Hunter Region

Residential Market Outlook

June Quarter 2013

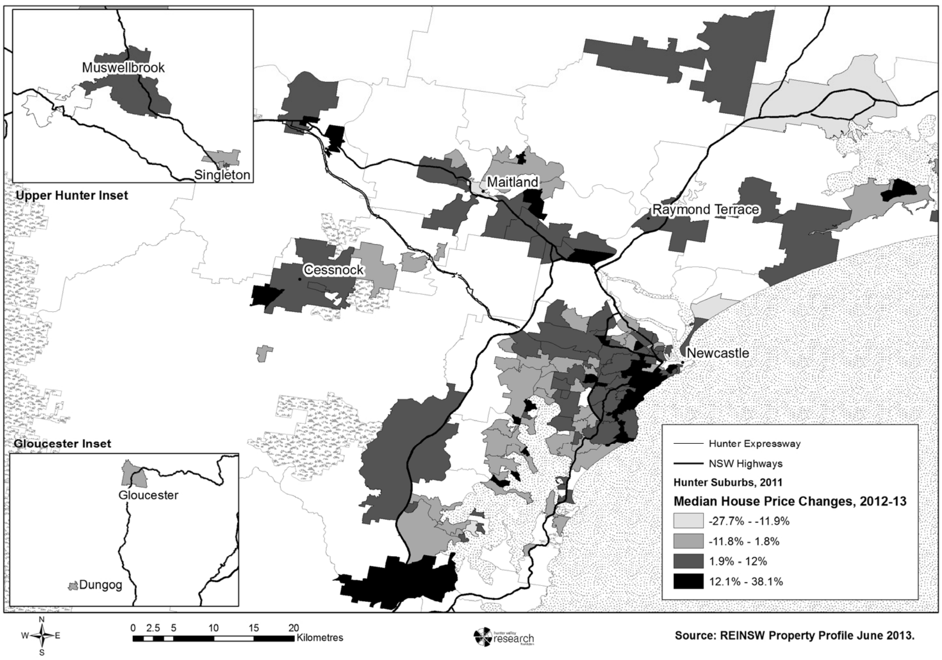
IN SUMMARY

- The general residential market in Metropolitan Newcastle[1] is not exhibiting the exuberance of Melbourne or Sydney, partly because the local market's performance is not recovering from a period of malaise. Trends in house prices and sales volumes infer a solid, but uninspiring performance, as the market's drivers transition from resources to interest rates.
- The prevailing rental market illustrates all the signs of a passing cycle. Despite tenant demand waning with the passing of the construction phase of the resources cycle, the new stock of rental housing continues to rise. Vacancy rates are rising and rental growth has stalled. The rental market will find a new equilibrium, but the interim period may produce relatively muted investment demand.
- The level of property development and housing construction appears to be rising with the number and value of residential approvals in the Hunter climbing around eight per cent in the year to Jun-2013. The price of vacant lots remains supportive (low) and sales numbers appear solid.
- Despite unsupportive monetary policy (interest rates), the Region's housing market has outperformed NSW and comparable markets in recent years. National policy has now been adjusted to encourage greater housing activity. While the general regional housing market should respond, the level of activity in some markets will be tempered by the recent resources-based additions to housing stock.

KEY DATA (Annual number or change compared to corresponding period last year, June 2013, Metropolitan Newcastle [1] unless noted)

Market Performance:		*Rental Market:*		*Residential Development:*	
Median house price:	$389,649	Rent 3-BR House:	- 0.3%	Vacant lot sales [3]:	2,465
Annual change:	+ 3.9%	Vacancy rate [2]:	2.9%	Detached house approvals [2]:	3,308
Number of sales:	8,668	Total rental bonds:	48,728	Annual change [2]:	+ 7.7%
Annual change	- 2.9%	Annual change:	+ 3.6%		

[1] Metropolitan Newcastle refers to the five LGAs in the traditional Lower Hunter, the name change seeks to avoid confusion with the new ABS Lower Hunter SA2, where referenced the upper Hunter refers to the remaining LGAs in the Hunter Region, [2] Hunter Region, [3] Preliminary data – Lot sales will rise moderately with late settlements



Source: REINSW Property Profile June 2013.

