Australian Housing Outlook 2016–2019

Prepared by BIS Shrapnel for QBE

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Introduction

Australian Housing Outlook Report 2016–2019

I am proud to welcome you to the latest QBE Housing Outlook. Unit, terrace, duplex, freestanding house or something in between, an Australian's home is most definitely considered their castle, regardless of size, location or value.

This is the 15th year we've commissioned BIS Shrapnel to analyse current home value trends as well as forecast the direction supply, demand and prices will move in the next three years.

It's a fascinating time to be looking at the Australian residential property market. For the first time, the Housing Outlook includes research into the role of investors and overseas buyers. We've also taken a closer look at some of our mining towns. We've continued our analysis into the capital cities, regional centres and the split between houses and units.

This BIS Shrapnel forecast projects residential property price movements over the coming three years. However, Australia's population growth projections from the ABS for the coming decades indicate that there is a risk that the demand for homes in the medium-term will once again outstrip supply in some of our largest cities. Whilst some will say this is good for prices, it will also continue to put pressure on affordability and those trying to get on the property ladder.

QBE LMI has been supporting the mortgage industry for more than 50 years. Our Financial Institutions team is committed to finding innovative solutions to ensure lenders can continue to help Australians realise their dream of home ownership. I hope this year's Housing Outlook sparks further discussion about the market and how we can support those seeking to buy a home.

I'd also like to take the opportunity to highlight an issue I'm passionate about. While we're building an Australia that is expected to grow to more than 30 million in the next 15 years, we also have a pressing challenge to solve homelessness and address housing affordability. We are proud to make our living from the mortgage market but our challenge now must also be to consider how we can help those other Australians who aren't as fortunate.

We're looking forward to continuing to explore potential remedies to some of these issues with our contacts in the property and financial sector as well as with government and charities.

I hope you enjoy this year's Housing Outlook.

Phil White
Chief Executive Officer
QBE LMI

About this report

This report provides an analysis and forecast of the key drivers influencing the residential market nationally, as well as across each of Australia's state and territory capital cities and selected regional centres. The analysis presents an outlook for the performance of the residential market, as measured by historical and forecast movement in the median house price and median unit price.

The "unit" market in this report refers to the attached dwelling market and includes all forms of multi-unit dwellings including townhouses, villa units, semi detached dwellings, terraces, flats and apartments. In the major capital cities, the majority of these dwellings are apartments. The "house" market refers to detached or separate dwellings that do not share a wall with adjoining dwellings. Where the report refers to the "residential" market, or to "dwellings", the reference is applicable across the whole market.

The key forecasts for the market outlook are the *median house price* and *median unit price*. The median price refers to the mid-point of sales that have taken place in a period and is considered a better indicative measure of prices than the average, which can be more influenced by extreme results.

Movements in the median price can also be influenced by changes to the composition of sales in between periods. Consequently, the *Australian Housing Outlook* median price refers to a "weighted median", which is a median weighted by the geographical distribution of the housing and unit stock. It is considered that the weighted median better accounts for the effect of an imbalance in the sales in the period. The raw sales data is sourced from APM PriceFinder.

In addition to the median price, the report refers to the "real" median price. This is the median price after accounting for the impact of inflation. The real median price allows for a better comparison of price growth over time.

The forecast annual percentage changes in the median house price and median unit price in the price forecast charts in this report are rounded to the nearest whole number. Any reference to price growth in the text may not be identical to that indicated in the charts due to the impact of this rounding.

1. Executive summary

The upturn in new dwelling activity and dwelling prices is now beginning to run its course. After an extended period in which the Australian residential market has been in aggregate undersupply, record dwelling construction is expected to see many undersupplied markets transition to an oversupply, alleviating the pressure that has driven rises in dwelling construction and prices over the past three to four years.

Sydney and Melbourne led the way through the upturn, with the other capital cities showing more limited growth in new dwelling activity and prices. However, with supply now reaching a level commensurate with population growth, there are signs that the Sydney and Melbourne markets may have peaked, with price growth easing back to the levels of the other capital cities.

Headwinds have also emerged for investor demand. Tighter lending criteria by banks for investors in response to Australian Prudential Regulation Authority (APRA) directives have reduced investors' capacity to bid up prices. Banks have also become increasingly concerned about exposure to overseas investors, having increased restrictions on lending to this group. New South Wales, Victoria and Queensland have imposed a stamp duty surcharge on overseas purchasers, while New South Wales and Victoria also introduced land tax surcharges. Additionally, tighter capital controls in China may limit capital outflow and impact investor activity in Australian markets.

Nevertheless, purchase activity continues to be encouraged by low interest rates, although banks have not passed on all of the 50 basis point cut in interest rates so far in 2016. The tightened policy toward investors saw this lending weaken in 2015/16, but this has provided an opportunity for upgrader/downsizer buyers to fill in the gap, with loans to this group increasing. In contrast, purchase activity from first home buyers remains weak.

Dwelling commencements were at record levels in 2014/15 and 2015/16, and well above underlying demand. Outside of New South Wales, all states are expected to be entering, or already experiencing, a rising oversupply of dwellings in 2016/17. The increased prevalence of unit dwelling commencements and the length of time for their construction means that total new dwelling supply will remain elevated in 2017/18 and 2018/19, and continue to place pressure on residential markets. Indeed, as State governments look to medium and high density dwellings to accommodate population growth, the time lag between construction starts and bringing projects onto the market could lead to markets tipping into oversupply and then reverting to undersupply going into the following upturn.

In an environment of rising dwelling completions, there is limited scope for significant price rises through to 2018/19 nationally and potential exists for price declines in a number of markets. Overall, house prices are forecast to remain relatively flat over the three years to 2018/19, with the individual capital city outlooks for the median house price ranging from an aggregate decline of 6% in Darwin (–2% per annum average over the three years), to an aggregate increase of 12% in Hobart (+4% per annum average).

Significant declines in house prices are not expected, with record low interest rates preventing forced sales coming to the market and providing support to prices. Nevertheless, in most cities price growth is forecast to be below the rate of inflation, and this represents a period in which affordability will be beginning to recover. In markets where there hasn't been recent strong price growth, affordability will improve further, making the market more accessible to first home buyers.

The price outlook for the unit market will be somewhat weaker, given the high level of units now being completed relative to long term averages. The weaker outlook will translate to reduced off-the-plan apartment demand and a decline in new unit supply. By the end of the decade, unit supply is expected to be falling below occupier demand, particularly with net overseas migration beginning to strengthen again. The long lead time in building new apartments suggests that counter-cyclical buying opportunities will begin to emerge for investors.

It should be noted that the outlook for the market represents a textbook residential market cycle. A dwelling undersupply delivers a price signal to the market which increases new dwelling construction. At the height of the upturn, supply begins to exceed underlying demand, with the subsequent oversupply initiating a correction in the market, creating the undersupply which sets the conditions for the next upturn.

Table 1: Median prices by capital city

Houses

Quarter ended June	Sydney		Melbourne		Brisbane		Adelaide		Perth		Canberra		Hobart		Darwin	
	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var
2000	333.5	17.5	223.6	14.2	161.0	6.7	147.2	11.2	176.5	6.8	113.3	6.7	184.0	15.0	190.4	8.2
2001	364.4	9.3	240.2	7.4	165.3	2.7	156.9	6.6	184.6	4.6	112.9	-0.3	210.0	14.1	187.0	-1.8
2002	442.5	21.4	285.1	18.7	194.9	17.9	184.6	17.6	207.0	12.1	118.3	4.8	255.1	21.5	200.0	7.0
2003	510.8	15.4	313.0	9.8	248.3	27.4	230.3	24.7	240.7	16.3	148.2	25.3	330.0	29.4	206.0	3.0
2004	546.0	6.9	335.0	7.0	320.5	29.1	268.0	16.4	278.2	15.6	235.5	58.8	375.0	13.7	255.0	23.8
2005	548.9	0.5	348.6	4.0	327.2	2.1	286.1	6.8	316.6	13.8	250.1	6.2	368.0	-1.9	279.8	9.7
2006	560.4	2.1	374.7	7.5	350.2	7.0	308.0	7.6	470.8	48.7	284.1	13.6	390.0	6.0	350.0	25.1
2007	584.8	4.3	434.9	16.1	406.1	16.0	340.7	10.6	517.0	9.8	298.5	5.1	443.3	13.7	395.0	12.9
2008	587.1	0.4	481.5	10.7	459.3	13.1	395.0	16.0	507.8	-1.8	318.4	6.7	470.0	6.0	423.3	7.2
2009	586.7	-0.1	479.8	-0.4	444.8	-3.2	386.9	-2.1	498.0	-1.9	323.6	1.6	451.8	-3.9	469.9	11.0
2010	667.1	13.7	599.3	24.9	485.3	9.1	429.7	11.1	544.3	9.3	350.3	8.2	505.0	11.8	555.3	18.2
2011	661.0	-0.9	581.8	-2.9	457.8	-5.7	421.4	-1.9	496.5	-8.8	347.9	-0.7	520.0	3.0	515.0	-7.3
2012	662.8	0.3	551.2	-5.3	445.2	-2.8	409.5	-2.8	491.4	-1.0	348.1	0.1	510.0	-1.9	570.0	10.7
2013	719.3	8.5	572.4	3.9	463.3	4.1	411.8	0.6	572.7	16.5	338.9	-2.6	540.0	5.9	612.0	7.4
2014	845.4	17.5	634.6	10.9	493.4	6.5	438.5	6.5	598.7	4.6	360.0	6.2	550.0	1.9	620.8	1.4
2015	1,034.1	22.3	734.3	15.7	507.8	2.9	446.6	1.9	579.1	-3.3	352.9	-2.0	580.0	5.5	610.0	-1.7
2016	1,047.6	-0.4	774.3	4.8	525.7	2.2	461.0	3.2	553.5	-5.6	377.9	6.8	608.5	5.2	576.0	+5.6
Forecast																
2017	1,065.0	1.7	790.0	2.0	540.0	2.7	465.0	0.9	540.0	-2.4	395.0	3.5	630.0	4.5	550.0	-4.5
2018	1,055.0	-0.9	780.0	-1.3	550.0	1.9	455.0	-2.2	535	-0.9	410.0	2.4	645.0	3.8	540.0	-1.8
2019	1,050.0	-0.5	770.0	-1.3	560.0	1.8	455.0	0.0	540.0	0.9	425.0	2.3	660.0	3.7	540.0	0.0
Forecast Growth (%)																
2016-2019		0.2		-0.6		6.5		-1.3		-2.4		8.5		12.5		-6.3

Units

Quarter ended June	Sydney		Melbourne		Brisbane		Adelaide		Perth		Canberra		Hobart		Darwin	
	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var	$'000	% Var
2000	277.3	11.3	199.4	14.1	183.0	11.4	107.3	9.4	138.7	9.2	115.4	12.4	142.0	5.2	140.3	-8.0
2001	312.5	12.7	222.5	11.6	185.2	1.2	125.5	16.9	150.4	8.5	102.1	-11.6	155.0	9.2	141.8	1.1
2002	356.1	13.9	264.9	19.0	192.7	4.0	139.8	11.4	175.2	16.4	112.7	10.4	216.0	39.4	152.8	7.8
2003	381.8	7.2	280.8	6.0	212.2	10.1	181.4	29.7	210.1	19.9	142.6	26.5	260.0	20.4	157.1	2.8
2004	395.3	3.5	284.5	1.3	256.0	20.6	203.7	12.3	222.8	6.0	206.7	45.0	300.0	15.4	190.0	20.9
2005	400.5	1.3	289.2	1.6	279.3	9.1	218.9	7.5	257.5	15.6	224.6	8.7	312.0	4.0	202.5	6.6
2006	406.0	1.4	307.0	6.2	324.6	16.2	229.9	5.0	345.6	34.2	245.8	9.4	325.0	4.2	267.5	32.1
2007	411.9	1.4	348.9	13.6	367.9	13.3	263.8	14.7	384.5	11.3	245.1	-0.3	355.0	9.2	279.3	4.4
2008	411.6	-0.1	375.8	7.7	409.3	11.3	295.2	11.9	387.9	0.9	272.5	11.2	350.0	-1.4	329.0	17.8
2009	424.0	3.0	393.0	4.6	391.3	-4.4	308.7	4.6	384.5	-0.9	267.1	-2.0	375.0	7.1	380.1	15.5
2010	489.3	15.3	465.5	18.4	423.3	8.2	335.1	8.6	414.2	7.7	288.0	7.8	415.0	10.7	437.6	15.1
2011	500.5	2.3	468.9	0.7	406.6	-3.9	333.8	-0.4	401.7	-3.0	288.1	0.0	420.0	1.2	425.0	-2.9
2012	518.8	3.7	454.4	-3.1	407.1	0.1	318.5	-4.4	406.7	1.2	292.0	1.3	418.0	-0.5	435.0	2.4
2013	551.0	6.2	465.3	2.4	413.6	1.6	328.7	3.0	433.5	6.6	304.6	4.3	412.3	-1.4	464.0	6.7
2014	615.4	11.7	491.5	5.6	434.9	5.2	340.8	3.7	445.7	2.8	295.6	-3.0	415.0	0.7	485.0	4.5
2015	708.3	15.1	512.4	4.3	445.0	2.3	334.5	-1.8	431.0	-3.3	421.0	1.4	421.0	0.3	480.0	-1.0
2016	729.8	3.0	527.3	2.9	424.7	-4.6	342.2	2.3	403.1	-6.5	410.3	-2.6	301.5	1.7	500.2	4.2
Forecast																
2017	717.0	-1.8	510.0	-3.3	410.0	-3.5	345.0	0.8	390.0	-3.2	400.0	-2.5	305.0	1.2	480.0	-4.0
2018	690.0	-3.8	490.0	-3.9	400.0	-2.4	340.0	-1.4	380.0	-2.6	395.0	-1.3	310.0	1.6	460.0	-4.2
2019	680.0	-1.4	480.0	-2.0	390.0	-2.5	340.0	0.0	380.0	0.0	395.0	0.0	315.0	1.6	450.0	-2.2
Forecast Growth (%)																
2016-2019		-6.8		-9.0		-8.2		-0.6		-5.7		-3.7		4.5		-10.0

Source: APM PriceFinder, Real Estate Institute of Australia, Forecasts: BIS Shrapnel

2. Economic outlook

2.1 State of play

Growth in Gross Domestic Product (GDP) for 2015/16 accelerated from 2.2% in 2014/15, to 2.9% for 2015/16. This improvement was underpinned by continued strong growth in export volumes and residential construction, which were key contributors to economic growth throughout the year. Increases in government recurring spending also made a contribution.

However, both consumer spending and confidence (consumer and business) remain weak; with average weekly earnings growth having slowed significantly over the past two years. The unemployment rate in this period has largely remained just below 6%; high enough to dampen wage pressures.

Along with residential property investment and construction, sectors such as education and tourism are also showing growth in response to a lower Australian dollar. The healthcare sector is similarly showing solid growth. Other trade exposed industries are also benefitting from a lower Australian dollar. However, despite declining over the last three years, the Australian dollar has not reached the level where many of these industries are sufficiently internationally competitive. This has forced many businesses to continue cost cutting and defer both investment and discretionary expenditure.

Whilst the deficiency in housing stocks, rental vacancies and growth in median rents vary between states, low interest rates are pervasive, and have driven the rise in new residential construction activity. Although it appears that new residential building approvals are now slowing, there is a time lag for new dwelling construction to be completed and become part of the housing stock, and this has maintained an aggregate dwelling deficiency across the market. Nevertheless, new dwelling starts are now reaching the point of accommodating demand in the majority of states, with New South Wales remaining a notable exception by remaining in deficiency. In fact, many of the factors encouraging new housing construction are currently only occurring in the south eastern region of Australia. So whilst median weekly rents in 2015/16 grew in Sydney, Melbourne, Hobart, Adelaide and Brisbane, rents in Canberra, Darwin and Perth experienced declines.

The unemployment rate was 5.7% at the end of 2015/16 and despite some expected movement, is forecast to remain at between 5.7%–6.1% over the next three financial years. Employment growth is expected to remain weak for 2016/17 as demand for labour remains soft due to slower growth in output and subdued private business investment. As labour force growth is expected to continue to outpace employment growth, this suggests that, if there is a movement in the unemployment rate, it is more likely to move above 6% in 2017/18, before returning back to 6% in 2018/19.

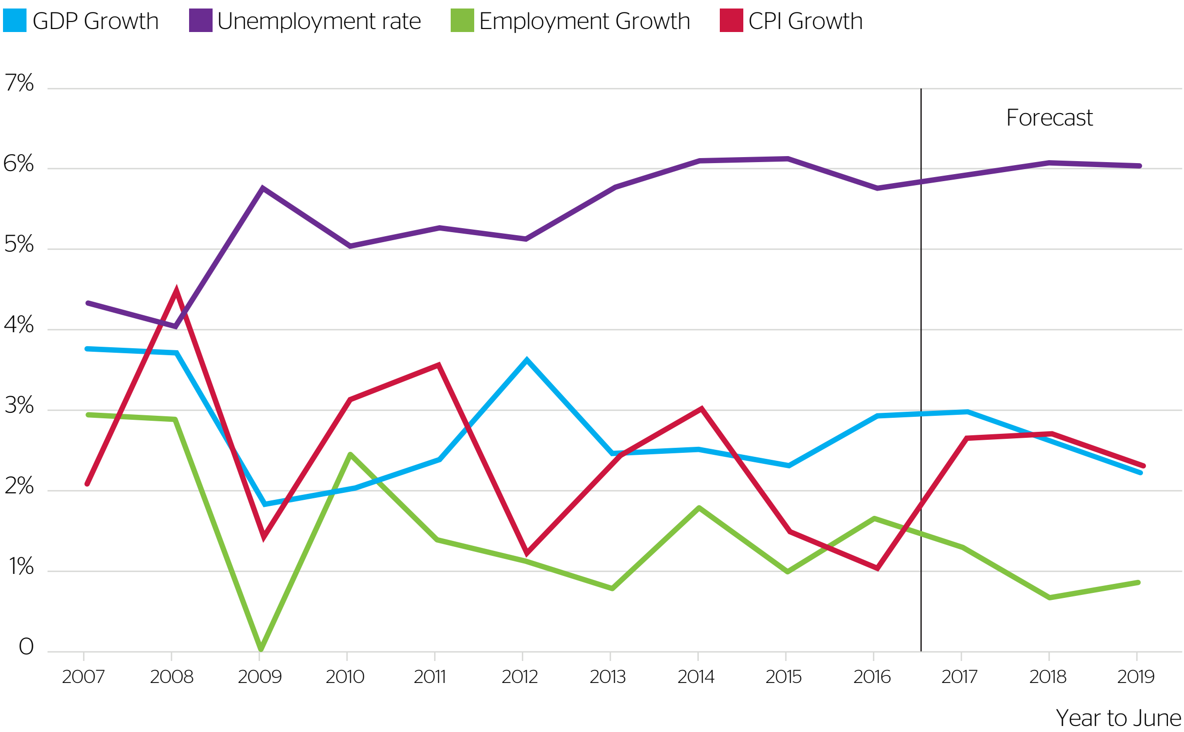
Retail sales are relatively soft in line with weak consumer confidence, suggesting consumers remain pessimistic. Inflation in 2015/16 was 1.0%; lower than the 2014/15 level of 1.5%, meaning it has now been consistently below the Reserve Bank of Australia's (RBA's) 2% to 3% target range. With economic growth expected to be slow in the short term and inflation benign, the RBA cut the cash rate by 25 basis points in May and again in August, to 1.5%. This is a record low. The major banks have not passed on all of the August cut, with the standard variable rate falling to an indicative 5.28%.

Guidelines voiced by the Australian Prudential Regulation Authority (APRA) in 2015 have effectively limited the supply of investor loans and have led to softer demand from investors. The major banks accommodated these measures by raising interest rates to investors. These macro prudential measures appear to have given the RBA the confidence to cut the cash rate as a means to encourage a lower Australian dollar without the risk of further stimulating growth in house prices.

The economy is forecast to maintain growth around the current level. The low interest rate regime may not stimulate a substantial increase in GDP as house prices begin to plateau and growth in consumer spending slows on the back of low confidence levels. The intended move towards a lower Australian dollar which would boost exports is being hampered by global political and economic events. Without strong acceleration in economic growth, it is expected that the underlying CPI rate will remain well within the RBA preferred band. Equally, the forecast waning resource sector investment through to 2018 will have a dampening influence suggesting that the economy will remain relatively subdued.

With the rise in dwelling building activity forecast to plateau in 2016/17, weakening residential construction will add to declining resource sector investment to be a drag on the economy over 2017/18. Similarly, the mining investment boom is translating to rising exports, but export growth will also plateau and stop contributing to economic growth. Consequently, interest rates are forecast to be subject to one or two further cuts through 2017/18 to place further downwards pressure on the dollar. The cyclical recovery is not expected to kick in until around the end of the decade, as the dwelling demand/supply balance begins to tighten, mining investment bottoms out, and non-mining business investment begins to return.

