price correction would be both likely and likely significant.

Could it however pan out that any correction is inverse? Playing the devil's advocate, if the physical Brexit does in time proceed as is currently legislated but more rot has set in at the EU in the interim, property prices in the UK may actually rise after it is effected rather than fall, and take the pound along with them for the ride.

Certainly it would not go down well at all were an Albania or similar granted entry before, at, or around any final Brexit date. That would have the world (including the other existing EU states) thinking, the UK was traded for who?

EN-GLOBO WATCHING BRIEF

TAILWINDS: Comparative Attractiveness of Brisbane House Prices | Slowly Cheapening Finance
HEADWINDS: Mining Meltdown | Moribund State Governance | Tenuous Federal Governance | RBA Intransigence
CROSSWINDS: China Slowdown | Eurogeddon [including Brexit] | Global Race to the (currency) Bottom
CRYSTAL BALL: 0% Benchmark Interest Rate | 60c AUD | Yuan Devaluations | QE (money printing) Aussie Style

---

PROPERTY INVESTMENT

- BUY Inner or Near Ring Brisbane Housing
- SELL Investment Apartments anywhere – particularly inner city and outer ring (assuming you still can)
- SELL Melbourne, Perth, Darwin anything (particularly Investment product)
- HOLD Sydney Inner and Near Ring Housing
- HOLD off buying anything mining industry reliant until 2025 (or boom, whichever comes first)
- HOLD off buying anything coastal for the foreseeable future unless lifestyle matters more than money

---

SAFE BETS

- 0% Australian interest rates
- Low interest rate and yield world until another China emerges or global money printing crosses the Rubicon
- Predicted US interest rate rises non events
- Share markets continue north whilesoever interest rates continue south
- The investment apartment oversupply in Australia (and particularly Brisbane & Melbourne) will not end well
- The Chinese will always find ways to get money out of China to put it where it is safest and most welcomed
- Brexit will be either a Go Slow or No Go affair, the latter if London and Bonn have got anything to do with it
- Our federal & state governments will continue to be economic with the real truth about the economy
- Money printing here (using the inappropriate EU and US examples) will become more likely and inviting
- China exporting deflation on just about everything except landed property in growing economies

++

That's it from me for this edition of HOME TRUTH

Warm Regards,

JOHN JOHNSTON
CEO

p 3858 8800
m 0409 44 33 22
e jjohnston@johnstondixon.com