The adjacent figure maps the annual change in median prices on a suburban scale across the Hunter Region. While caution has to be shown regarding individual results due to small sales numbers, the analysis shows a somewhat diffuse pattern. In contrast to two years prior, prices in the upper Hunter are no longer accelerating above average. The piecemeal profile most probably reflects the transition occurring within the Hunter economy, as the lagged effect of the resources cycle peaks and latent markets emerge.

The Hunter Valley Research Foundation (ABN 91 257 269 334)
PO Box 322, Newcastle NSW 2300, Australia
Phone: (02) 4041 5555; Fax: (02) 4961 4981; email: info@hvrf.com.au; internet: http://www.hvrf.com.au

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General Residential Market
– Regional prices and sales volumes

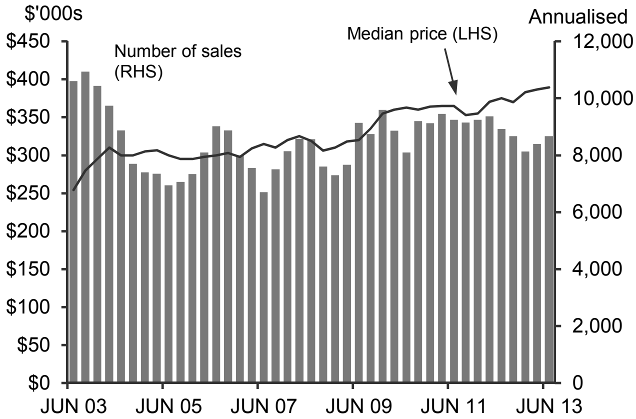
Detached house sales trends, June quarter 2013

Area	Median Price	Annual change	No. of sales
Metropolitan Newcastle [1]	$389,649[1]	+ 3.9%[1]	8,668
Wollongong	$450,000	+ 2.3%	2,186
Metropolitan Sydney	$610,000	+ 8.0%	44,543

Source: HVRF, Real Estate Institute NSW (REINSW), LJ Hooker Hamilton
Note: [1] Series break at Dec-2012, following which median prices derived from a weighted average of Cessnock, Lake Macquarie, Maitland, Newcastle & Port Stephens LGA, weighting founded upon annualised sales volumes

In Oct/Nov-2003, the Reserve Bank tightened monetary policy settings to manage the emerging resources boom and effectively brought the preceding housing boom to a screeching halt. As the construction phase of the resources cycle passes, policy has now been adjusted to boost the contribution from housing investment to national economic growth. At this point an upturn in the local housing market appears tentative. Median house prices increased by 3.9%, but the number of sales declined by 3% illustrating a fair but uninspired market.

Detached house sales (new and established) [1]
Metropolitan Newcastle



SOURCE: HVRF, Real Estate Institute of NSW, LJ Hooker Hamilton

General Residential Market
– Intra-regional prices and price trends

Median house price trends, Year to June quarter 2013

Local Government Area (LGA)	Median price	Price change (%) pa	No. of Sales
Cessnock	$280,000	+ 4.5%	825
Dungog	$360,000	+ 0.7%	108
Gloucester	$281,000	- 0.5%	98
Great Lakes	$350,000	+ 0.1%	575
Lake Macquarie	$400,000	+ 5.3%	2,983
Maitland	$370,000	+ 5.1%	1,094
Muswellbrook	$330,000	+ 1.7%	247
Newcastle	$414,593	+ 7.7%	2,352
Port Stephens	$405,500	+ 1.4%	1,414
Singleton	$437,000	+ 2.1%	313
Upper Hunter Shire	$320,000	+ 3.2%	225