Chart 1: Key economic indicators



Source: Australian Bureau of Statistics, Forecasts: BIS Shrapnel
Employment growth to August and unemployment rate as at August

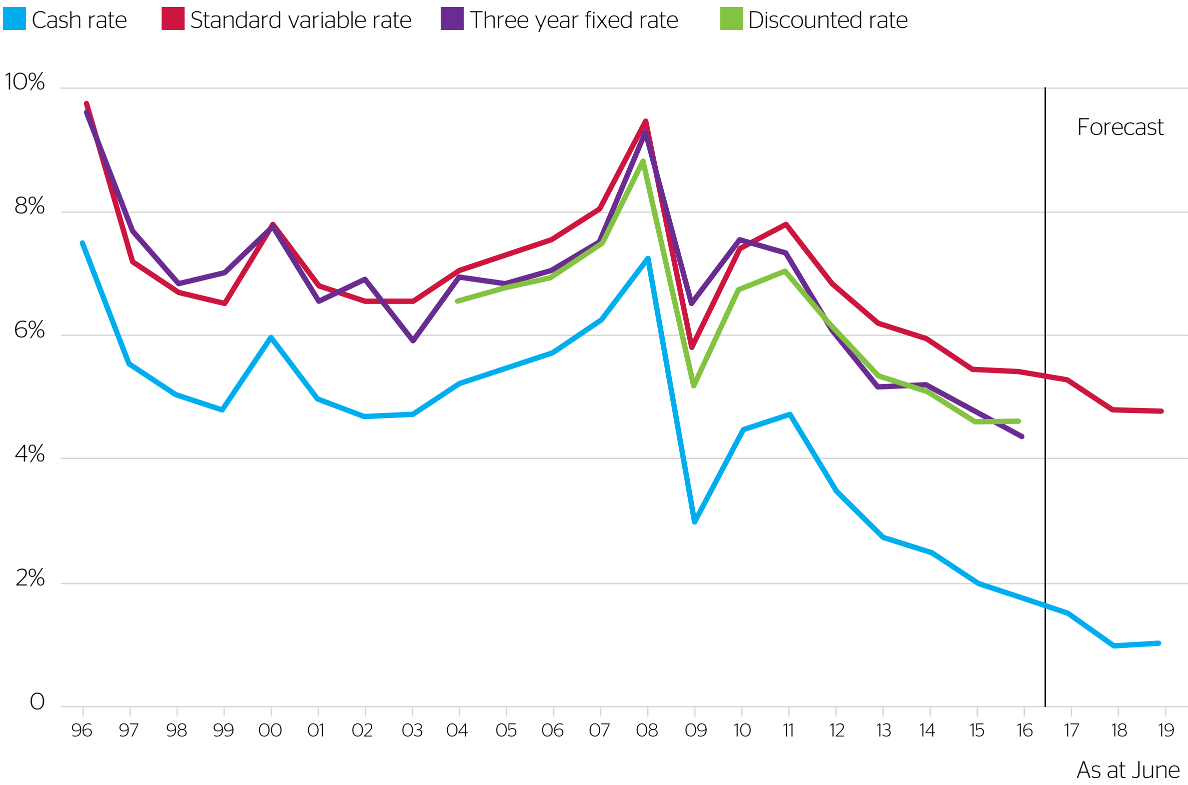
2.2 Interest rates

Given the low inflation environment, the RBA reduced the cash rate by 25 basis points in each of May and August 2016, taking it to 1.5%. After passing on the full cut to the cash rate in May, the banks cut the standard variable rate by around 15 basis points in August. This took the indicative rate, as published by the Reserve Bank, to 5.28%. In its minutes, the RBA judged that residential price growth was sufficiently contained and the interest rate reductions were unlikely to re-ignite excessive price growth in Sydney and Melbourne. It is likely that the cuts to the cash rate were also a measure to lower the Australian dollar to provide stimulus by making the economy more competitive internationally. After being below US70 cents at the start of the year, the Australian dollar has risen above US75 cents in August.

At this stage, the cash rate is expected to remain stable at 1.5%. The outlook for inflation is expected to remain benign, as weak domestic demand and spare capacity in the economy keeps wages growth and non-tradeables inflation contained. However, there is a potential further downside risk to the economy from 2018. Residential construction work done is expected to peak in 2017 as the current pipeline of residential projects progresses through to completion. The subsequent easing in residential building will combine with further falls in resource sector investment to be a drag on the economy over 2017/18. In response, the RBA is expected to cut interest rates further to a low of 1% during 2017/18, translating to a standard variable rate of 4.8%.

It should be noted that the correlation between changes in the cash rate and the variable rate is not as strong as it has been in the past. Wholesale funding costs have had a greater influence since the Global Financial Crisis. More recently, macroprudential measures initiated by APRA to provide more stability to the financial system have also had an impact on the setting of interest rates. In December 2014, APRA announced greater oversight of residential lending practices with a view to containing growth in higher risk loans, particularly in relation to residential investment lending. In July 2015, APRA mandated increased capital adequacy requirements for the banks. As a result, most financial institutions now offer different interest rates to owner occupiers and investors – typically a premium of 25 basis points for investors. Approved owner occupiers also receive varying discounts to the standard variable rate on their borrowing. While the standard variable rate is often used as the indicative rate, the RBA sets the cash rate with a view to the impact on the borrowing costs across all loans.

Chart 2: Interest rates and inflation



Source: Australian Bureau of Statistics, Forecasts: BIS Shrapnel

2.3 Investor demand

Investor environment

Investor purchasers reached a peak in 2014/15, nationally accounting for a high of 51% of all residential loan activity. However, APRA's guidance on home lending to investors resulted in a number of financial institutions raising interest rates on investor loans by 25 to 30 basis points in July 2015 (despite no change in the RBA cash rate), while also including increased interest rate buffers and tightened loan-to-value ratios in their lending criteria.

These measures effectively limited the supply of investor loans, and the value of loans to investors nationally fell by 17% in 2015/16. Moreover, investors' share of total residential loan activity has fallen back to around long term levels, to 44% in 2015/16. Nevertheless, at this level, investors remain a key driver of capital city residential markets.

In contrast, owner occupier demand has risen. While first home buyer activity remained flat in 2015/16, loans to non-first home buyers rose by 7% in 2015/16. It may be that with less competition from investors, owner occupiers are stepping in to fill the gap. As a result, non-first home buyers accounted for 43% of total residential finance in 2015/16, back to its 15 year average. Meanwhile, at 13% in 2015/16, the share of residential finance to first home buyers remains below its long-term average of 15%.

Growth in investment lending has also slowed as a result of APRA's preference for financial institutions to contain annual portfolio growth in investment lending to below a 10% threshold, and lending policy toward investors appears to have eased slightly. The rate of decline in investor lending has slowed a little toward the end of 2015/16. Monthly loans to investors edged up between April and June 2016, although in June 2016 still remained 15% below a year earlier. A return to the 2014/15 peak in investor activity is not expected. Slowing rental and price growth is likely to contain investor appetite for residential property, while more recent tightening in bank lending policy toward overseas investors will also slow overall investor demand.

Table 2: Share of loans to residential purchasers by purchaser type, Australia

	15 years to 2015/16	2014/15	2015/16
First home buyers	15%	12%	13%
Non-first home buyers	43%	37%	43%
Investors	42%	51%	44%

Source: Australian Bureau of Statistics

Foreign investment

Overseas investors have been a key driver of demand for new dwellings, with some demand also flowing into the established home market. Typically, an overseas resident purchaser can only buy a new dwelling, while a temporary resident can purchase an established dwelling that must be sold upon returning home.

Chart 3 shows the number and dollar amount in billions approved and reported by the Foreign Investment Review Board (FIRB) of total residential purchases by temporary residents and people overseas for new dwellings. The "Developer Off-The-Plan" category refers to the number of buildings that have been pre-approved, although not all will have necessarily been purchased by overseas residents.

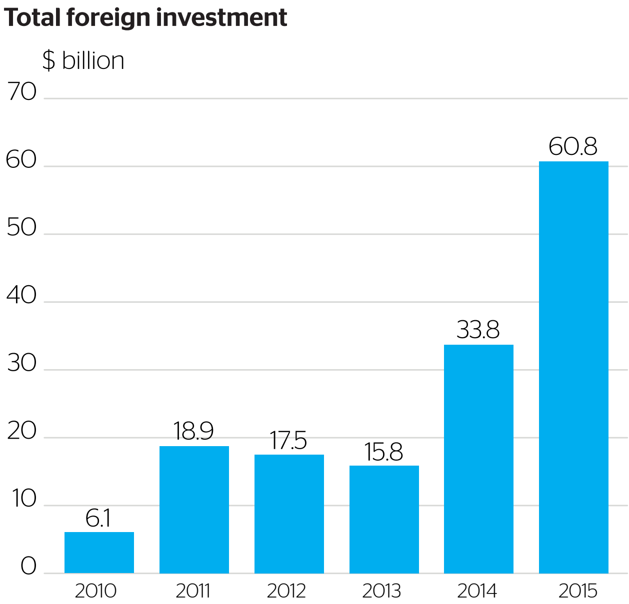
The total value of overseas investment in residential property (which includes the entire value of buildings where 100% of dwellings have been pre-approved for overseas buyers, although all of these may not have been taken up) surged tenfold, from $6.09 billion in 2009/10 to $60.75 billion in 2014/15.

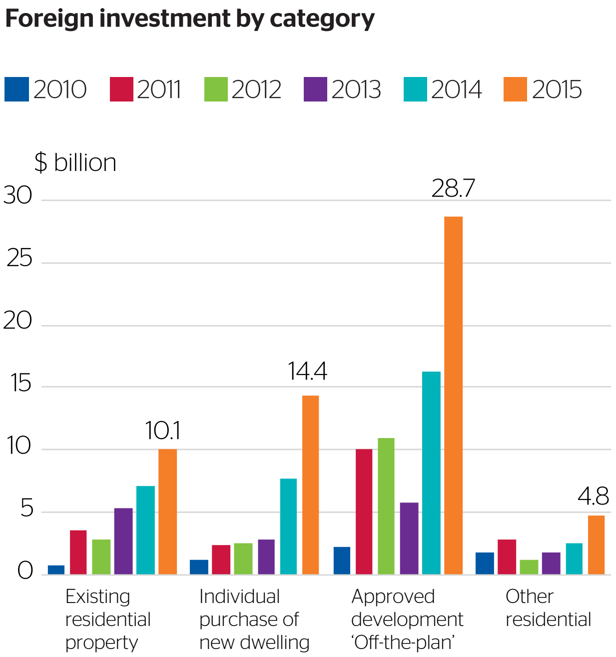
Foreign investors have been attracted to Australian property as a means to geographically diversify out of their own country in a stable and transparent market. A lower Australian dollar is likely to have also assisted the rise in foreign demand in 2014/15. FIRB approvals are likely to have remained elevated in 2015/16, although a number of forces are now coming into play that are seeing the number of overseas purchasers decline:

- Slowing price growth and low residential yields will encourage investment elsewhere;
- Banks have tightened lending policy toward overseas buyers, such as not accepting foreign income in serviceability assessments, and reducing loan-to-value ratios depending on residency status.
- New South Wales, Victoria and Queensland have imposed a surcharge on stamp duty of 3%, 4% and 7% respectively to foreign purchasers. New South Wales also introduced a 0.75% land tax surcharge for foreign residential owners, while in Victoria the 0.5% absentee owner (primarily foreign owners) land tax surcharge will rise to 1.5% from 1 February 2017.
- Tighter capital controls in China, a key source of foreign investment into Australia's property market, may limit capital outflow and impact investor activity in Australian markets.

The headwinds for foreign investors are expected to have the greatest impact on the new dwelling market, particularly the apartment sector, where substantial pre-sales are required for a project to obtain development finance for construction. For those that have already purchased off-the-plan, it will become more difficult for foreign investors to settle, particularly if a lower loan-to-value ratio and potential lower valuation requires a significantly higher equity contribution by the purchaser. If there is an increase is apartments that do not settle, there is likely to be greater downward price pressure in the apartment market as these apartments are placed back onto the market for re-sale, most likely at a lower price.

Chart 3: Value ($b) of Australian residential property purchases by temporary residents and overseas people, 2009-10 to 2014-15





Source: Foreign Review Investment Board

3. Buyer activity

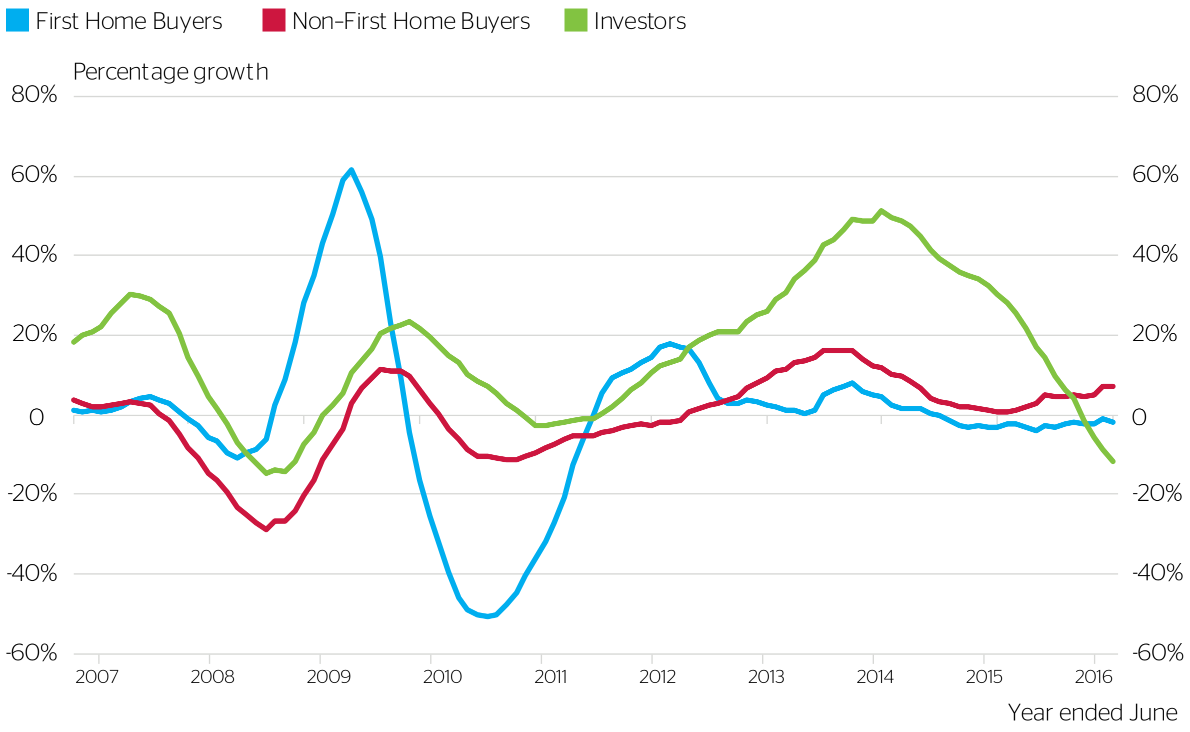
3.1 Current trends

Chart 4 illustrates the change in moving annual turnover of residential loans to first home buyers, non-first home buyers (i.e. upgraders and downsizers, which include all purchases made for owner occupation and where the buyer has previously owned another dwelling) and investors. The chart represents trends for Australia, which masks some differences across the states, as outlined later in this report.

First home buyer demand has been declining since the end of calendar 2014. In 2015/16 the number of first home buyer loans was 1.8% below the year prior. Loans to non-first home buyers rose by 7.1% in 2015/16, after recording an annual 0.9% rise in 2014/15.

Growth in loans to investors peaked in 2014 and has steadily slowed before recording a decline in 2015/16. Monthly loans to investors have been below the same month a year earlier since August 2015, which has corresponded with the timing of tightening bank lending policy toward investors. The total annual decline in the value of loans to investors in 2015/16 was 16.8%.

Chart 4: Annual growth in home loans – moving annual turnover, Australia



Investor activity based on value of lending, owner occupier data based on number of loans

Source: Australian Bureau of Statistics

3.2 First home buyers

Incentives available

First home buyer demand is important because it creates demand for entry-level properties, facilitating broader demand by encouraging current occupiers to upgrade through the value chain. As a result, incentives have often been put in place to promote first home buyer demand during times of market weakness.

Table 3 shows existing state and federal government incentives offered to first home buyers. It refers to grants available specifically to first home buyers and not broader grants and incentives first home buyers can also access. Where stamp duty concessions are offered, the maximum concession is indicated. It should be noted there are some purchase price limits for grant eligibility which vary by state.

Table 3: First home buyer incentives by state at September 2016

	Established Home Grant		New Home Grant		
	Cash grant	Stamp duty concession (max)	Cash grant	Stamp duty concession (max)	Future expiry / changes
NSW	$0	$0	$10k	$20.2k	
VIC	$0	$15.5k	$10k	$15.5k	
QLD	$0	$8.8k	$15k	$8.8k	
SA	$0	$0	$15k	$21.3k	
WA	$3K	$13k	$10k	$14.4k	
TAS	$0	$0	$20k	$0	
NT	$0	$0	$26k	$0	
ACT	$0	$0	$10k	$0	2015/16 budget to reduce cash grant to $7k at Jan 2017

Source: State Government State Revenue Offices, BIS Shrapnel

Over the past five years there have been progressive changes in first home buyer incentives across all states to favour purchasers of new homes over existing homes. The long-term impact will be a shift of first home buyer demand that would have otherwise been for established homes into the new home market, thereby adding to supply.

The short-term impacts on the market as a result of the progressive removal of incentives for the purchase of established dwellings are:

- Future first home buyer demand was brought forward to take advantage of the grants before they expire, leaving a vacuum of first home buyers in the established market immediately afterwards.
- A delay in the next round of first home buyers who then have to accumulate a larger deposit to compensate for the lack of financial assistance. In periods where prices are rising, this delay could take longer as the deposit hurdle progressively increases.

With first home owner demand being fixed (i.e. households are first home buyers only once), incentives do not create or diminish demand but rather serve to shift existing demand through time. Once the impacts of the changes to incentives are worked through, first home buyer demand should return to long-term averages. This is likely to be the case in the coming years with first home buyer incentives now being relatively stable.

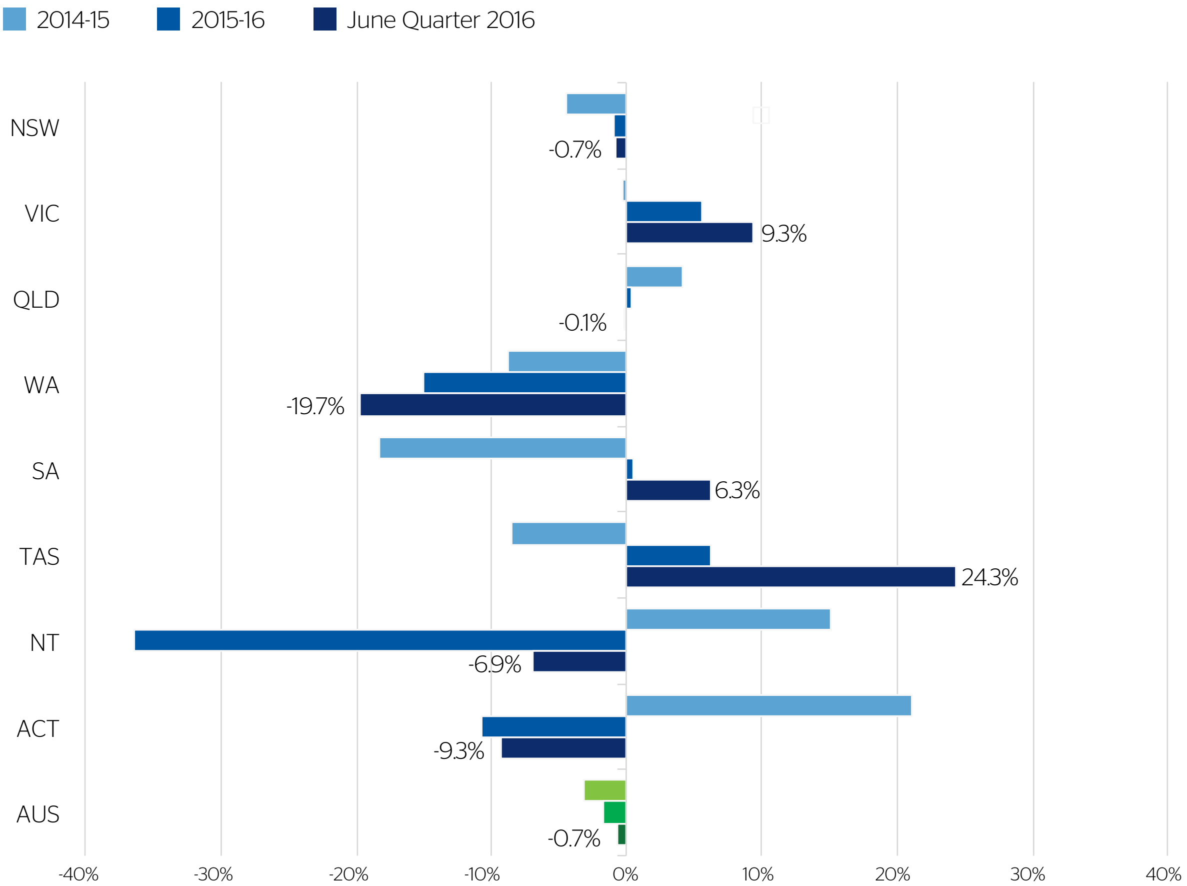
Tasmania and South Australia removed the first home buyer incentives for existing dwellings in July 2014 and have accordingly shown higher first home buyer activity in 2015/16 as they progressively recover to long-term levels.

Victoria experienced 5.6% growth in first home buyer loans in 2015/16, with the 9.3% year-on-year growth in June quarter 2016 suggesting that first home buyer activity is strengthening. In Queensland first home buyer loans have been stable in recent years with little to no change in the number of loans over 2014/15 and 2015/16. New South Wales has been similarly flat, recording recent marginal declines in loans, but the average annual number of loans in New South Wales in the five years to 2015/16 is down 32% on the average over the six years to 2010/11.

Western Australia experienced a decline in first home buyer loans in 2015/16, caused by a deteriorating economy, and the fact that first home buyer demand had held up strongly between 2011/12 and 2014/15. The Northern Territory removed the incentives for existing dwellings in January 2015 and accordingly first home buyer activity was significantly lower in 2015/16, although the pace of decline was beginning to slow by June quarter 2016. The Australian Capital Territory has also shown declining numbers of loans to first home buyers after a peak in activity in 2014/15.

Australian Bureau of Statistics (ABS) data on loans to first home buyers are derived from returns submitted by financial institutions to APRA at the time of the loan approval. A first home buyer is defined as "a borrower entering the home ownership market for the first time". The definition includes all first home buyers obtaining a loan (and not just those eligible for grants) but excludes first home buyers who are investors as the data relates to loans for owner occupied properties. There is some evidence to suggest that an increasing percentage of first home buyers, particularly in the higher priced cities of Sydney and Melbourne, are purchasing an investment property as their first home as a stepping stone into the market.

Chart 5: Annual growth in number of loans to first home buyers by state



Source: Australian Bureau of Statistics

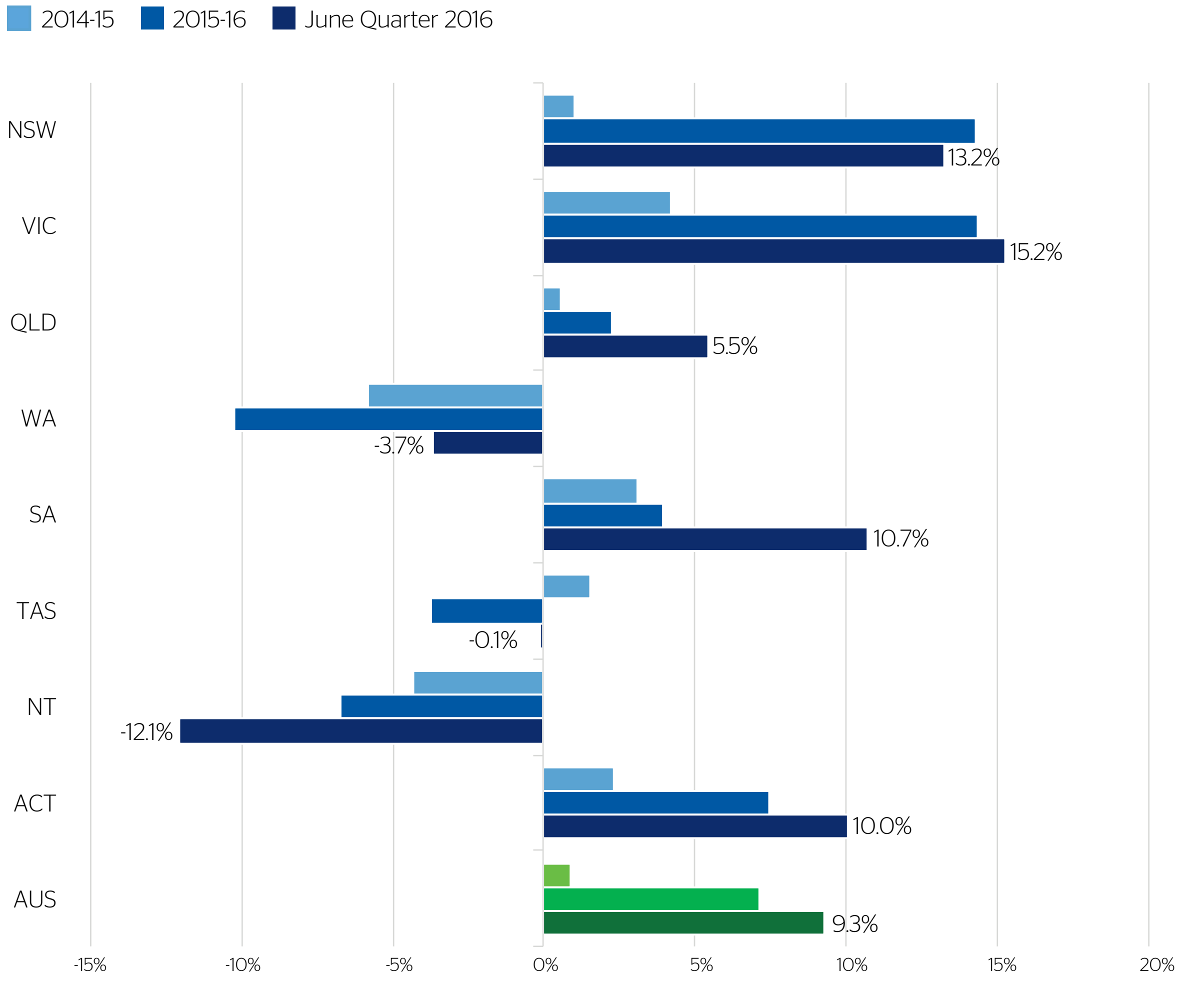
3.3 Upgraders and downsizers

Upgraders and downsizers have historically represented the largest component of residential demand, being 43% of total residential lending activity in the past 15 years. This is two to three times the size of the first home buyer market.

Since bottoming out in 2011 and 2012 in all states, upgrader demand strengthened over the last four years. In the year to June 2016, growth in the number of loans to upgraders was 7.1% nationally. However, upgrader demand varies by state.

- Victoria, New South Wales, South Australia, Australian Capital Territory, Queensland and Tasmania saw growth in loans to upgraders during 2015/16.
- In contrast, in Western Australia and the Northern Territory the number of loans to upgraders declined in 2015/16, following on from declines in the previous year. Similarly, upgrader loans declined in Tasmania in 2015/16, although this was after growth in 2014/15. In Western Australia, there was a less significant decline in loans in June quarter 2016, suggesting that the pace of decline is slowing and the market will soon bottom out, whereas in the Northern Territory the number of loans to upgraders experienced a greater annual decline in June quarter 2016.

Chart 6: Annual growth in number of loans to upgraders and downsizers by state



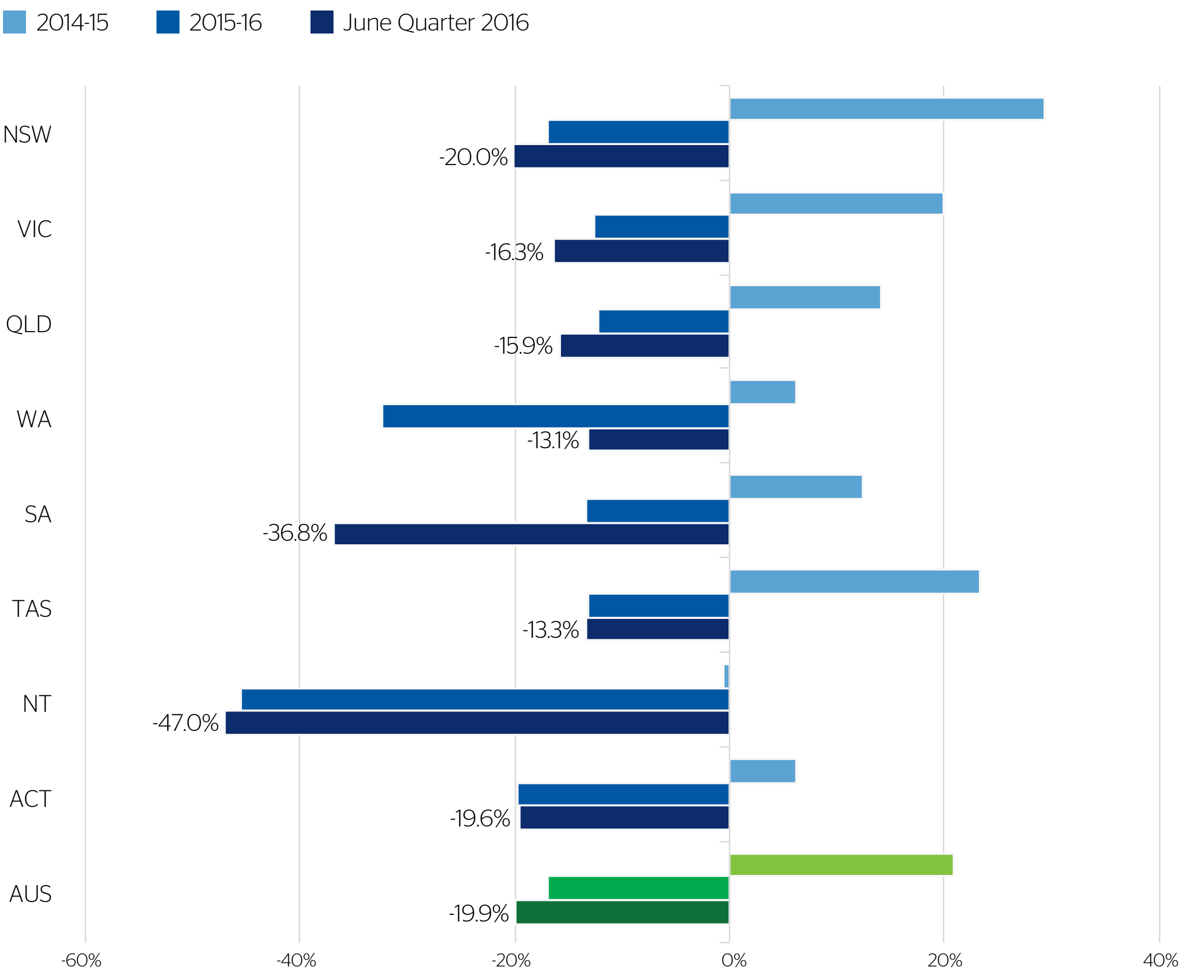
Source: Australian Bureau of Statistics

3.4 Investors

The ABS provides data on residential investment in terms of the value of total loans rather than the number of loans. As a result, changes in the value of loans over time reflect a change in values for property and purchaser volumes.

- All states reported double digit decreases in lending for residential investment in 2015/16, after strong annual rises up to the peak in 2014/15. Year-on-year declines were still being recorded in June quarter 2016.
- Investment lending in Victoria, Queensland, Western Australia and Tasmania recorded the smallest annual decline in investment loans in 2015/16.
- The Northern Territory and South Australia recorded the highest decline in lending for residential investment during 2015/16.

Chart 7: Annual growth in value of loans to investors by state



Source: Australian Bureau of Statistics

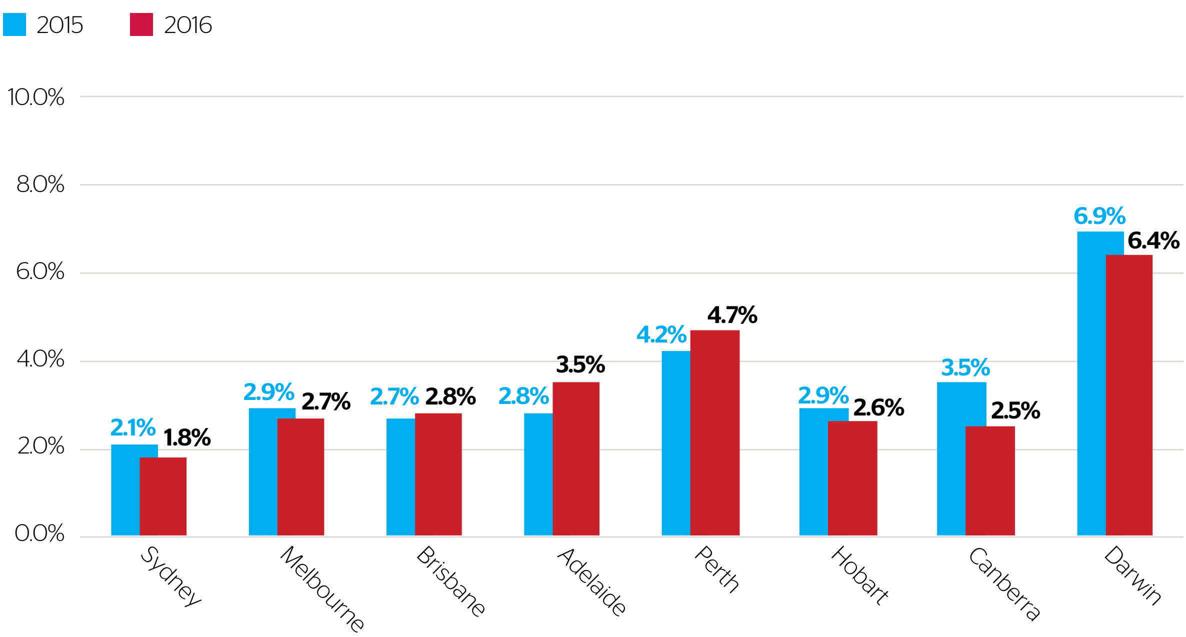
4. Rental markets

4.1 Vacancy rates

The vacancy rate is calculated as the number of unoccupied rental dwellings as a percentage of the total rental stock and is sourced from a survey of state Real Estate Institute members. The vacancy rate in each city is a measure of the balance of rental demand and rental supply. A vacancy rate of 3% in a market is considered balanced, where rents on average will rise broadly in line with inflation.

- In Sydney, since 2006 there has been a considerable deficiency of residential dwelling stock after an extended period of low new dwelling construction. Given the extent of the dwelling shortage, vacancy rates have remained tight at 1.8% in June quarter 2016, and the return to a balanced rental vacancy rate is unlikely to occur until beyond 2018/19.
- In Melbourne, vacancy rates were below the balanced market level of 3% in 2013/14 and 2014/15. However, with record dwelling completions vacancy levels are now closer to balance at 2.7% in June quarter 2016. With dwelling completions on track to increase further in 2016/17, vacancy rates in Melbourne are expected to move above 3% over the year.
- Brisbane vacancy rates increased marginally to 2.8% at June 2016; still close to the balanced market rate. In Adelaide, vacancy rates have risen to 3.3% in the same period. Vacancy rates in both cities are anticipated to continue to trend upwards. In Brisbane, the forecast is due to upcoming dwelling completions outpacing demand, and in Adelaide the excess of dwelling stock may rise further due to weak population growth.
- Perth (6.0%) and Darwin (6.4%) recorded the highest vacancy rates among all capital cities at June 2016. Rising new dwelling completions, rapidly slowing net overseas migration inflows and falling interstate migration levels, as a result of the collapse in mining investment are causing an exit from rental properties. As a result, the pace of new rental tenants coming to the market is failing to keep up with the pace of new additions to the rental stock.
- In Hobart, vacancy rates remain at the upper end of the 2–3% band. Elevated dwelling completions relative to population growth are keeping the market around balance. In the Australian Capital Territory, declines in rents appear to be attracting new tenants with its vacancy rate falling to 2.5% in June 2016. With both states estimated to experience a rising dwelling surplus, the downward trend in vacancy rates is not expected to continue.

Chart 8: Residential vacancy rates, at June quarter 2015 vs June quarter 2016



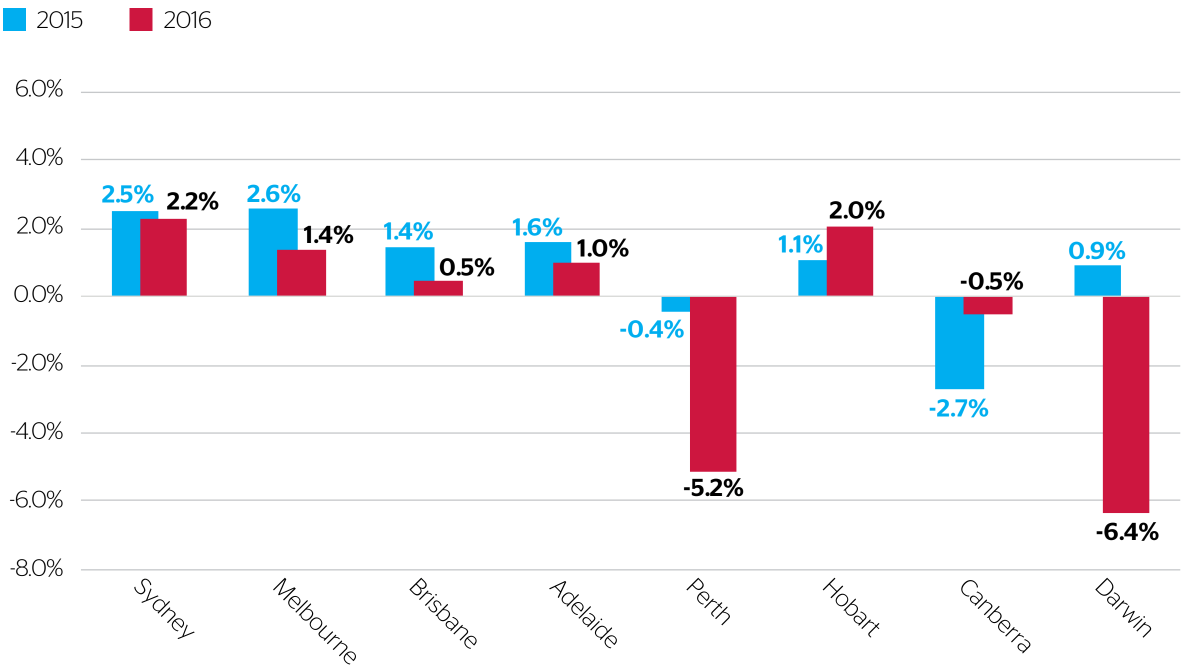
Source: Real Estate Institute of Australia

4.2 Rental growth

Rental growth, as calculated from the rental component of the Consumer Price Index, was strong in the latter half of the 2000s after a period of underperformance in the first half of the decade. In recent years, rental growth has generally been moderate, despite vacancy rates remaining tight in all capital cities up to 2013. This suggests there may be some rental affordability constraints preventing stronger rises.

- With a deficiency of dwellings in place and low vacancy rates, New South Wales had the highest level of rental growth of 2.2% in 2015/16. In Hobart, a lower vacancy rate of 2.8% assisted the second highest level of rental growth of 2% in 2015/16. Melbourne and Adelaide, with rental growth of 1.4% and 1% respectively, experienced minimal rental growth as their respective vacancy rates rose above the balanced market rate over the year.
- Brisbane and Canberra rents stayed fairly static in 2015/16, despite a low vacancy rate in Canberra. Canberra recorded a 0.5% decline in rents, which is an improvement on its 2.7% decline in 2014/15.
- In Darwin and Perth, rents declined by 6.4% and 5.2% respectively in 2015/16.This reflects the high level of vacancy rates in each capital city. In both states, while new dwelling supply continues to rise, falling resource investment spending is leading to significant reductions in migration and subsequent weaker tenant demand.

Chart 9: Annual rental growth, year to June



Source: Australian Bureau of Statistics

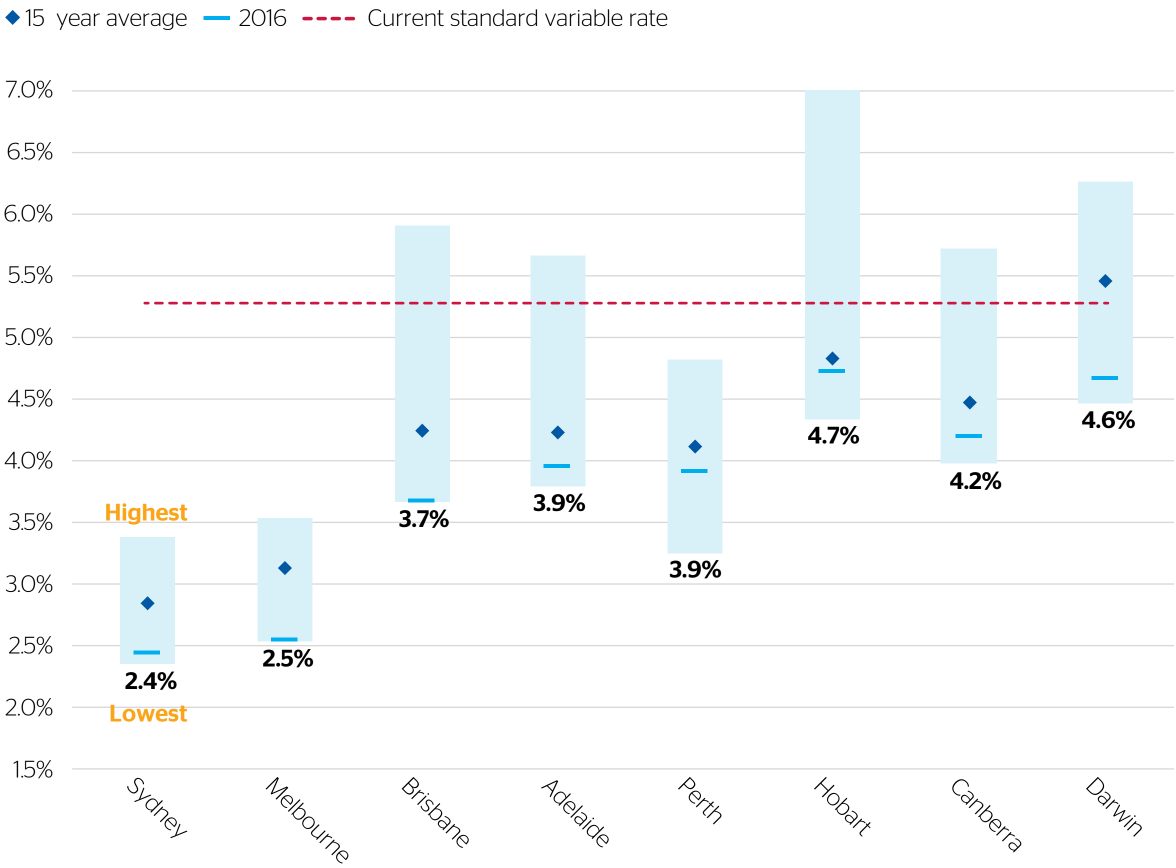
5. Yields

Chart 10 shows movement in indicative rental yields for houses by capital city. The indicative yield is calculated as the median three-bedroom house rent divided by the median house price. The indicative yield slightly understates actual yields, as the median house price is reflective of the whole market (investors and owner occupiers) while rents are reflective of just properties in the investment market. Investment properties are more likely to be priced below the median house price of all dwellings, although achieve a typical rent. Nevertheless, movement in the indicative yield should correspond with actual yields. We have compared the rental return with the cost of financing by using the measurements for indicative rental yield and the standard variable interest rate respectively.