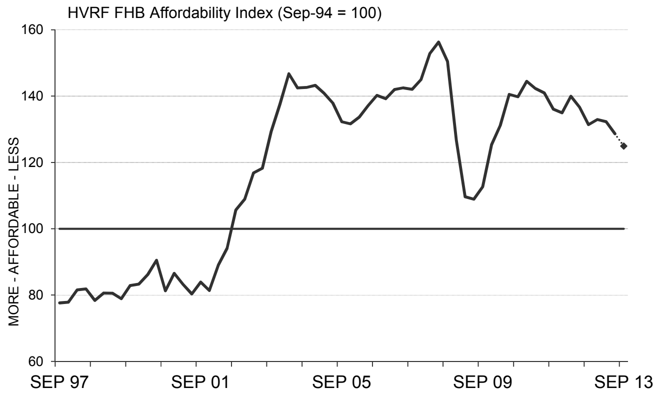
Source: LJ Hooker Hamilton, REINSW, Australian Property Monitors (APM)

The adjacent table provides more detail for market activity within the Hunter Region. In recent years the exceptional level of resource-related capital investment, combined with a lagged response to housing supply (constrained by planning and a general lack of resources), translated to exceptional levels of dwelling price growth in the upper Hunter and subsequently strong growth in adjacent regions. A clear illustration of this trend can be seen in the ratio of median house prices between the upper Hunter LGAs and Lake Macquarie. Whereas median house prices in Singleton LGA measured around 77% of the equivalent in Lake Macquarie LGA in Sep-2003 (the start of the resources cycle), the equivalent ratio in Jun-2013 was 109%. The equivalent in Muswellbrook shifted from 50% to around 83% respectively. The upswing in the resources' cycle has now clearly turned, and while the housing market will lag to some extent through latent price and construction activity, modelling suggests that market growth in the upper Hunter will stall, particularly relative to the metropolitan LGAs.

General Residential Market
– Housing affordability

The prospects for the Region's housing market and consequently, housing construction is extensively informed by the prospects for new entrants into housing ownership. The issues shaping investor decisions are addressed in following sections. The relative difficulty for First Home Buyers (FHBs) to enter owner-occupation can be demonstrated by the *HVRF FHB Affordability Index*. The Index reveals relative changes in the ratio of regional incomes (earnings) versus the cost for a FHB to acquire an established house, accounting for prices, mortgage rates, transfer duties, grants and exemptions. The series shows that the hurdle to market entry remains substantially higher than prior to the period when the housing market accelerated in Sept-2001. Since the removal of temporary GFC policy settings, affordability has progressively improved, as prices remained flat, earnings rose and mortgage rates declined (although grants disappeared). The estimates for Sept-2013 show this trend continuing, but the setting may preclude a rapid upturn.

Housing affordability for First Home Buyers
Lower Hunter



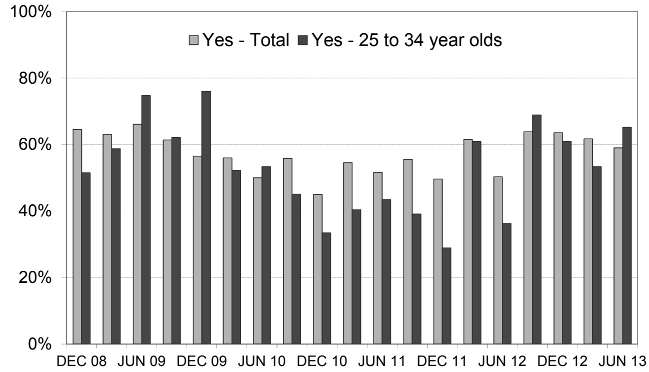
SOURCE: HVRF, RBA, Real Estate Institute of NSW, NSW Office of State Revenue, ABS
Note: A decline in the index represents an improvement in housing affordability for first home buyers; Projection to Sep-2013 assumes known mortgage rates, grants / exemptions and assumed continuation of recent price and earnings trends.