- In Sydney and Melbourne, indicative rental yields for houses are well below other capital cities, with stronger house price growth in these two capitals over the past three years widening the gap. At June 2016, the indicative rental yield for houses in Sydney was 2.4% and in Melbourne was 2.5%. For Melbourne, this was the lowest yield on record, for Sydney, yields are at their lowest level since 2004.
- In Adelaide and Perth, yields at June 2016 were on par at 3.9%. In Canberra, yields were a little higher at 4.2%. Adelaide's yield has varied over the past ten years, while sharp falls in rents in Perth have seen its yield decline. In Canberra, yields rose in the year to June 2016 as the fall in rents stabilised.
- Brisbane's yields have fallen to 3.7% in 2015/16 as house price growth has been above the minimal rise in rents over the year. This is the lowest level recorded.
- In Darwin weaker rental growth has resulted in a continued decline in housing yields in 2015/16, to 4.6%. Darwin has the highest indicative house yield of the capital cities, just edging out Hobart which had yields relatively stable at 4.6% during the year.

Yields in all capital cities are below the 15-year average. Despite the low yields, the corresponding low mortgage interest rates means the gap between rental yields and interest rates in most capital cities remains narrow. In some instances, selected properties in individual markets are likely to be positively geared, particularly with the current ability of purchasers to obtain a rate better than the current standard variable rate.

Chart 10: Indicative rental yields by capital city, houses



Source: Real Estate Institute of Australia, Reserve Bank

6. Housing affordability

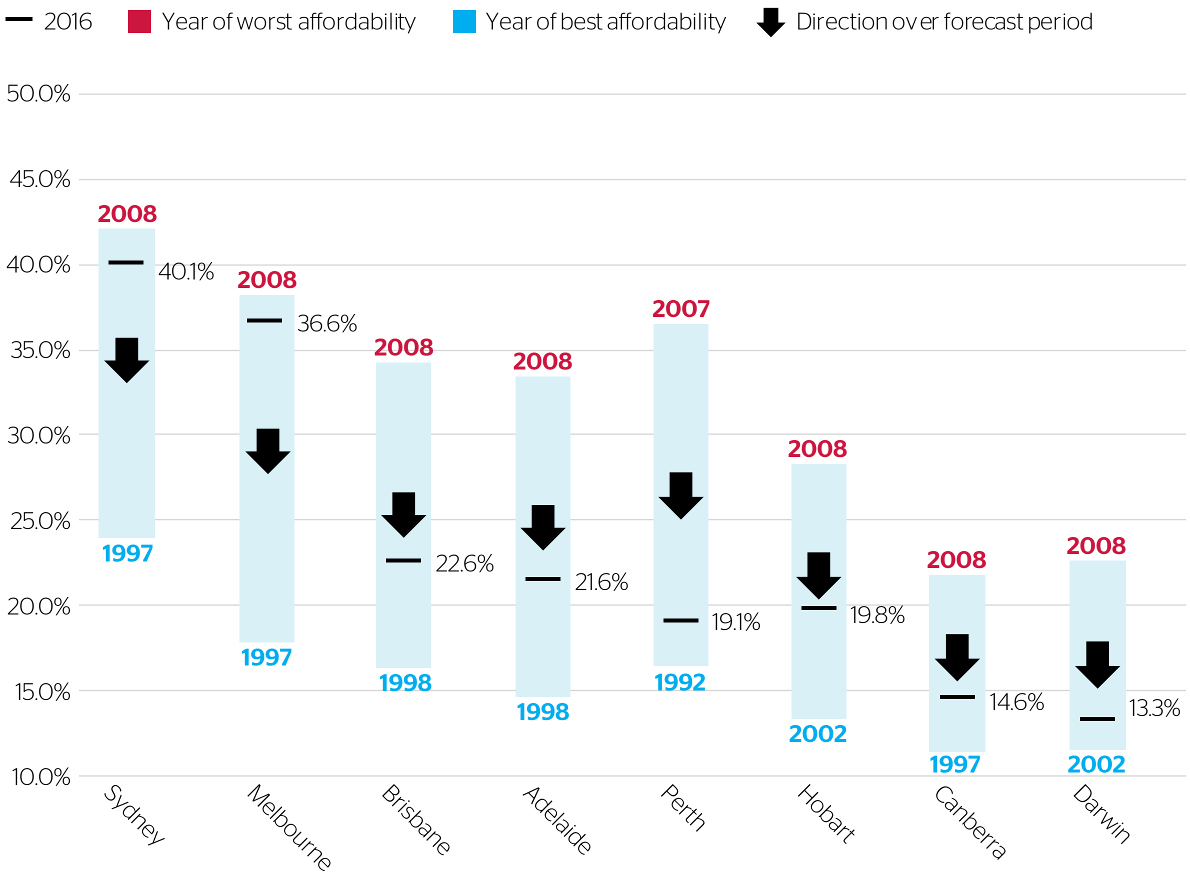
Housing affordability in this report is defined by the mortgage repayments on a 25-year loan of 75% of the median house price at June 30 each year, at the prevailing June 30 standard variable rate, as a percentage of average household disposable income. Average household disposable income is derived from the National Accounts data, based on aggregate income divided by an estimate of the number of households.

Strong house price growth in Sydney and Melbourne since 2012/13 has reduced affordability in these cities markedly. The ratio of mortgage repayments to household income of 40.1% in Sydney and 36.6% in Melbourne at June 2016 is close to its previous highest, indicating limited scope for continuing solid price growth.

Affordability ratios at June 2016 in all other capital cities are around the mid-point of their historical range (as indicated in the chart) or slightly better. The anticipation of limited house price growth and the cuts to interest rates in 2016 will combine to keep the affordability ratio steady in these cities.

While interest rates at all-time lows in a tight market should stimulate house price growth, all cities bar Sydney are in or moving into a housing stock surplus, which should curb these factors. Outside of Sydney and Melbourne, weaker economic conditions are also having an impact. Affordability is expected to remain challenging in Sydney and Melbourne. In the other capital cities, better relative affordability should mitigate some of the downward pressure on prices in oversupplied markets and in resource-sector exposed markets such as Perth, Darwin and to a lesser extent Brisbane.

Chart 11: Mortgage repayments on a median priced home* as a proportion of monthly disposable household income



Source: Australian Bureau of Statistics, Reserve Bank, Real Estate Institute of Australia, Forecasts: BIS Shrapnel

* Mortgage repayment based on 75% of the median house price

7. Demand

Underlying demand for new dwellings is driven primarily by population growth which, at the state level, is a combination of an increase in births less deaths and net overseas and net interstate migration flows. The demand from net overseas and net interstate migration is more immediate because this group typically requires accommodation upon arrival, be it owner occupied or rental. Net overseas migration refers to the balance of arrivals to, and departures from, Australia. To be included in this calculation, an arrival is counted if they are resident in the country for 12 out of 16 months.

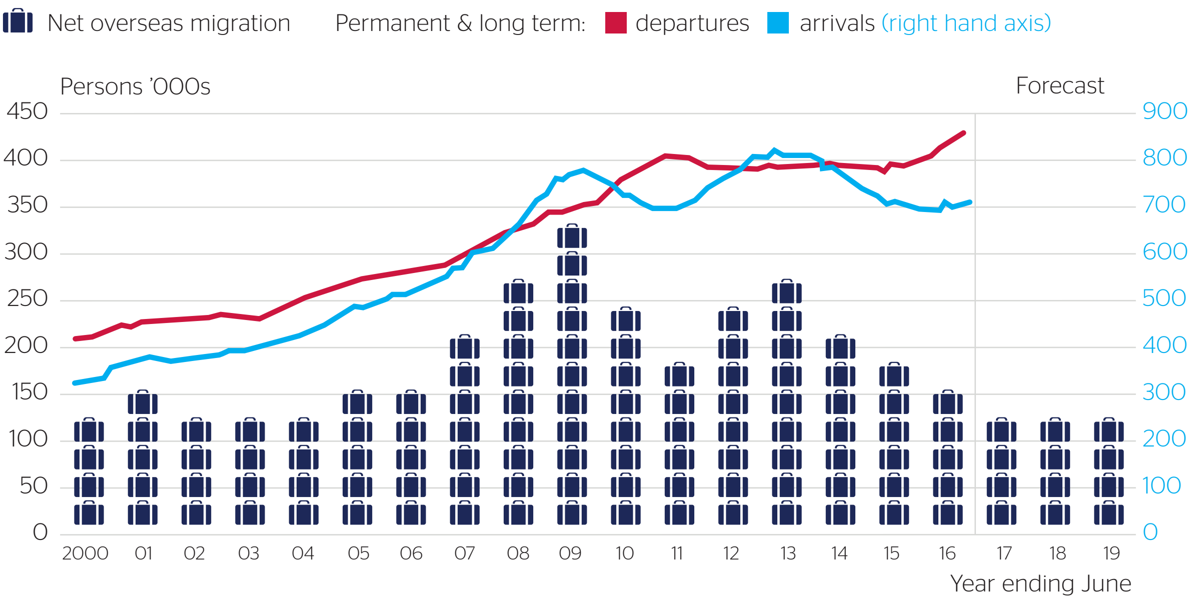
7.1 Overseas migration

Long term arrivals – which predominantly comprise people on student or skilled temporary subclass 457 visas – surged to an annual record of 516,000 in the year to March 2013. Solid employment growth in mining sector-related industries resulted in a re-emergence of skills shortages which underpinned the rise in long term overseas visitors. Although arrivals from overseas were at record levels in March 2013, departures from Australia were also increasing, with the net effect that net overseas migration was below the record levels set in 2008.

Since the second half of 2013, long term arrivals have contracted in response to the slowing conditions in the Australian economy. There has been a decline in work-related visas such as subclass 457 visas as the reduction in the resource sector investment leads to diminished employment opportunities. Long term departures are on the increase as temporary migrants return to their country of origin upon expiry of their visas. Net migration from New Zealand has also declined in this period because its economy has improved relative to Australia.

With the decline in annual net inflow from long term arrivals, net overseas migration has decreased to an estimated 155,000 at June 2016. Falling arrivals and increasing departures, due to the lack of opportunities for temporary migrants to extend their stay, is forecast to continue, taking net overseas migration to a low of 140,000 in 2017/18 and 2018/19. While lower than recent peaks, this figure is elevated in a long term sense, being higher than most years through the 1990s and early 2000s. There may be some upside to these forecasts. Strong growth is occurring in international student enrolments, with the number of overseas students commencing courses in Australia increasing by 42% in the three years to 2015/16, and net overseas migration could be higher if many elect to stay on.

Chart 12: Arrivals and departures (movements) and net overseas migration (persons), moving annual totals, Australia



Source: Australian Bureau of Statistics, BIS Shrapnel

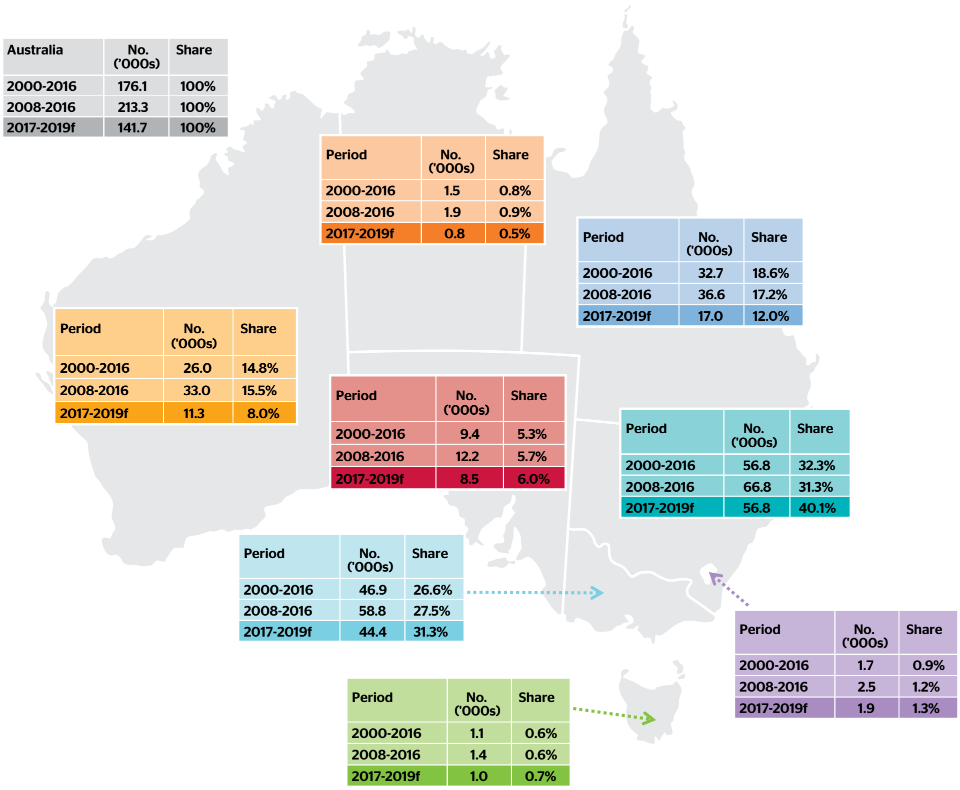
Average annual net overseas migration over the 2016/17 to 2018/19 period is forecast to be lower across all states (with the exception of the Australian Capital Territory) than the long term 1999/2000 to 2015/16 average.

The largest declines are expected to be in the states where net overseas migration inflows have been high as a result of skills shortage generated by booming resource sector investment. The forecast share of national net overseas migration in Western Australia (8.0%), Queensland (12.0%) and Northern Territory (0.5%) over 2016/17 to 2018/19 will be significantly lower than their long term average. Weak employment prospects as mining investment continues to decline will encourage more overseas migrants to settle in the other states, while overseas migrants employed on temporary working visas are increasingly returning home as projects wind up.

Growth in overseas migration into New South Wales and Victoria lagged that of the resource states during the mining investment boom. As a result, the states are not experiencing rising outflows of temporary workers. Moreover, with the strongest performing state economies, these states are also attracting a greater share of arrivals. The states are forecast to attract an average 40.1% and 31.3% of Australia's net overseas migration respectively between 2016/17 to 2018/19; higher than their long term average share. The Australian Capital Territory is also forecast to attract an increased share of national net overseas migration. Overseas students look to be one of the few components of net overseas migration to increase. Australian National University has a large overseas student population, which has an influence in a smaller city such as Canberra.

As with New South Wales and Victoria, net overseas migration into South Australia and Tasmania was also behind the resource states. With economic conditions remaining challenging in these states, their share of national net overseas migration over 2016/17 to 2018/19 is forecast to be similar to their recent average since 2007/08 (6.0% and 0.7% respectively).

Chart 13: Annual net overseas migration by state



Australia	No. ('000s)	Share
2000-2016	176.1	100%
2008-2016	213.3	100%
2017-2019f	141.7	100%

Period	No. ('000s)	Share
2000-2016	1.5	0.8%
2008-2016	1.9	0.9%
2017-2019f	0.8	0.5%

Period	No. ('000s)	Share
2000-2016	32.7	18.6%
2008-2016	36.6	17.2%
2017-2019f	17.0	12.0%

Period	No. ('000s)	Share
2000-2016	26.0	14.8%
2008-2016	33.0	15.5%
2017-2019f	11.3	8.0%

Period	No. ('000s)	Share
2000-2016	9.4	5.3%
2008-2016	12.2	5.7%
2017-2019f	8.5	6.0%

Period	No. ('000s)	Share
2000-2016	56.8	32.3%
2008-2016	66.8	31.3%
2017-2019f	56.8	40.1%

Period	No. ('000s)	Share
2000-2016	46.9	26.6%
2008-2016	58.8	27.5%
2017-2019f	44.4	31.3%

Period	No. ('000s)	Share
2000-2016	1.7	0.9%
2008-2016	2.5	1.2%
2017-2019f	1.9	1.3%

Period	No. ('000s)	Share
2000-2016	1.1	0.6%
2008-2016	1.4	0.6%
2017-2019f	1.0	0.7%

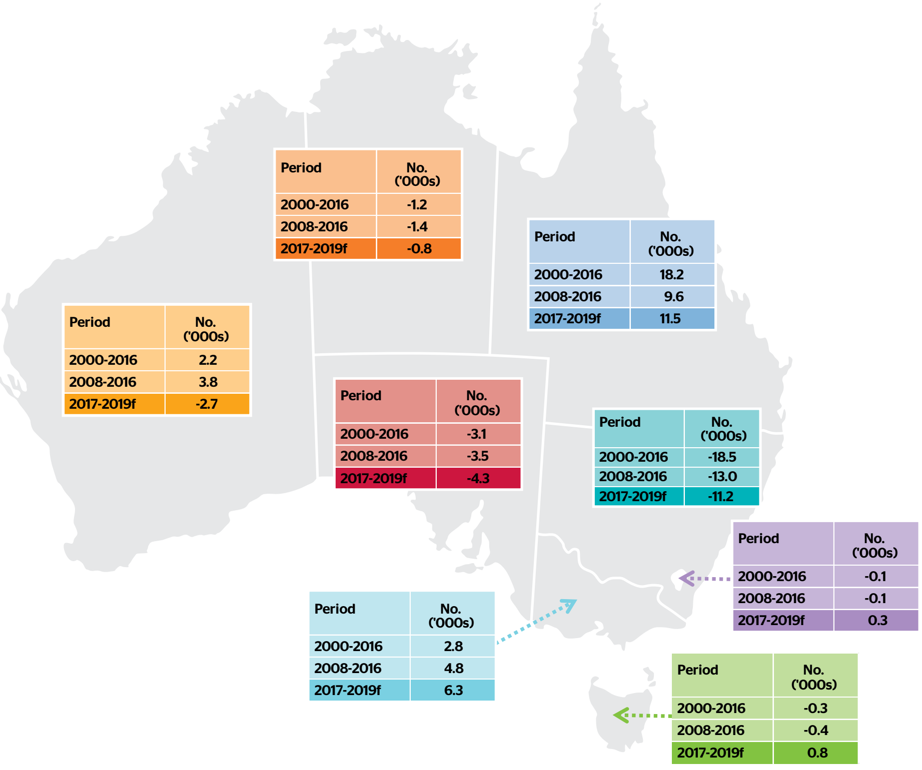
Source: Australian Bureau of Statistics. Forecasts: BIS Shrapnel

7.2 Interstate migration

The main drivers of migration between the states are relative housing affordability and economic conditions. Reduced interstate movement occurs when economic conditions deteriorate – i.e. limited job prospects elsewhere encourage people to stay where they are.

- New South Wales' net interstate population outflow has improved from a long term annual average of 18,500 (2000–2016) to 13,000 (2008–2016). Despite strong house price growth and reduced affordability, the strength of the New South Wales economy relative to most other states is retaining population, with the state's net outflow to remain low at an average 11,200 per annum in the three years to 2018/19.
- Victoria's net interstate migration inflow has improved from a long term average of 2,800 per annum (2000–2016) to 4,800 per annum (2008–2016). It is anticipated that there will be a net intake of approximately 11,000 people in 2015/16, which will be a record and the highest annual total among all states. Victoria's net interstate migration inflow is expected to remain strong, although ease to an average 6,300 per annum in the next three years to 2018/19.
- Queensland's net interstate migration inflow has declined from its long term annual average of 18,200 (2000–2016) to 9,600 (2008–2016), reflecting recent weak economic conditions. Net interstate migration into Queensland is expected to improve to 11,500 per annum on average in the three years to 2018/19, as migrants from New South Wales and Victoria increasingly escape higher house prices. However, with only a slow recovery expected for the Queensland economy, this level of net interstate migration will still be well below the long term average.
- In Western Australia, employment conditions continue to weaken as resource sector investment winds down, and interstate migration has reverted from a net inflow through to 2013/14 to a net outflow since 2014/15. The net interstate outflow is forecast to average 2,700 people per annum over the three years to 2018/19. Similarly, as Northern Territory's economic conditions worsened as resource investment reduces, and with fewer job opportunities, it is expected to continue to experience a small net interstate migration outflow.
- In South Australia, the estimated net interstate migration outflow of 4,500 persons in 2015/16 is projected to persist through to 2018/19 as unemployment remains high. In Tasmania and the Australian Capital Territory, interstate migration is anticipated to revert from a net outflow to a net inflow during the next three years. Improved affordability relative to Sydney and Melbourne is expected to result in increased "tree change" migration to Tasmania, while a more stable employment environment should benefit the A.C.T.

Chart 14: Annual net interstate migration by state



Source: Australian Bureau of Statistics. Forecasts: BIS Shrapnel

7.3 Demand and supply

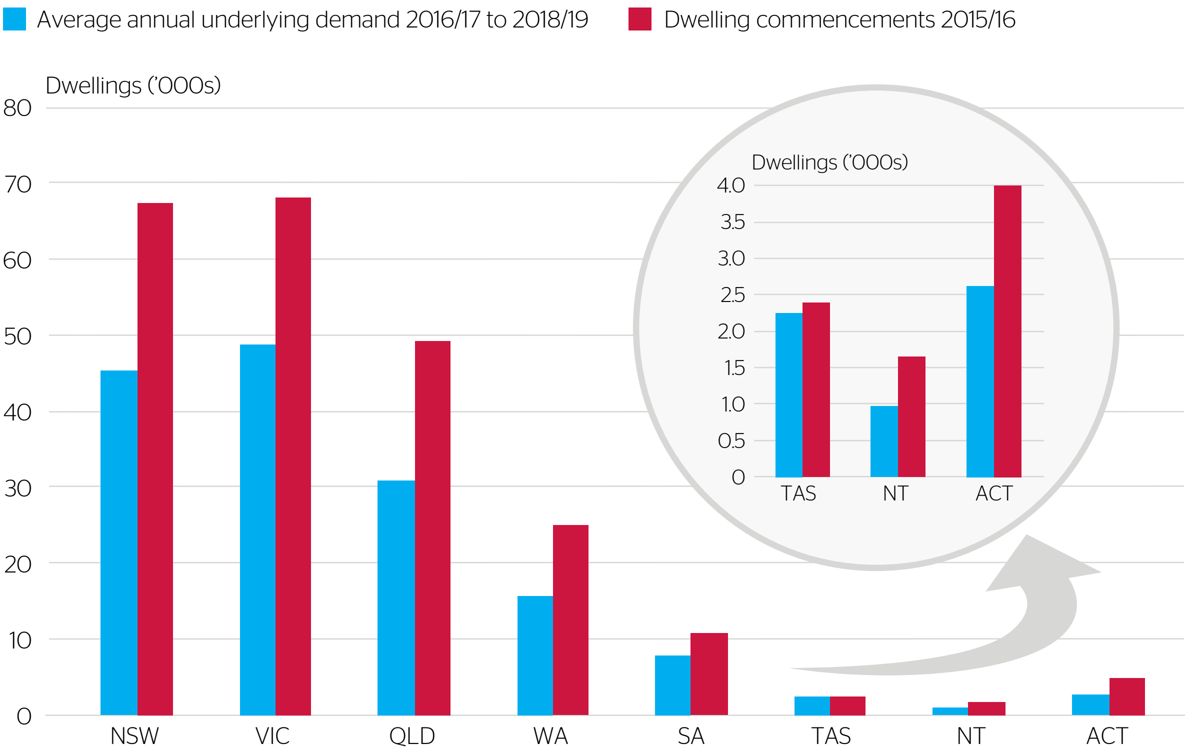
The underlying demand for new dwellings is driven largely by the increase in households, which is underpinned by population growth. The balance between underlying demand and supply has an impact on vacancy rates, rents, prices and construction.

Chart 15 shows the forecast average underlying demand for additional dwellings by state in the next three years compared with current supply, with supply indicated by total new dwelling starts in 2015/16.

New dwelling starts in 2015/16 in all states are on track to be higher than forecast annual underlying demand over the three years to 2018/19. The boost to new dwelling supply will move all the states into oversupply, with the exception of New South Wales, where the accumulation of a high dwelling deficiency will take some time to be absorbed.

The states where commencements are now highest relative to forecast underlying demand are Australian Capital Territory (86% above), the Northern Territory (69% above) and Western Australia (61% above).

Chart 15: Annual underlying demand and supply by state



Source: Australian Bureau of Statistics, BIS Shrapnel, Forecasts: BIS Shrapnel

Chart 16 shows dwelling stock deficiency by state as a percentage of forecast annual underlying demand as at June from 2016 through to 2019.

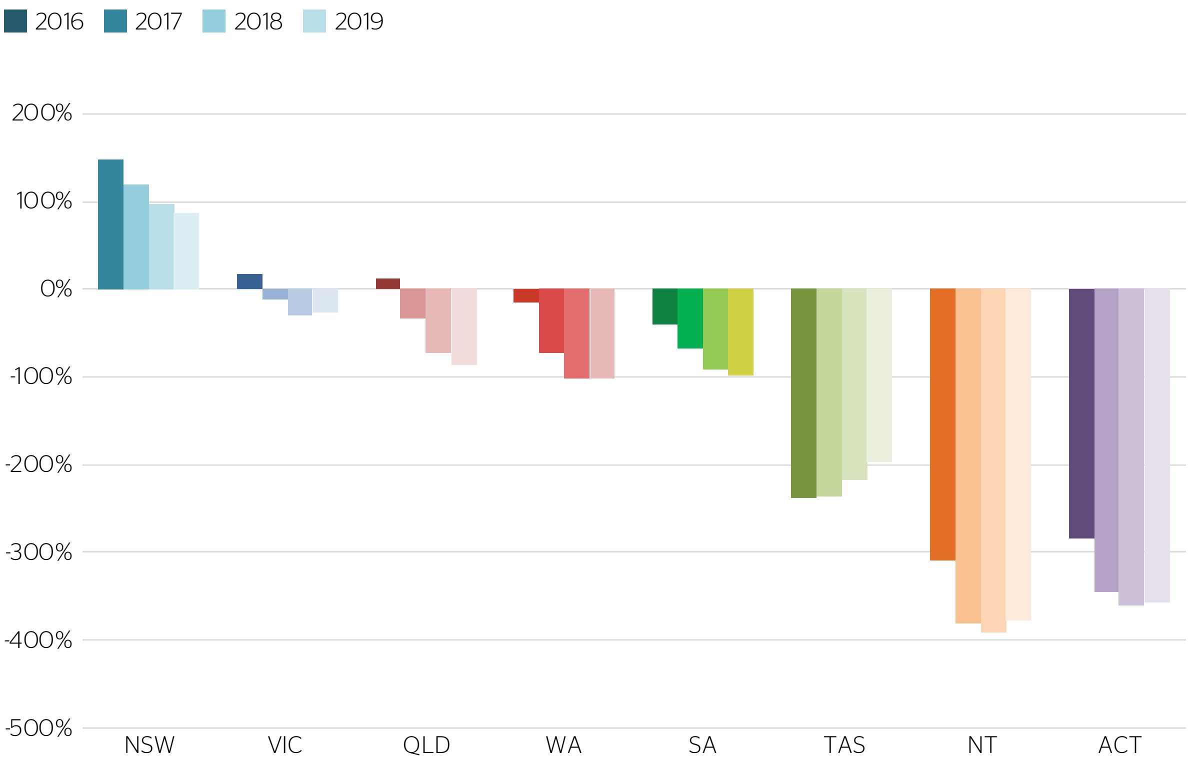
A large dwelling stock deficiency has accumulated in New South Wales and is currently the highest of all states at June 2016. This is evidenced by its low vacancy rate. With dwelling starts now eclipsing annual underlying demand; being 49% higher, the dwelling stock deficiency in New South Wales is beginning to be absorbed, and is projected to fall below one year's worth of underlying demand from 2017/18.

Record high-rise apartment construction activity in the inner city areas of both Melbourne and Brisbane is taking supply above underlying demand. In Victoria, dwelling starts were 40% above underlying demand, while in Queensland they were 59% higher. As a result, the small dwelling stock deficiencies in each state at June 2016 are anticipated to erode and become a dwelling stock surplus by June 2017. The stock surplus in each state is forecast to increase with the surplus likely to be most concentrated in the apartment sector.

With Western Australia's commencements being 61% higher than underlying demand in 2015/16, a small stock surplus has already emerged, which is evidenced by Perth's high vacancy rate. With much of Western Australia's temporary skilled migrants living in camps onsite and in temporary accommodation during periods of not working, it is likely that the surplus dwelling stock is higher than indicated. As the Western Australian economy continues to slow and temporary migrants return to their country of origin, the oversupply is expected to become more acute over the next three years.

In the Northern Territory the current dwelling surplus is illustrated by Darwin's high vacancy rates and falling rents, and the surplus is expected to persist throughout the forecast period. Similarly, in Tasmania and South Australia, based on current and forecast construction levels, the current dwelling surplus in both states is forecast to rise through to 2018/19 and be higher than a year's underlying demand. The Australian Capital Territory has been consistently overbuilding, culminating in a growing surplus of dwellings over the next three years. This is characterised by falls in rents, and until recently, high vacancy rates.

Chart 16: Dwelling stock deficiency/surplus by state, percentage of forecast annual underlying demand, as at June



Source: Australian Bureau of Statistics, BIS Shrapnel, Forecasts: BIS Shrapnel

Note a positive percentage represents a dwelling deficiency and a negative percentage represents a dwelling surplus

7.4 Composition of dwelling supply

There has been a marked shift toward new unit development since 2012/13, which includes villa units, townhouses, semi detached dwellings, terraces, flats and apartments. The rising demand for new units has partly been underpinned by demographic trends, with an increase in preference by some of the population to live in smaller dwellings. However, the largest driver of the shift has been the strong investor demand in this period, with units typically favoured by investor purchasers. Units have accounted for 46% of total dwelling approvals in Australia between 2012/13 and 2015/16. This compares with a 33% share in the ten years to 2011/12.

The largest increase in unit development has been in Victoria (from 30% share in the ten years to 2011/12, to 47% over the past four years) and Queensland (33% share rising to 46%). While over half of new dwelling approvals in New South Wales, Northern Territory and Australian Capital Territory are units, unit building activity has always accounted for a high share of new dwelling activity in this state and these territories. Gains in unit development have been less pronounced in the other states.

With the increase in unit construction being higher than for house construction over the past four years, it is likely that oversupplies in the states will be most prevalent in the unit sector. In Victoria and Queensland, where the greatest increases in unit dwelling building is occurring, the projected surpluses will be most heavily concentrated amongst apartments in the inner city markets.

Table 4: Unit dwelling approval share of total dwelling building approvals by state

State	10 years to 2012	4 years to 2016
NSW	50%	$0
VIC	30%	$15.5k
QLD	33%	$8.8k
SA	23%	$0
WA	19%	$13k
TAS	17%	$0
NT	47%	$0
ACT	54%	$0
AUS	33%	

Source: State Government State Revenue Offices, BIS Shrapnel

8. Capital city overviews and price forecasts

8.1 Sydney

House market

Median house prices in Sydney began to escalate at the end of 2012 as successive cuts to interest rates and the underlying dwelling deficiency firmly in place released pent up demand into the market. Sydney's median house price experienced a considerable increase totalling 58% over the four years to June 2016 to be $1,047,600.

Purchaser demand was initially boosted by improved affordability as variable rates fell below 6.5% in 2012 keeping the ratio of mortgage repayments on a median priced house to just over 31% of average household income, which initiated the upturn before further interest rate cuts fuelled stronger price growth through 2013. The return of solid price growth drove more investors into the market. At the same time, a strong recovery in the New South Wales economy, attracted surging overseas migration and a record low interstate outflow, which in turn caused Sydney's dwelling deficiency to escalate.

As prices rose, the next wave of demand was driven by investor buyers attracted by price growth and attractive yields in light of the falling interest rates. The value of residential investor loans in New South Wales surged 153% in the three years to 2014/15. In comparison, the number of loans to owner occupiers were 9% higher in the same period.

Table 5: Median house price growth in Sydney by region, per cent, year to June quarter 2016

	INNER	MIDDLE	OUTER	MEDIAN
Annual % increase	-0.2	-2.1	3.9	-0.4

Source: APM PriceFinder, BIS Shrapnel

Median house price growth peaked at 24.4% per annum over 2014/15 but has since slowed considerably, estimated to have declined by a marginal 0.4% in the year to June 2016. Investor finance is now contracting after banks tightened access to credit and increased interest rates for investor loans in 2015. Loans to investors began to fall dramatically in December quarter 2015, being 22% down on the corresponding period a year earlier, while the total annual decline of loans to investors in 2015/16 was 17%. Over the twelve months to June 2016, median house prices in inner and middle Sydney (where prices are significantly higher) were in decline while outer Sydney maintained growth of 3.9%.

This correction, largely driven by the impact of regulatory changes targeted at investor buyers, is in contrast to the strong fundamentals in the house market. Vacancy rates continue to remain tight at 1.8% in June 2016 while underlying demand is forecast to remain strong due to strong population growth from solid net overseas migration and low net interstate migration. With investors making room in the market, loans to owner occupiers have accelerated, recording an 11% rise in 2015/16. This is expected to somewhat offset further expected weakness in investor loans, with Sydney's median house price forecast to see further price growth of 1.7% in 2016/17 to be $1,065,000 at June 2017.

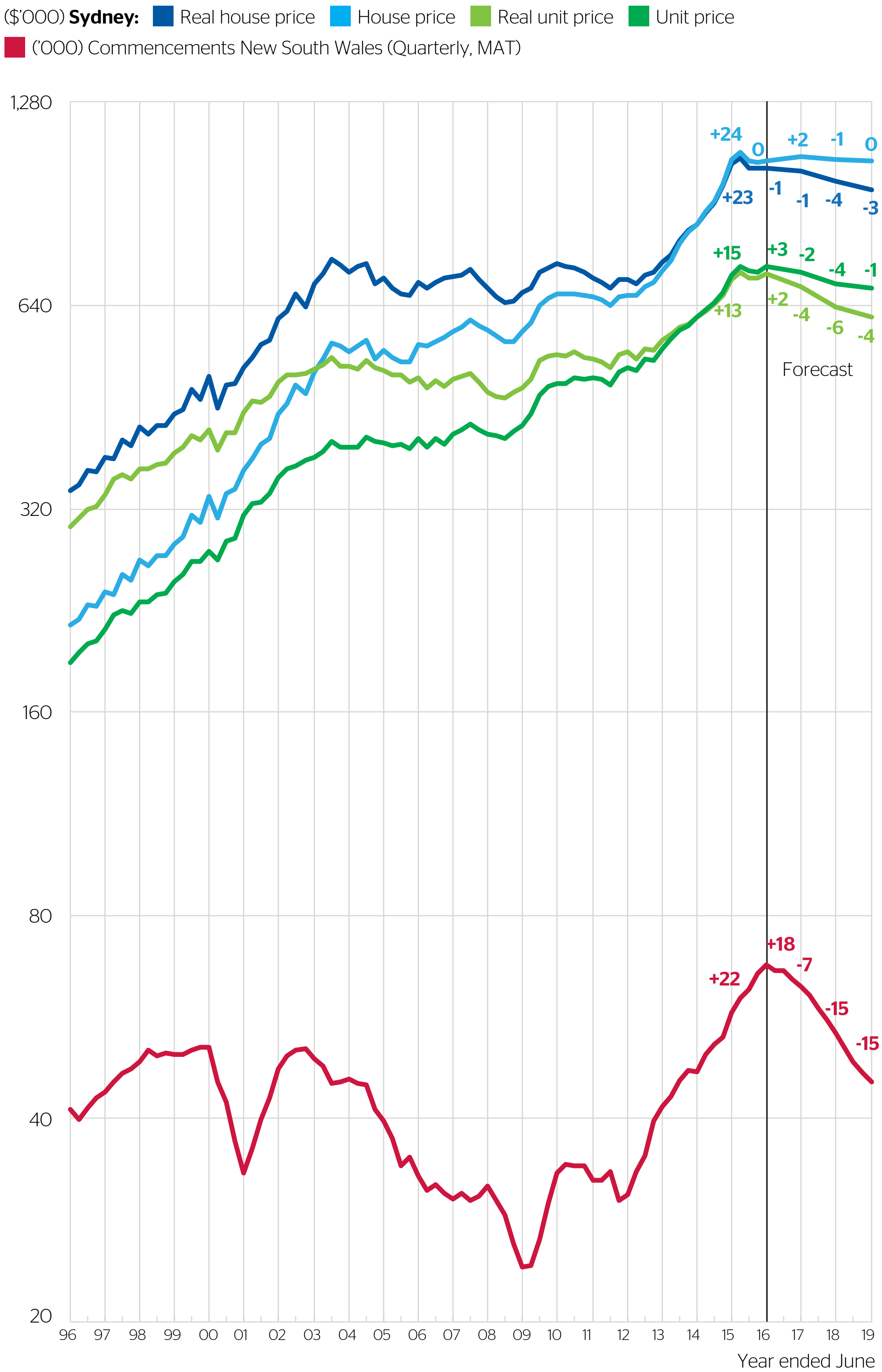
However, the growing impetus from owner occupiers is likely to slow. New dwelling supply began to exceed demand in 2015/16, with Sydney's underlying dwelling deficiency finally beginning to ease. Further expected falls in the deficiency through to 2018/19 is expected to continue to ease pressure on prices. Together with continued weakening investor demand, this is expected to precipitate a fall in Sydney's median house price. Low interest rates should prevent any major flood of forced sales onto the market to drive down prices significantly, with a forecast fall in the standard variable rate to below 5% in 2017/18 also providing some support. Sydney's median house price is forecast to pull back to $1,055,000 by June 2018 and $1,050,000 by June 2019, resulting in median house price growth being effectively flat by the end of the forecast period.

Unit market

New South Wales is the only state that is forecast to maintain its underlying dwelling deficiency through to 2019 despite record levels of dwelling completions coming through. Strong population growth has supported rising underlying demand while the low interest rate environment has supported affordability. Tight vacancy rates and limited rental growth are expected to continue to drive investor demand. Moreover, compared to many other capital cities, aggregate new dwelling supply in Sydney has been characterised by a proportionate increase in both new house and unit supply. As a result, both house and unit markets are likely to remain in deficiency over the forecast period.

Price growth in the Sydney unit market has been below that of the house market. Sydney's median unit price rose by an estimated 41% in the four years to June 2016. However, price growth has already started to flatten with the median unit price growing by just 3% in 2015/16. Slowing rental growth and falling yields as well as changes to the regulatory landscape have impacted investor demand. Investors are more prevalent in the unit market than the detached house market and it is expected that the larger falls expected in investor demand mean the unit market will have greater downside in price than the house market over the forecast period. With higher interest rates and lower loan-to-value ratios for investor lending, capacity for investors to enter the market or pay higher prices is being curtailed. Similarly, the new level of apartment construction taking place may have an impact on vacancy rates and rental growth as the dwelling deficiency is slowly eroded. Sydney's median unit price growth is forecast to fall 1.8% in 2016/17 and cumulatively by 6.8% over the three years to June 2019 to a median unit price of $680,000.

Chart 17: Sydney dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

8.2 Regional NSW centres

In addition to local economic demand and supply factors, residential property prices in the Newcastle region and the Wollongong region are often impacted by the residential cycles taking place in Sydney. Relative house prices play an influential role driving migration between the state capital and these regional centres.

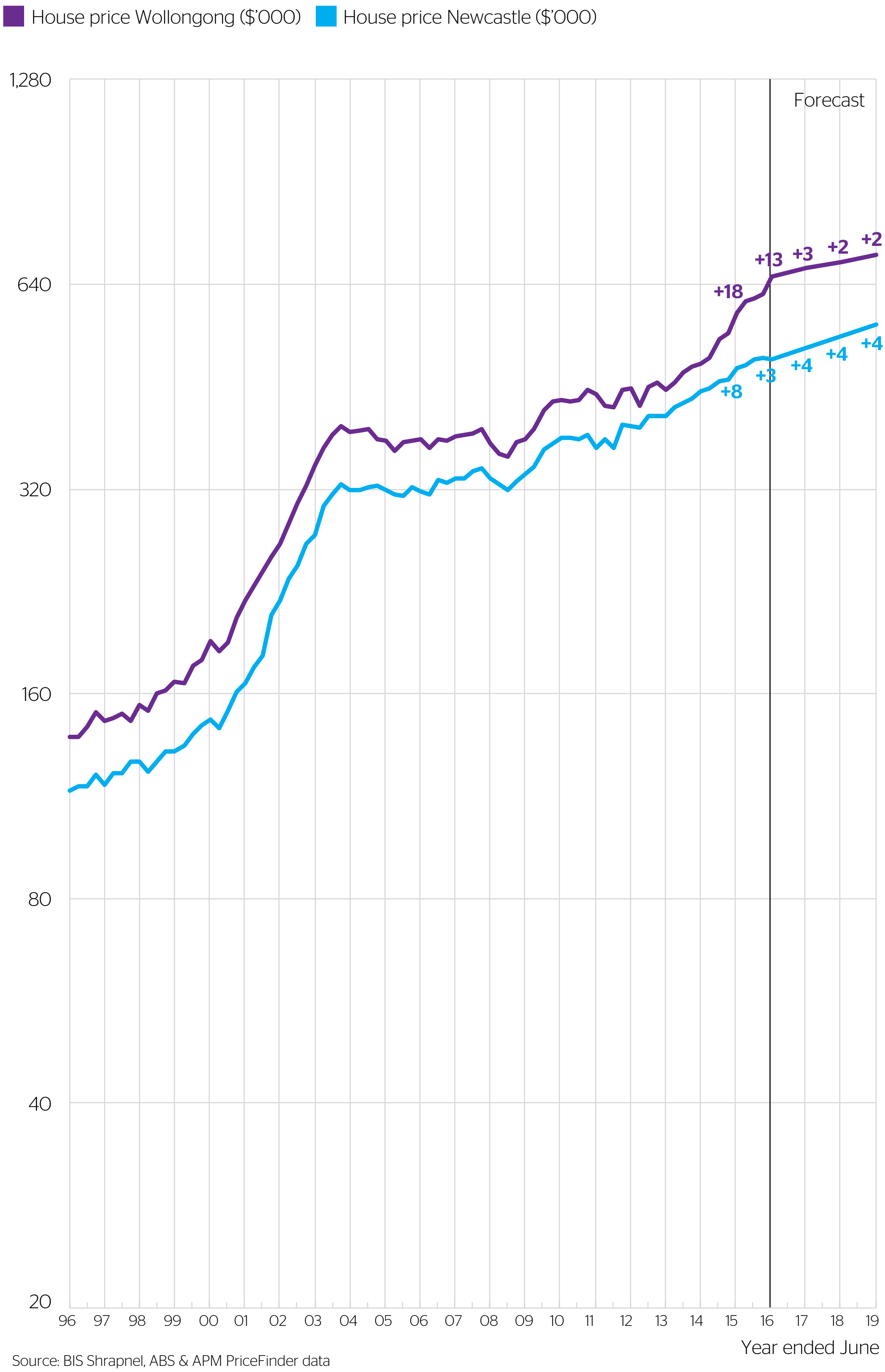
Newcastle has experienced solid price growth over the past five years to June 2016, averaging 6.1% per annum as purchaser sentiment improved and low interest rates supported market entry. Newcastle also offers first home buyers a more affordable option to the rapid price growth seen in the Sydney market. However, it is sufficiently distant from Sydney that it does not typically benefit from a commuter population and supportive local fundamentals are required to support demand. In line with rises in prices, residential construction activity has also been on the rise. Nevertheless, the market remains tight and conditions are improving. Vacancy rates are below the 3% balanced market rate at 2.4% in June 2016 while employment has improved with the unemployment rate falling to 6.5% in March quarter 2016, from a high of 8.1% a year earlier.