General Residential Market – Buyer sentiment

The HVRF survey Hunter households on a quarterly basis regarding their personal financial circumstances, their perspective of the regional economy and their propensity to incur substantial expenses including housing. The results show that the majority of the general population believe that now *is* a good time to purchase a dwelling. This optimistic position has been held for around 12 months. It is notable that housing sentiment has not fallen sharply despite the well-reported transition in the coal industry. The adjacent chart also profiles the housing market sentiment of the key FHB demographic (25-34 year olds). Given the data is derived via a sample survey, a statistically significant difference cannot be determined between the general population and the FHB demographic. As a consequence, the data implies that in comparison to late-2009, FHBs remain disposed to, but not exuberant about, the potential to enter the Region's housing market. This is consistent with the prior inferences from the *HVRF FHB Affordability Index*.

HVRF housing sentiment, Hunter Region

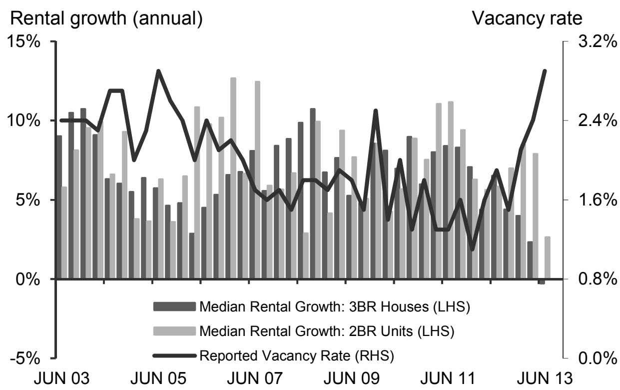
Proportion of residents believing the next three months is a good time to purchase a dwelling



Source: HVRF Household Surveys

Rental growth and vacancy rate

Annual change in *nominal* [1] rents [2], Quarterly vacancy rate [3]



SOURCE: HVRF, NSW Dept of Housing, REINSW

Note: [1] *Nominal* rents do not account for inflation, [2] *Rents refers to the weighted average of rents for new bonds in the five LGAs comprising Metropolitan Newcastle,* [3] *Vacancy rate refers to Hunter*

Rental Market – Rents and bonds

Residential rental market, Nominal rents, June 2013

LGA / SA3	Weekly rent, 3 BR Houses (new bonds)	Weekly rent, 3BR Houses (change, % pa)	Total Bonds (Annual change, %)
Cessnock	$320	0.0%	6.0%
Lake Macquarie	$370	2.8%	2.5%
Maitland	$350	2.9%	6.1%
Newcastle	$400	2.6%	3.4%
Port Stephens	$345	1.5%	2.4%
Lower Hunter SA3	$330	0.0%	3.1%
Upper Hunter SA3	$300	- 1.6%	2.7%

Source: HVRF, NSW Dept. of Housing

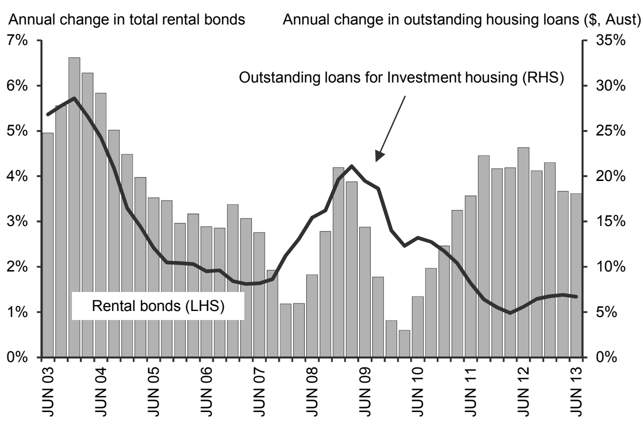
An examination of rental trends shows that rental growth in Metropolitan Newcastle has stalled with the growth to Jun-2013 negative for three-bedroom houses. While caution has to be placed in the vacancy data, the trend is consistent with a soft market, rising to 2.9% for the 'Hunter' in Jun-2013. The decline in contract labour arising through the mining sector's consolidation is driving this trend, although lower interest rates may also be encouraging some FHBs to leave the rental market.