The Hunter region's principal industry is coal mining with the port of Newcastle the world's largest export facility for coal. Recent declines in coal sector investment has created more challenging local economic conditions although global demand for thermal coal remains strong and this should keep production volumes up. In addition, Newcastle's role as a logistics hub are anticipated to continue to feed jobs and growth into the local economy while other sectors such as tourism should eventually offset some of the resource sector related declines. Plans to revitalise Newcastle taking place over the next three years will see the relocation of the train terminal and development of the light rail line, encouraging job creation and further investment in the area. Overall, the medium term outlook for the Hunter region economy remains positive. With these urban renewal projects and with Newcastle's median house price just 48% of Sydney's at June 2016, the expected increased movement of Sydney's residents to Newcastle will add demand to the local residential market through to 2019. Median house prices are forecast to continue rising by a cumulative 12% by June 2019, or around 4% per annum, to a median price of $550,000.

The Wollongong region saw a sharper rise in median house prices compared to Newcastle with price growth of 9.2% in 2013/14 accelerating to 18.4% in 2014/15, and remaining high at 13% in 2015/16. As with other nearby regional centres in New South Wales, price growth has been driven by relative affordability of the Illawarra region compared to house prices in Sydney as well as wider buoyant economic conditions. Wollongong has also benefitted from its proximity to Sydney with around 20% of the Wollongong region's working population commuting to Sydney for employment at the 2011 Census. However, the expectation for slower price growth in Sydney means it becomes more difficult for apartment owners in Sydney to upgrade to a Wollongong house, while a weaker market for their existing dwelling is likely to discourage downsizers. Consequently, median house price growth is forecast to slow to rise by an aggregate 8% in the three years to June 2019 or just under 3% per annum. This will take the median house price to $710,000.

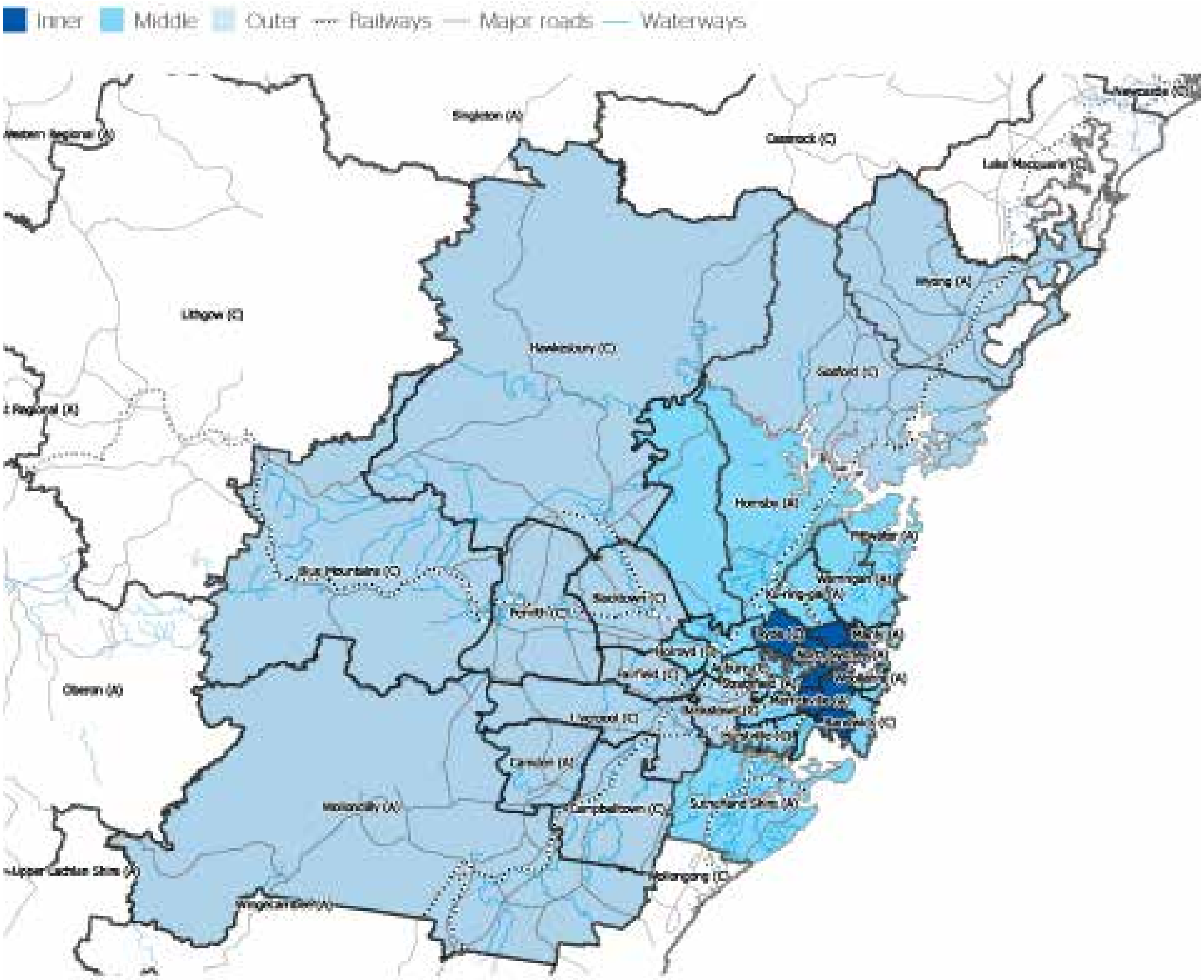
Wollongong has a relatively diversified economy with tourism and education sectors contributing to economic growth significantly. Much like Newcastle, median house price growth is driven by better affordability relative to Sydney with prices in Wollongong estimated to be 63% of Sydney's median house price at June 2016, making Wollongong an increasingly attractive option for Sydney residents opting to relocate. However, slowing price growth in Sydney is likely to also reduce the impetus for price growth in Wollongong.

Chart 18: Regional New South Wales, median house prices



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 19: Sydney regions



8.3 Melbourne

House market

The Melbourne house market saw significant growth in the two years to 2014/15 with the median house price growing by 11.4% and 16.9% in 2013/14 and 2014/15 respectively. Underlying demand has been underpinned by strong population growth over this period. Net overseas migration into Victoria has averaged 55,400 persons per annum in the four years to 2015/16; above its 15-year average of 49,200 per annum. Net interstate migration has also been improving. Based on published data to December 2015, Victoria is on track to experience a record net inflow of 11,000 persons in 2015/16. This population growth has continued to maintain a deficiency of dwellings in the Melbourne market despite continued growth in new dwelling supply. This deficiency, together with low interest rates, has driven purchaser demand.

However, median house price growth has slowed in 2015/16 to 4.8%. Further rises in new dwelling supply have taken the market almost back into balance, reducing the pressure on prices. Investor demand has also weakened in 2015/16 due to regulatory pressures, and the net result has been slowing price growth.

Table 6: Median house price growth in Melbourne by region, per cent, year to June quarter 2016

	INNER	MIDDLE	OUTER	MEDIAN
Annual % increase	0.7	2.8	10.0	4.8

Source: APM PriceFinder, BIS Shrapnel

The slowing market has been most felt in the Inner and Middle rings of Melbourne, where median house price growth was a minimal 0.7% and 2.8% respectively in 2015/16. In contrast, median house price growth in Outer Melbourne was 10% in 2015/16 as stronger price growth moved into the more affordable regions of Melbourne.

Without experiencing a large benefit in economic activity from the boom in resource sector investment in the prior years, Victoria has been relatively insulated from the tapering off in mining investment compared to the resource-driven states. This should sustain an elevated migration inflow, although the net inflow is forecast to nevertheless weaken.

Many of Victoria's trade exposed and service industries have benefited from a lower Australian dollar over the past two to three years. However, the dollar has been creeping upwards again through 2016, maintaining pressure on these sectors and preventing further investment. Moreover, further headwinds will emerge in the short term as the automotive manufacturing sector sees all three remaining locally based car manufacturers close their production facilities across 2016 and 2017. Negative impact on employment across the entire supply chain is likely to weigh heavily on the local economies focussed in the outer suburbs.

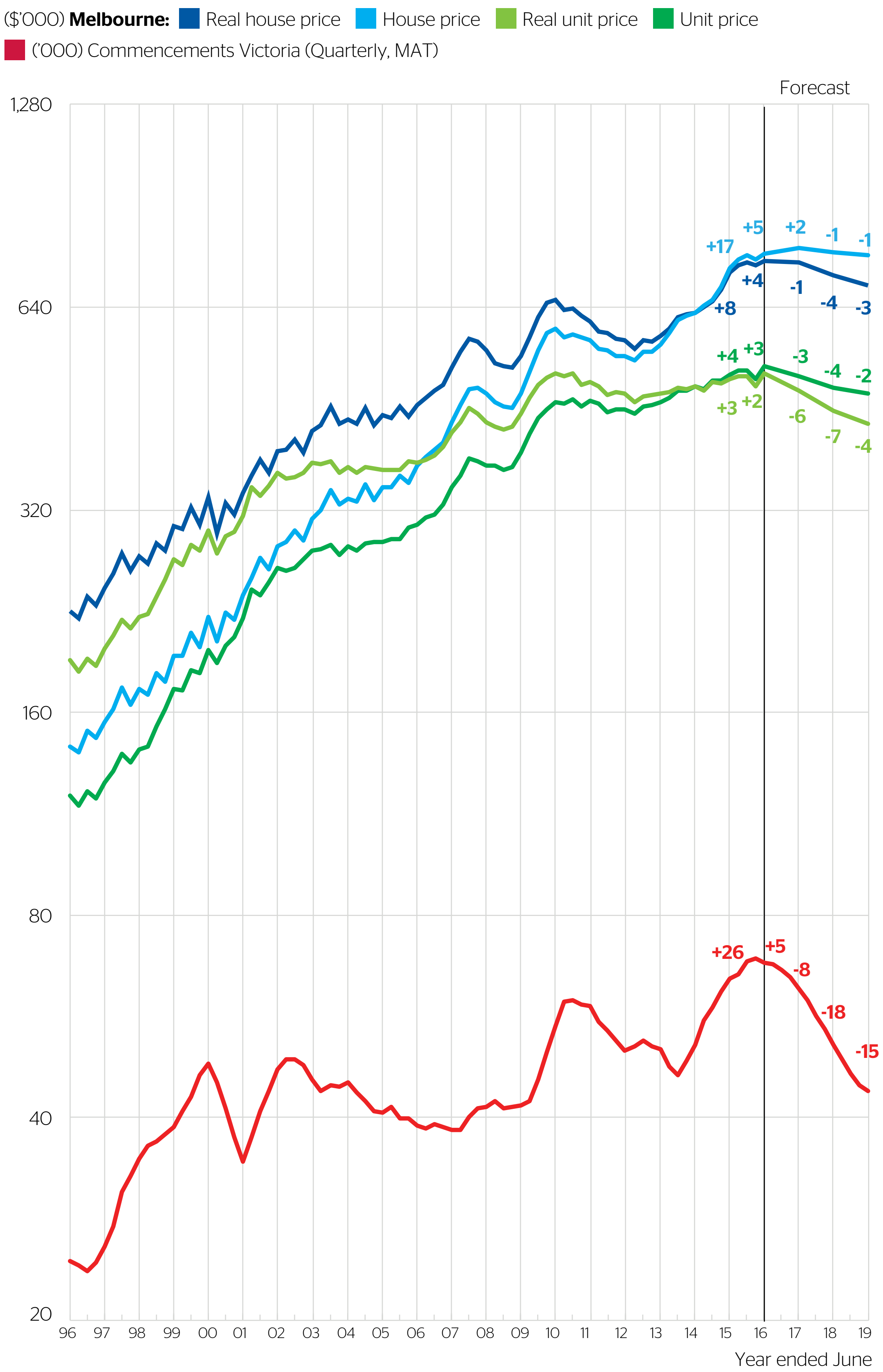
Melbourne also faces a significant supply pipeline that will see dwelling completions peak in 2016/17 and tip the market into oversupply. With population growth also expected to ease through the forecast period and lead to weaker underlying demand, this oversupply is forecast to steadily increase through to 2018/19. While expected to be mainly in the unit sector, there is likely to still be flow on impact in the housing market. Rising vacancy rates are expected to result in a further retreat from the market by investors, who were already declining in demand due to tightening lending policies by the banks. While there is expected to be enough momentum in the market to drive limited median house price growth of 2% in 2016/17, price growth is forecast to be negative in 2017/18 and 2018/19 as Victoria's oversupply continues to increase, with a cumulative fall of 3% over the two years resulting in an aggregate 0.6% decline over the forecast period.

Unit market

The unit market has underperformed in comparison to the house market with median unit prices growing 13% compared to median house price growth of 36% over the three years to June 2016. This reflects the growth in new supply with unit completions far surpassing completions in houses over the same period.

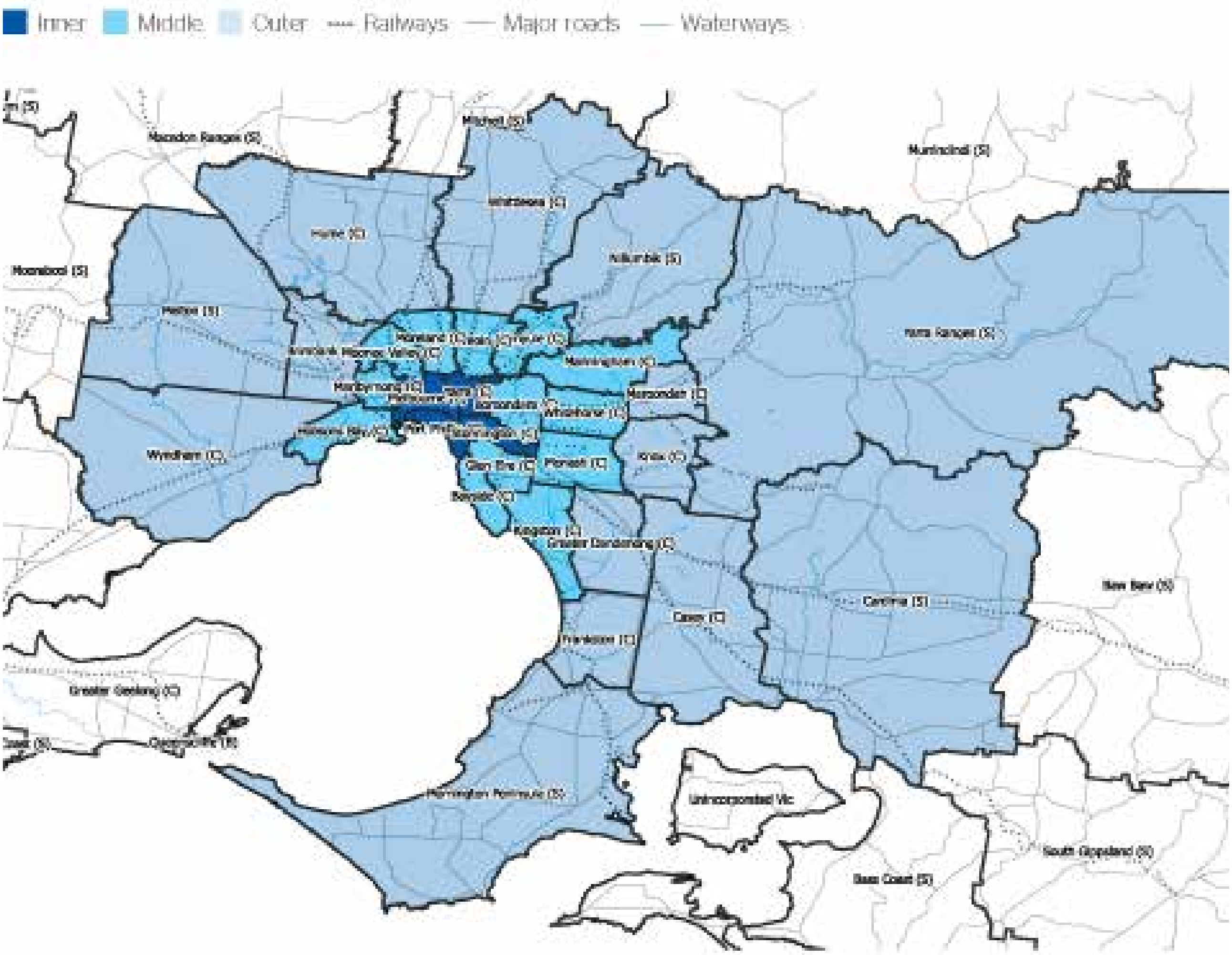
The high levels of unit construction have added significant supply to the market. While a modest aggregate dwelling deficiency is estimated at June 2016, the unit market is estimated to be in oversupply. Record levels of apartment completions, as well as a strong project pipeline expected though to 2017/18, is likely to continue to impact vacancy rates, rental growth and unit prices. At the state level, the oversupply in dwellings is expected to grow through to 2019 with the excess concentrated in the unit sector. This excess is also expected to be compounded by changes to investor lending guidelines which have already started to impact investor demand. Melbourne's median unit price is forecast to decline by a total of 9% over the three year period to $480,000 by June 2019.

Chart 20: Melbourne dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 21: Melbourne regions



8.4 Regional Victorian centres

As well as local economic demand and supply factors, house prices in Geelong, Ballarat and Bendigo can be impacted by the timing of the residential cycle in Melbourne. New infrastructure, and relative house prices, which drive migration between the capital and regional centres, can also be contributing factors.

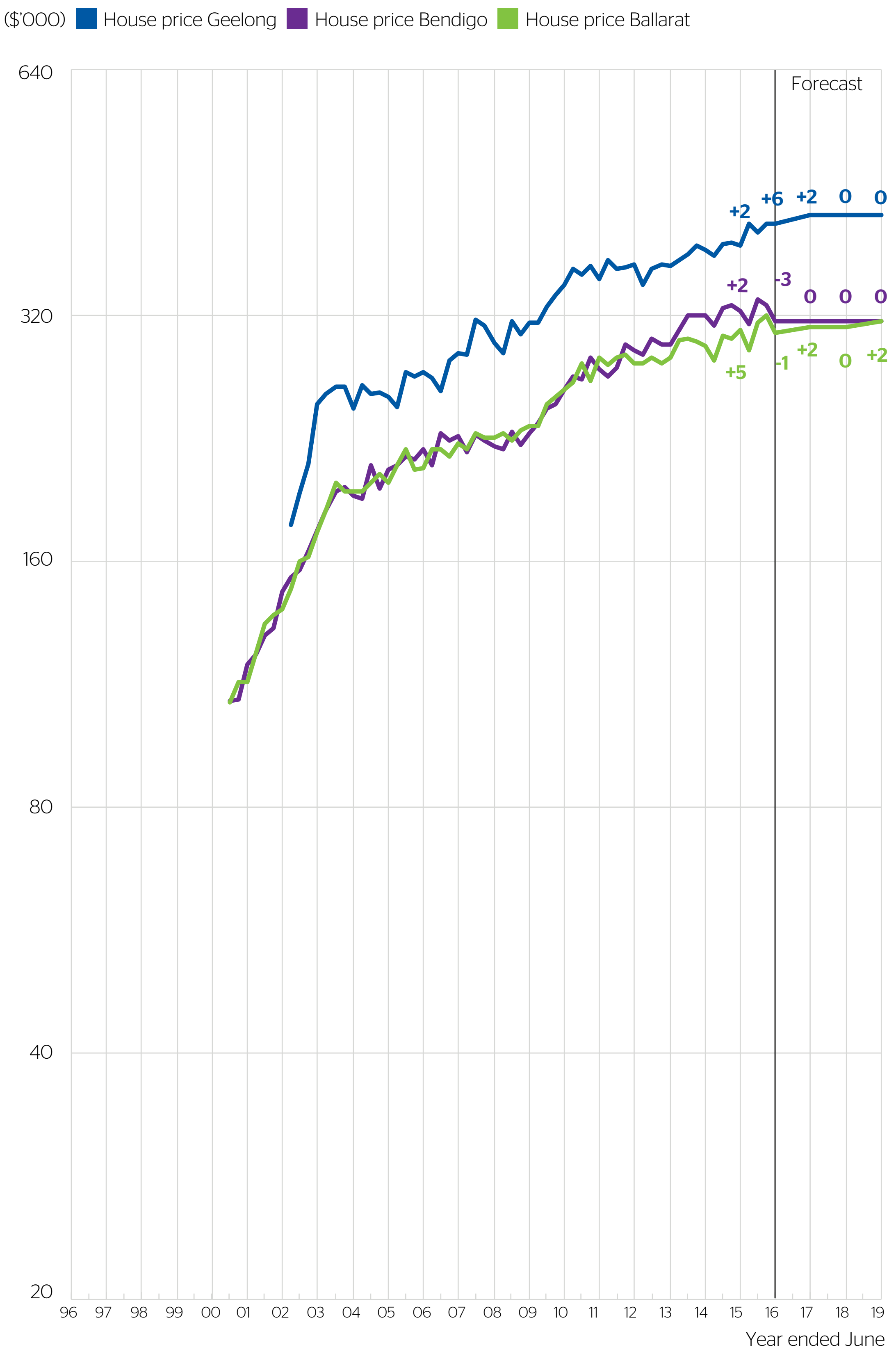
All three regions have benefitted from the construction of the Regional Rail Link last year. While the Rail Link does not necessarily result in a faster trip to Melbourne, the more frequent and reliable transport service is likely to increase the attraction to live in Geelong and Ballarat. The knock on benefits of population growth have yet to be seen with population statistics only available to 2015. Increased access and amenity from new infrastructure has the potential to create higher demand for dwellings. However, competition with Melbourne's outer suburbs which offer existing options of affordable housing and located closer to central Melbourne is expected to limit potential price growth.

The median house price in Geelong has seen solid growth of 6.1% in 2015/16, after a modest rise of 1.6% in 2014/15. This has seen the median house price reach a peak of $415,000. Vacancy rates have been steady around the 3% balanced market rate although healthy construction activity has been contributing to supply and vacancy rates have since been slowly trending upwards to 3.5% at June 2016. The local economy saw the closure of the Alcoa aluminium smelter, downsizing of the Target head office and winding down of the Ford engine plant all reducing employment. On the other hand, the local economy has received a boost with the establishment of the National Disability Insurance Scheme headquarters and Worksafe Victoria relocating to Geelong. Overall, the decline in the manufacturing sector is likely to offset any gains in the services sector but there are some positive indicators with the unemployment rate improving from 8.4% in March 2015 to 6.2% in March 2016. Forecast median house price growth is expected to continue, growing 2.4% in 2016/17 although continued high supply should result in flat prices through the remainder of the forecast period. The median house price is expected to be $425,000 at June 2019.

Ballarat's median house price has been more volatile than house prices in other regional Victorian centres. The median house price peaked at $320,000 in March 2016 before falling back to $305,100 at June 2016. The unemployment rate in Ballarat has been low, but has risen from 5.4% at March 2015 to 5.9% at March 2016. Population growth has also started to slow. Vacancy rates have also steadily increased from below the balanced market rate of 3% in 2015, to 3.6% in June 2016. As a result, growth is expected to be muted over the forecast period at a cumulative 3%, taking the median house price to $315,000 at June 2019.

The benefits from the boost to dwelling demand from the construction of the Bendigo Hospital were largely confined to the period of construction, with the median house price falling by 3% in 2015/16 to be $315,000 at June 2016. Vacancy rates remain tight, at 2.5% in June 2016. However, with few new projects to maintain activity and spur economic growth and job creation, population growth has also slowed based on preliminary 2015 statistics. The unemployment rate at 7.1% in the March quarter 2016 is also above the Victorian unemployment rate. Without any emerging economic drivers, Bendigo house prices are forecast to remain flat over the three years to 2018/19 with the median house price unchanged at $315,000 at June 2019.

Chart 22: Regional Victorian centres, median house prices



Source: BIS Shrapnel, ABS & APM PriceFinder data

8.5 Brisbane

House market

House price growth in Brisbane has been more moderate over the four years to 2015/16 than in Sydney or Melbourne, with an aggregate increase of 18% in the median house price recorded, or an average 4% per annum. Price growth has been spurred by an undersupply still present in the market and low interest rates keeping affordability attractive compared to other capital city markets. Furthermore, house commencements have only risen moderately eroding the undersupply very gradually.

However, the rate of price growth has been limited in line with weak state economic conditions, which have resulted in low migration, population growth, and underlying demand. The tapering off of the resource investment boom since 2014 has diminished employment conditions in a number of major urban centres throughout Queensland, while the mining investment trough is still yet to come. Consequently, interstate and overseas migration have been below the long term average over the two years to 2015/16.

Median house price growth in 2015/16 has been strongest in Inner Brisbane (+7.6%). This rise has largely driven the market, with more modest increases occurring in Middle (+2.8%) and Outer (+1.0%) Brisbane.

Table 7: Median house price growth in Brisbane by region, per cent, year to June quarter 2016

	INNER	MIDDLE	OUTER	MEDIAN
Annual % increase	7.6	2.8	1.0	2.2

Source: APM PriceFinder, BIS Shrapnel

Without strong employment drivers, the state is not expected to be able to capitalise from the considerable widening of Brisbane's affordability advantage relative to Sydney and Melbourne. Further, the state is unlikely to benefit from weaker employment prospects in Western Australia as Sydney and Melbourne are, as there is insufficient employment growth to encourage potential movers. An emerging, and rising, oversupply in the unit market through the forecast period is likely to also have a broader impact on the wider residential market, having a dampening effect on the detached house market.

Nevertheless, an overall dwelling deficiency is expected to still in be in place in the house market, which should help to support house prices. Brisbane's median house price is forecast to rise by 3% to $540,000 at June 2017. Modest growth of around 2% per annum is forecast in 2017/18 and 2018/19 as net interstate migration into Queensland increases and another cut to interest rates encourage some pick up in prices. Cumulatively, median house prices are expected to rise 6.5% over the forecast period to $560,000 at June 2019, the highest price growth over this period between the three largest state capitals.

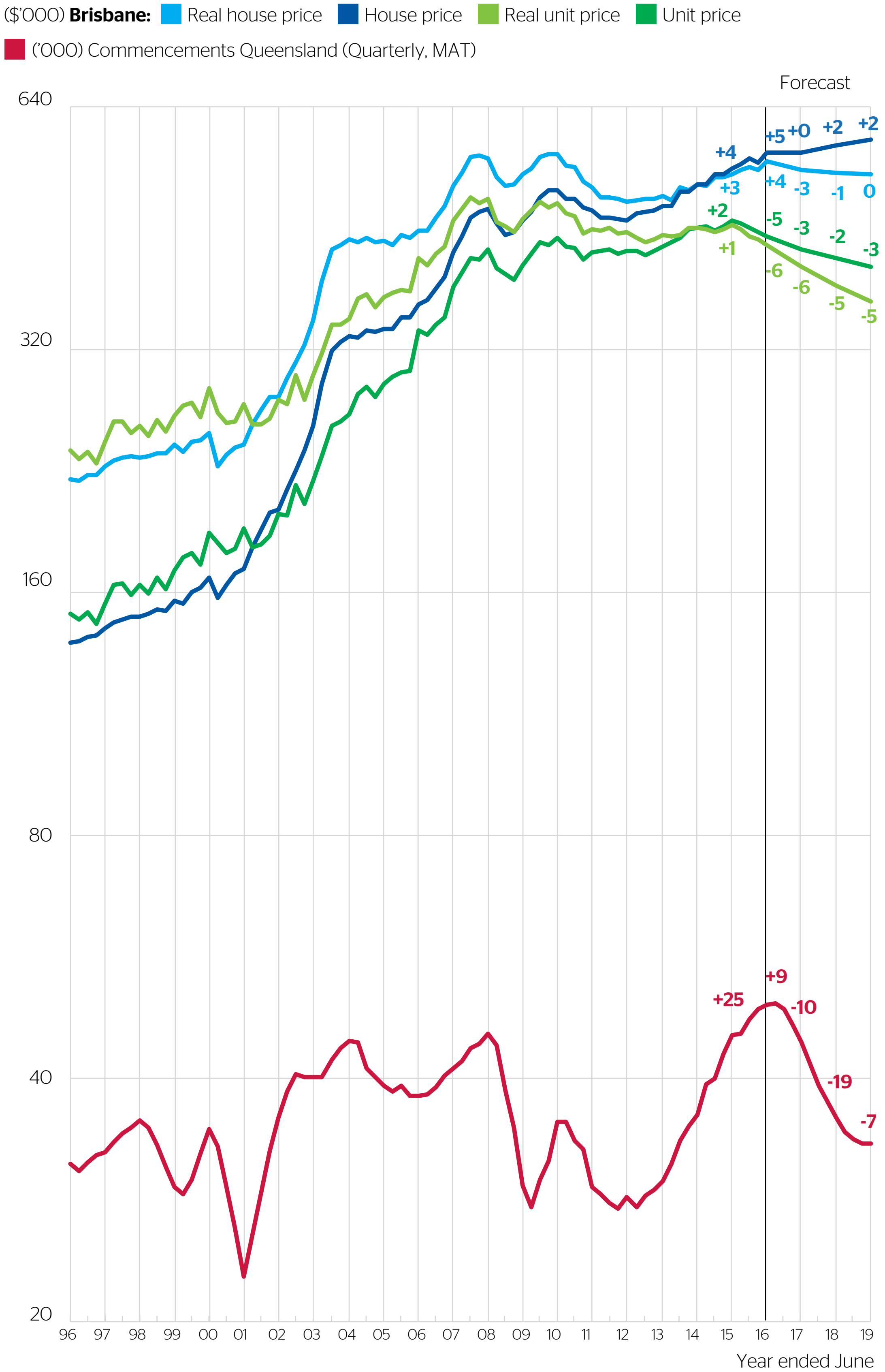
Unit market

The upturn in residential construction has been dominated by commencements in the unit and apartment sector in Inner Brisbane. Demand has been driven by interstate and overseas purchasers attracted by healthy yields and low borrowing costs. However, underlying demand has fallen in line with falls in net overseas migration, while supply has continued to rise. The overall market is close to balance at June 2016, with the apartment market already expected to have entered into an oversupply.

The oversupply is forecast to continue to rise as the pipeline of apartment projects works through to completion and increasingly apply pressure on rents and consequently prices. Greater competition for purchasers and tenants for inner city apartments is forecast to cause investor owners of apartments to lower rents to try to draw tenants from more affordable city fringe locations. Those who are looking to sell are expected to also find it increasingly difficult as more apartments come onto the re-sale market.

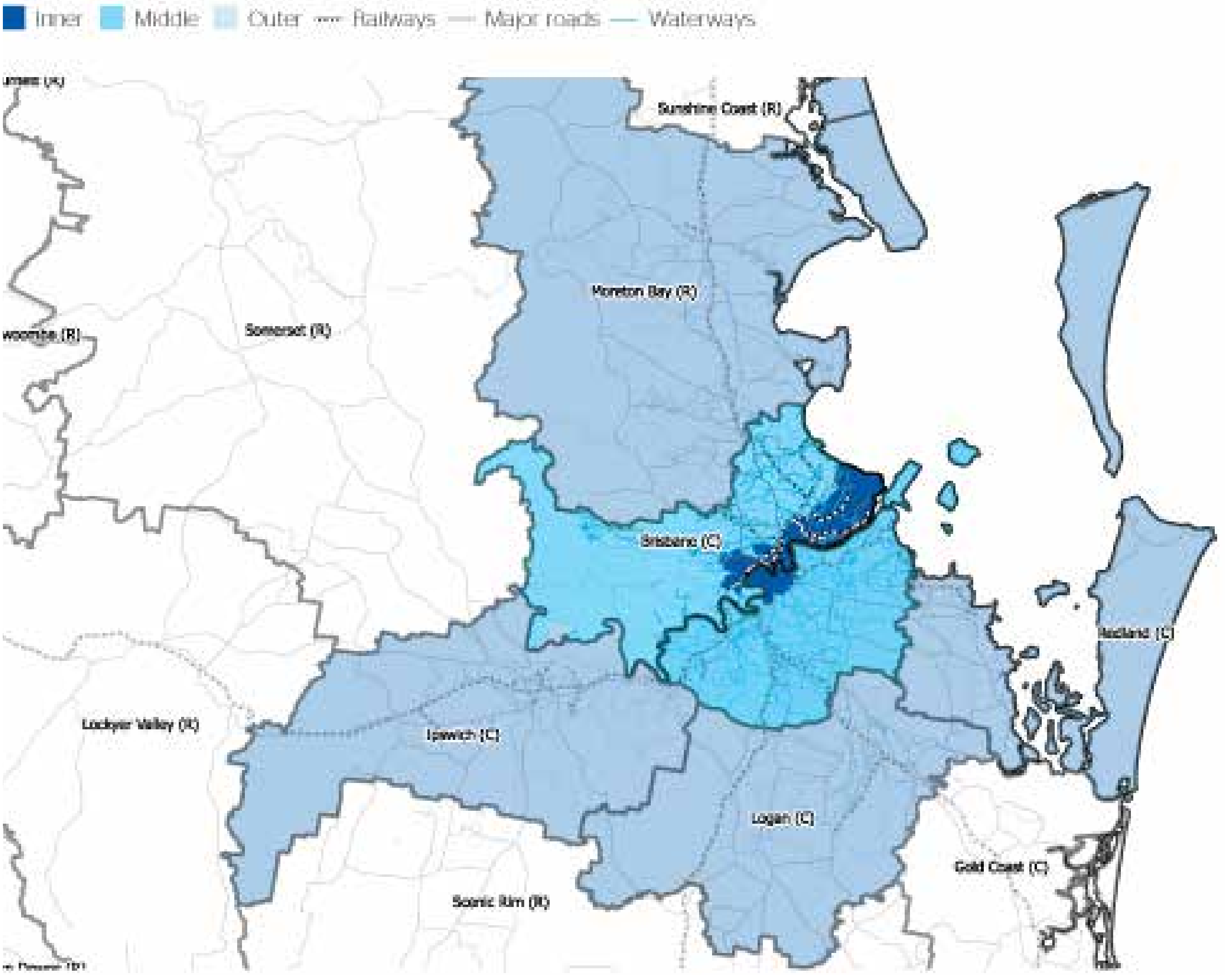
As a result, investor owners are likely to retreat further from the unit market. The prospect for lower unit prices also means finance is anticipated to become more difficult to obtain due to tighter lending criteria by the banks. The median unit price in Brisbane has already begun to contract in 2015/16 falling 4.6% in the year to June 2016. Prices are expected to continue falling by a cumulative 8.2% over the following three years to $390,000 at June 2019, down from $424,700 at June 2016.

Chart 23: Brisbane dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 24: Brisbane regions



8.6 Regional Queensland centres

Median house prices in the regional Queensland markets of the Gold Coast, Sunshine Coast and Cairns have generally seen moderate price growth over the four year period to 2015/16. Due to local economic conditions, Townsville has suffered falls in prices over the same period. Apart from Townsville, the other centres did not benefit significantly from the resource sector boom and therefore do not have the downside to be a drag on the residential market.

Key drivers of the Gold Coast economy have enjoyed favourable conditions in the three years to 2015/16. The local economy has been buoyed by the tourism sector capitalising on the lower Australian dollar making it a more competitive holiday destination. Public spending has been boosted by infrastructure and other related works in preparation for the 2018 Commonwealth Games, as well as the expansion of Pacific Fair, the Gold Coast Light Rail project and the Jupiter Casino development. These local economic drivers have led to job creation and greater underlying demand for dwellings, which is reflected in tight vacancy rates and median house price growth of 26% in the four years to June 2016. With new dwelling construction in the Gold Coast now increasing from long term lows, further, although more moderate, price growth totalling 8% is forecast to June 2019.

Price growth for units in the Gold Coast has been around half of that of houses, totalling 12% in the four years to June 2016. Unit price growth lagged houses as a greater oversupply in the unit sector needed to be absorbed after the last peak. With new unit projects now quickly coming to the market again, price growth is likely to be moderate, totalling 8% over the three years to June 2019. Unit price growth may also be dampened by the 1,200 apartments for the Commonwealth Games Village that will eventually find their way onto the market after the Commonwealth Games in 2018.

The Sunshine Coast is still experiencing an undersupply of housing stock due to a prolonged period of low new construction in the early years of this decade. Underlying demand is expected to remain strong, driven by interstate migration from New South Wales and Victoria, which is expected to push the deficiency up further. This is evidenced by low vacancy rates and solid growth in rents and prices. The median house price has risen 20% in the four years to June 2016 to be $535,000. While construction activity has ramped up since 2014/15, the lag from commencement to completions should maintain the dwelling deficiency in the short term, encouraging further investor demand with low vacancy rates and good yields. Sunshine Coast is also expected to benefit from relatively better affordability compared to Melbourne, Brisbane and Sydney attracting empty nesters and retirees from these cities. The median house price is forecast to grow an aggregate 7% in the three years to June 2019 to $575,000. The rate of price growth is expected to progressively slow in this period in line with slowing price growth in Sydney and Melbourne.

Economic conditions in Townsville have been negatively impacted by fiscal consolidation by the Federal Government. The public administration and defence sectors have seen job cuts while the local area has also seen a decline in thermal coal sector investment. These trends, which have resulted in lower population growth, have cut into underlying demand while there has not been a commensurate reduction in residential construction. This has resulted in an excess of dwellings in the Townsville market, evident in the high vacancy rate of 5.7% at June 2016. The median house price at June 2016 is 8% below its June 2010 peak and is forecast to continue to decline until local economic conditions improve – most likely towards the end of the decade. Median house prices are expected to lose 1.4% per annum in the two years to 2017/18 before bottoming out and showing no growth in the year to June 2019, taking the median house price to $340,000.

The Cairns residential market experienced a long period of low construction activity and a rising stock deficiency, as evidenced by tight vacancy rates of 1.9% in June 2016. Local economic conditions have also improved with a strengthening in the tourism sector and greater migration inflows. However, house price growth slowed in 2015/16, with the median house price of $395,000 at June 2016 being 3.7% down on a year earlier. This is likely to be in response to rising supply, with new dwelling commencements having increased markedly in 2014/15 and 2015/16. Consequently, without any rising deficiency, Cairns' median house price is forecast to remain flat over the two years to 2017/18, with a minimal rise taking the median house price to $400,000 by June 2019.

Regional mining centres

Both small and large regional centres in Queensland that have a high economic dependence on the resource sector have been impacted greatest by the downturn in coal and gas expansion projects. Smaller localities, such as Isaac Local Government Area, which includes the main centres of Dysart and Moranbah have borne the brunt more than larger and more diversified centres such as Gladstone Regional LGA and Mackay Regional LGA. These centres in turn have experienced more variation in prices than the much larger and more economically diversified Brisbane.

Median house prices climbed rapidly through the early boom period as the influx of mining investment led to job creation, population growth and demand for housing. As the mining investment wound down, median house prices fell sharply while unemployment rates grew rapidly and population left.

- Isaac LGA, which contains the smaller towns of Dysart and Moranbah, experienced a 97% rise in its median house price between December 2007 and March 2012, which has since declined by 83%.
- Gladstone and Mackay LGAs experienced a smaller boom and bust cycle. These are both larger centres where movements in population have a smaller impact, and with a more diversified economic base.

Both Gladstone and Mackay also have the highest unemployment rate, having a greater percentage of permanent residents who are less likely to leave when the employment situation becomes averse. This contrasts with the 2.7% unemployment rate in Isaac LGA and reflects the temporary nature of residents in smaller centres. Without other employment opportunities in the smaller centres, the unemployed population leaves. Sales volumes in all mining centres have also fallen significantly in 2015/16. It is likely that many owners would rather hold onto their property than sell at a loss, with a large proportion of sales likely to be forced sales, thereby placing further downward pressure on the median price.

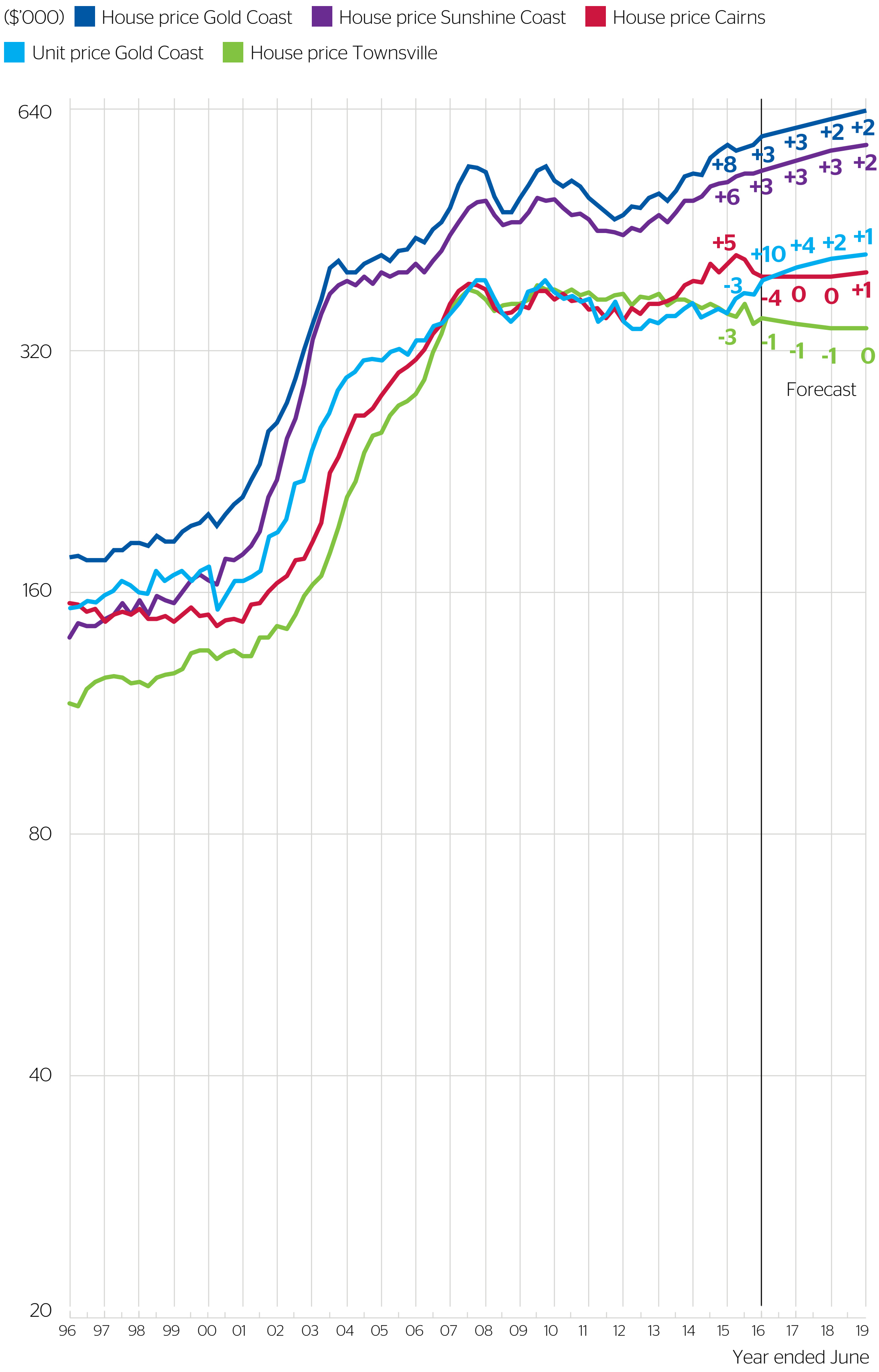
The trends in price growth in the mining centres contrasts with that of Brisbane. Median house price growth in Brisbane was more limited through the mining investment boom, and house prices have continued to increase through to 2016, albeit at a modest rate. The unemployment rate has also remained relatively stable over the past three years, in contrast to the rise in the mining centres.