Rental market – Investors and rental stock

Prior to Mar-2011 a strong statistical correlation existed between the level of loans provided for investor housing nationally and changes to the stock of rental housing provided in Metropolitan Newcastle. The adjacent chart shows that this relationship subsequently broke down. In the two years to Jun-2013, an additional 3,782 rental bonds were added to the market in the metropolitan area. This represents an increase of 8.4% in the available tenancies during this period, compared to an increase of just 5.0% over the preceding two years. The relationship was broken by investors chasing the perceived and real tenant demand associated with the mining boom. As evident from the above table, the upsurge in rental bonds was concentrated in the Cessnock and Maitland LGAs i.e. proximate to the mining expansion. This analysis implies that investment demand has underpinned a substantial level of activity in these markets. With resource-related employment rapidly receding, the pressure exists for vacancy rates to rise further, rents to see further downward pressure and investor demand to remain muted until the affected markets adjust to a new equilibrium.

Changing patterns in rental households and investors

Annual change in rental bonds (Metropolitan Newcastle) & housing investment loans (Australia)



SOURCE: HVRF, ABS Cat. No. 5609.0, NSW Dept of Housing

Residential Development – Lot sales and prices

Vacant lot sales trends, June quarter 2013

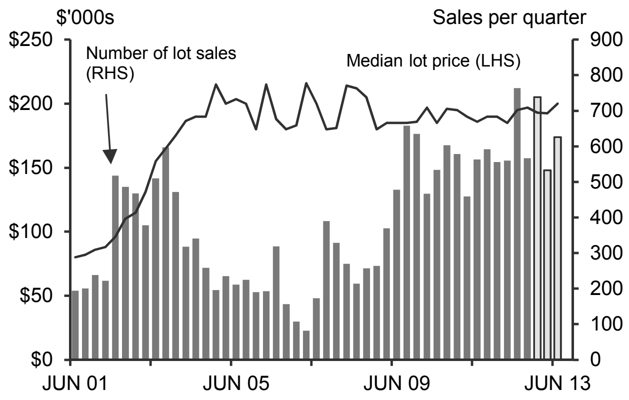
Area	Median Price	Annual change	Annual sales
Metropolitan Newcastle	$200,000	+ 2.6%	2,465

Source: HVRF, APM: Note: Subsequent settlements will see annual sales rise modestly in coming quarters, median prices typically change only modestly

The price and sales volumes of vacant lots represents an indicator of the propensity of housing demand to spill into new housing, and consequently to drive new housing construction. The first noteworthy trend is the lack of growth in the price of vacant lots. Accounting for inflation and income growth, the *real* cost of vacant lots in Metropolitan Newcastle has declined steadily over the last eight years. While the latest data for the number of lots sold is preliminary, and in effect conservative, it suggests that demand remains solid at present, despite the passing of the resources-based stimulus. From Oct-2012, the *First Home Owner Grant* was increased to $15,000 and re-focussed upon new homes or land only. This initiative improves the relative value of new homes for first home buyers and should continue to assist construction in affordable markets.

Residential lot sales volumes and prices

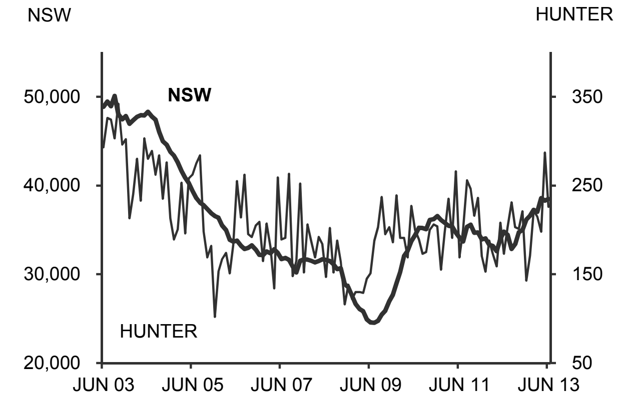
Metropolitan Newcastle



SOURCE: HVRF, APM, Note: Last three quarters reflect preliminary only

Number of residential building approvals

Hunter - Actual houses monthly; NSW - Trend (three month) data



Note: Minor boundary changes in the upper Hunter prior to Sept 2005
SOURCE: HVRF, ABS

Residential Development – Supply trends

Residential building approvals, Annualised to Jun-2013

Area	Houses & Other (no.)	Annual change (no.)	Annual change (value*)
Hunter Region	3,308	+ 7.7%	+ 7.5%**
NSW	38,466	+10.5%	+ 6.7%**

Source: HVRF, ABS, Note: **Nominal, **including alterations and additions*

Dwelling approvals represent another leading indicator of housing construction. The charted data for the Hunter Region represents detached house approvals only, as strata dwelling approvals are relatively small and volatile. The benchmark NSW trend includes strata dwellings, as multi-unit projects comprise the majority of activity in Sydney, which dominates State activity. The data suggests that housing construction in the Hunter Region does appear to be rising in line with NSW. House approvals in the upper Hunter now account for approximately 14% of the Region's activity, compared to the five-year average of 10%. The shift in the resources cycle should see construction slow in the upper Hunter, although the evidence is more anecdotal than quantified to date.

Residential Development - Market outlook

The prospects for residential development in the Region are shaped directly by supply, demand and pricing, but also indirectly by a number of key fundamentals. Three of the key demand fundamentals are household formation (as shaped partly by population growth), employment and interest rates. Prevailing forecasts anticipate that interest rates will remain in a supportive position for some time, albeit filtered through the affordability challenges. The labour market will probably soften further from recent strength, but not to the extent of undermining widespread demand. The latest ERP shows that the Hunter population rose by 1.3% p.a. in the five years to Jun-2011, much higher than previous estimates. This growth is anticipated to slow with the passing resources expansion, but it should still provide a latent stimulus for new housing demand. It is important that the capacity to introduce both greenfield subdivision and urban development, in terms of time, cost and risk is minimised to retain a 'high volume / low profit margin' market to optimise the associated benefits for economic growth and service provision, without worsening housing affordability.

Total change in Estimated Resident Population (ERP) over five-year periods, historical and DPI's preliminary projected populations**, 2013*

LGA / ASGC Area	2006-11 Historical	2011-16 Projected	2016-21 Projected	2021-26 Projected	2026-31 Projected
Cessnock	5,059	3,600	3,900	3,800	3,600
Dungog	311	500	300	300	200
Gloucester	112	300	100	200	100
Great Lakes	2,161	2,600	1,500	1,000	900
Lake Macquarie	8,308	4,000	7,000	6,600	6,100
Maitland	6,419	7,800	7,300	7,300	6,900
Muswellbrook	689	800	800	700	700
Newcastle	8,927	9,900	9,400	9,200	9,100
Port Stephens	5,082	7,600	5,700	5,600	5,200
Singleton	988	1,200	1,100	1,000	900
Upper Hunter Shire	873	700	600	500	500
Hunter (ASGC)	**38,929**	**39,000**	**37,700**	**36,200**	**34,200**
Metro. Newc. (ASGC)	33,795	32,900	33,300	32,500	30,900
Hunter Balance (ASGC)	5,134	6,100	4,400	3,700	3,300

Source: *ABS, **NSW Dept. of Planning & Infrastructure (DPI) 2013, projections derived upon a range of assumptions including net interstate migration and net overseas migration to NSW, fertility and mortality rates, final projections should reflect on latest ERP data and address any potential anomalies e.g. Lake Macquarie 2011-16