Table 8: Median house prices and unemployment rates in regional mining centres and Brisbane

	Median house price ($) Sales in prior year			% change		Unemployment rate (%)	
Region	**Start of upturn**	**Peak**	**Jun 16 Qtr**	**Start to peak**	**Peak to Jun 16**	**Mar 13**	**Mar 16**
Isaac LGA (Moranbah, Dysart)	$335k 451 Dec 07	$660K 658 Mar 12	$110K 93 Jun 16	97%	-83%	1.0	2.7
Gladstone Regional LGA	$365k 905 Mar 09	$480k 1,524 Dec 11	$348k 475 Jun 16	32%	-28%	4.2	6.3
Mackay Regional LGA	$372k 2,736 Sep 07	$445k 2,192 Sep 12	$330k 910 Jun 16	20%	-26%	3.1	7.7
Greater Brisbane	$427k Dec 08	$463k Jun 13	$526k Jun 16	8%	13%	5.7	5.7

Source: Department of Employment, Australian Bureau of Statistics, APM PriceFinder, BIS Shrapnel

Chart 25: Regional Queensland centres, median house prices



Source: BIS Shrapnel, ABS & APM PriceFinder data

8.7 Adelaide

House market

The median house price in Adelaide has shown steady growth since 2012/13 as lower interest rates and prices at a relatively low base resulted in a period of improved affordability. Employment drivers at the time, in the form of public infrastructure projects, also spurred migration inflows propping up underlying demand. The median house prices at June 2016 was $461,000 up 3.2% on a year earlier. Inner Adelaide median house prices have grown 26.7% on a year earlier. However, the inner region covers a small sample area and is a tightly held market with low transactional activity increasing volatility in the median price measurement. The Middle and Outer ring medians have shown much more moderate growth at 2.7% and 2.1% respectively.

Table 9: Median house price growth in Adelaide by region, per cent, year to June quarter 2016

	INNER	MIDDLE	OUTER	MEDIAN
Annual % increase	26.7	2.7	2.1	3.2

Source: APM PriceFinder, BIS Shrapnel

The South Australia economy is forecast to face some significant economic headwinds with the manufacturing sector suffering from the relatively high Australian Dollar compared to lower cost competitors overseas. Several public engineering construction projects have also been completed such as the Noarlunga Line Electrification, the South Road Superway and the Southern Expressway Duplication. With the completion of these projects, public investment will decline significantly with few projects to fill the void in employment growth. Additionally, the scheduled closure of the Holden manufacturing plant in Elizabeth in 2017 is expected to further drag on the economy. Some job creation should come from increased ship and submarine building, but with few other large employment drivers, the state economy is expected to struggle for growth.

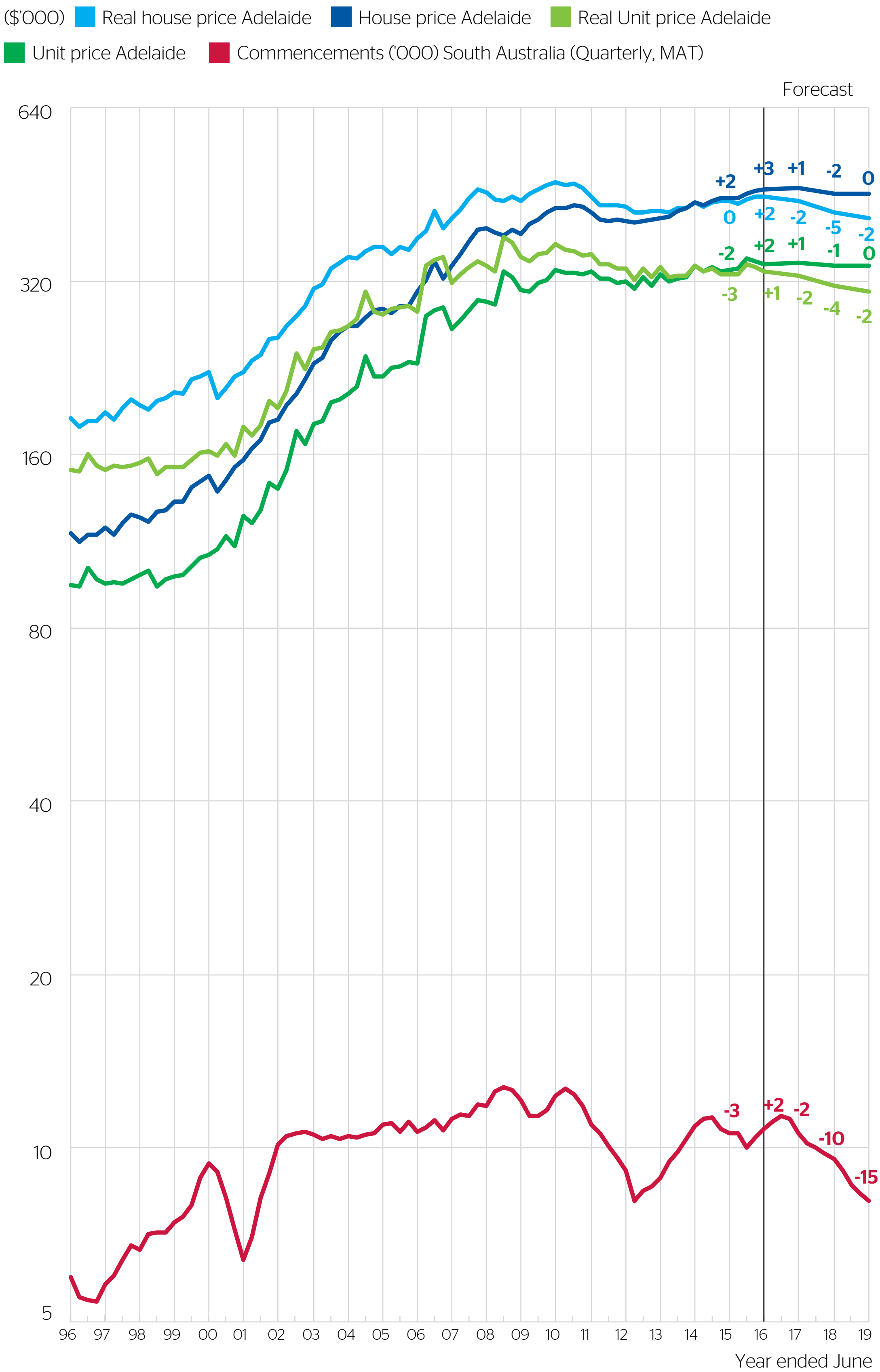
Dwelling construction activity has also peaked in 2015/16 as price growth and low borrowing costs has driven commencements. Underlying demand has not kept pace and an excess in dwellings is forecast to have emerged in Adelaide in 2015/16. Furthermore, this surplus is expected to accelerate over the forecast period as underlying demand remains weak brought on by softening economic conditions. This is expected to put pressure on vacancy rates, already climbing above the balanced rate in June 2016 at 3.3%. As rental yields fall and competition increases for tenants, investor demand is expected to contract leading to limited house price growth.

Nevertheless, the low interest rate environment with potential cuts over the next year, is expected to result in affordability improving. The ratio of mortgage repayments on a median priced house is forecast to be around 21%, which is the lower end of its range over the past 20 years. This will prevent major falls in house prices and median house price growth of 0.9% is expected in 2017/18, before the rising surplus and slowing economic activity result in a 2.2% decline in prices in 2017/18. A total decline of 1.3% is expected for median house prices over the forecast period, taking the median house price to $455,000 at June 2019.

Unit market

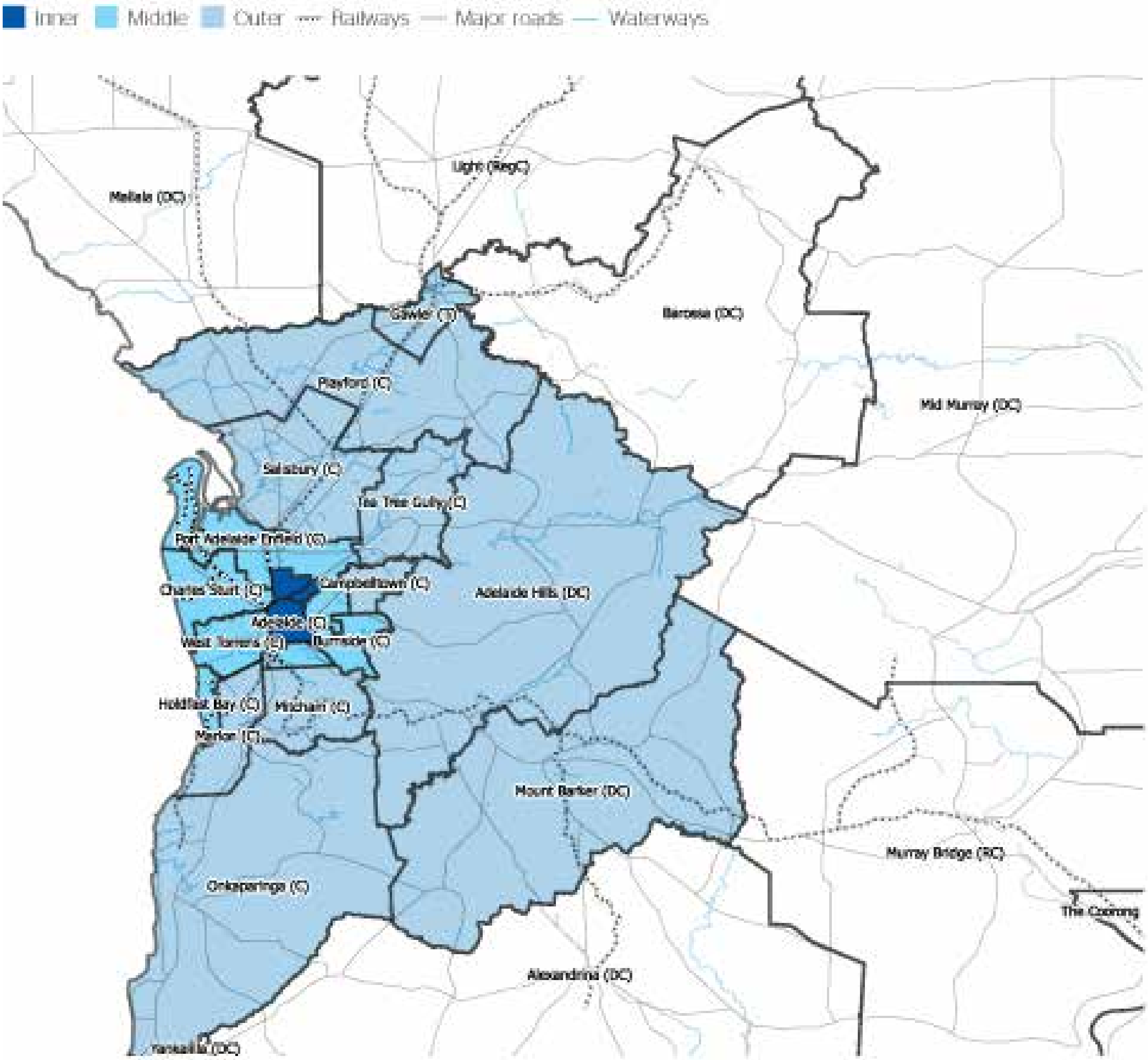
Compared with the east coast capital cities, Adelaide does not experience the same level of new unit or apartment development activity and the unit market in Adelaide is consequently forecast to move in line with the forecast for house prices. However, much like the other state capitals, investor purchasers are more prevalent in the unit market. Tighter restrictions on investor lending is seeing a decline in investor demand and as a result median unit prices are forecast to remain relatively flat over the three years to 2019, declining an aggregate 0.6% over this period to $340,000 at June 2019.

Chart 26: Adelaide dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 27: Adelaide regions



8.8 Perth

House market

Perth's median house price grew by 18% over the three years to December 2014, underpinned by record net overseas and interstate migration inflows. This resulted in tight vacancy rates and significant rental growth. Demand was driven by strong economic conditions brought on by booming mining investment and significantly improved affordability as interest rates were lowered.

Mining investment is now retreating rapidly, and economic conditions have weakened considerably. New engineering construction has tapered off as projects adding additional mining capacity are progressively completed. Diminished employment opportunity has led to a substantial fall in net migration. In 2014/15, net overseas migration fell below 15,000 persons for the first time since 2004. Interstate migration has also become a net outflow for the first time since 2003. State unemployment has increased above 6% in the first half of 2016; above the national level of 5.7%. While mining output has increased, the production phase is less labour intensive than the investment phase, and Western Australia's unemployment rate is likely to continue to rise and remain elevated in the medium term. Net migration inflows are likely to remain soft for now.

After peaking in December 2014, Perth's median house price fell by 2% in the six months to June 2015, and this has accelerated to a decline of 5.6% in 2015/16. The decline was greatest in the inner Perth suburbs (–7.2%) while both Middle and Outer ring suburbs fell 5.2% in 2015/16. The higher priced inner suburbs are likely to be feeling the largest impact from the weakness in the higher income resource sector jobs.

Table 10: Median house price growth in Perth by region, per cent, year to June quarter 2016

	INNER	MIDDLE	OUTER	MEDIAN
Annual % increase	–7.2	–5.2	–5.2	–5.6

Source: APM PriceFinder, BIS Shrapnel

Weakening owner occupier demand has seen the number of loans to both first home buyers and upgraders/downsizers decline by 15% and 10% respectively in 2015/16. The decline in investor demand has been more dramatic, with the value of loans to investors falling by 32% in 2015/16.

Rising new dwelling building approvals through the upturn in prices is being reflected in new dwelling completions continuing to rise in 2016. This contrasts with a sharp decline in the rate of population growth and consequently underlying demand. The Western Australian market has moved into oversupply, which is reflected in vacancy rates of close to 5%; far above the balanced market rate of 3%. With underlying demand likely to continue to weaken, and further dwellings under construction working their way to completion, there is little to place upward pressure on rents and prices through to 2018/19.

Overall, the Perth market is expected to weaken across both house and unit markets. The impact of a rising stock surplus and a slowing state economy is forecast to result in a further decline in Perth's median house price of 3% to June 2018. Low interest rates should mitigate a deeper fall in the median house price, which is expected to stabilise in 2018/19, and potentially show a minimal rise, with mining investment bottoming out and interest rates forecast to be cut further in 2018. The forecast median house price of $540,000 at June 2019 is forecast to be 10% below its December 2014 peak. However, Perth's median house price in real terms is forecast to be 24% below its peak in March 2007 set during the first mining boom through the middle of the decade.

Unit market

The unit market has seen rising completions across Perth over the last three years. However, units remain just a third of all new dwelling approvals; well below the other capitals of Sydney, Melbourne and Brisbane. Much of the strong migration into Perth has been temporary in nature with the unit market consequently expected to see a greater fall in rents and higher vacancy rates. Temporary residents tend to favour the unit market over the house market given the short term nature of their stay.

Downward rent and price pressures are therefore forecast to be greater in the unit market than the house market. Median unit rents have weakened significantly and Perth's median unit price has begun to decline, falling by 6.5% in the year to June 2016 to $403,100. Further declines totalling 6% are forecast in 2016/17 and 2017/18, before unit prices bottom out over 2018/19 to be $380,000 at June 2019.

Regional mining centres

Regional centres in Western Australia have borne the brunt of the impact of the downturn in resource sector investment. Table 11 below highlights price growth in the selected regions of Port Hedland LGA and Karratha LGA. These towns typically have a narrow industry profile and are susceptible to local economic events. Median house prices climbed rapidly through the early boom period as the influx of mining investment led to job creation, population growth and demand for housing. As the mining investment wound down, median house prices fell sharply while unemployment rates grew rapidly and population left.

- Karratha LGA in the Pilbara region saw earlier price growth as a result of the mid 2000s boom in mining investment, with the median house price already elevated after the GFC in 2009. The median house prices grew 21% to peak at $850,000 from their 2009 level. Since the peak, the median house price has fallen 64% to $304,000 in June quarter 2016. The unemployment rate has risen from 1.8% to 2.3% over the three years to March 2016.
- Port Hedland LGA saw its median house prices rising by 127% between June 2007 and March 2013, reaching a peak of $1.1 million. However, the median house price has since collapsed by 72% to $305,000 at June 2016, while the unemployment rate has risen from 3.3% to 5.0% in the three years to March 2016. It is likely that the unemployment rate in these centres is relatively low as those that are not employed are likely to have left.

Sales volumes in Port Hedland and Karratha in 2015/16 are also well down on previous levels. The lower sales volumes suggests that many owners are retaining their property rather than accepting a loss on sale. Those that are sold are more likely to be forced sales, which would be helping to drive the median sale price down.

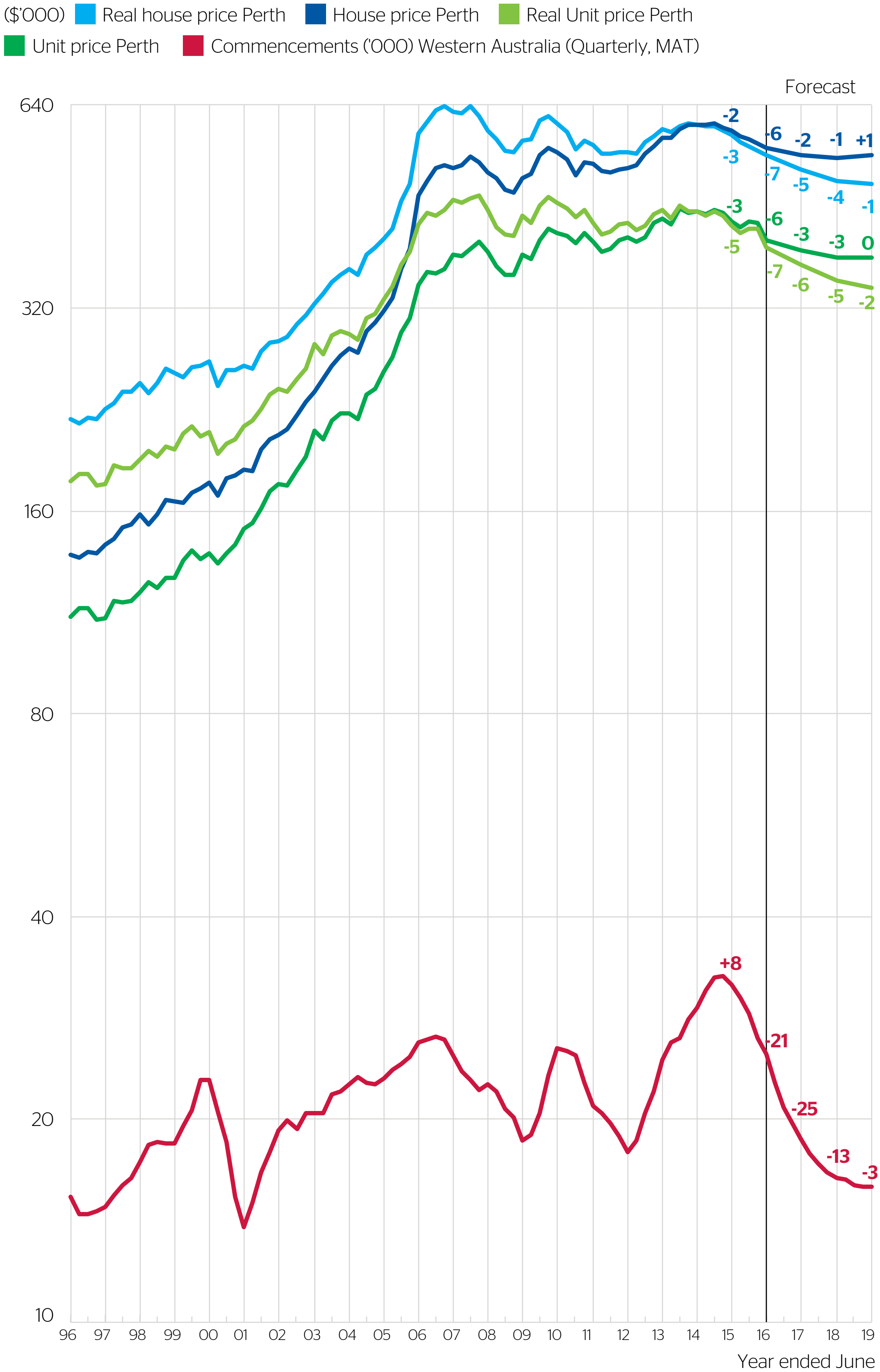
Movements in population and demand have had a big impact on prices in the smaller regional centres, in contrast with Perth, where the median house price has only declined by 4% from its peak. Perth also experienced a more moderate cycle in prices in the most recent boom in mining investment, with the median house price rising by 32% between December 2008 and September 2014. The larger size of the residential market and more diversified economic base of Perth has helped to support prices.

Table 11: Median house prices and unemployment rates in regional mining centres and Perth

	Median house price ($) Sales in prior year			% change		Unemployment rate (%)	
Region	**Start of upturn**	**Peak**	**Jun 16 Qtr**	**Start to peak**	**Peak to Jun 2016**	**Mar 13**	**Mar 16**
Port Hedland LGA	**$442k** 318 **Jun 07**	**$1,125k** 205 **Mar 13**	**$309k** 129 **Jun 16**	**155%**	**-73%**	**3.3**	**5.0**
Karratha LGA	**$700k** 395 **Sep 09**	**$850k** 262 **Sep 10**	**$304k** 216 **Jun 16**	**21%**	**-64%**	**1.8**	**2.3**
Greater Perth	**$420k** **Dec 08**	**$555k** **Sep 14**	**$535k** **Dec 15**	**32%**	**-4%**	**4.0**	**6.0**

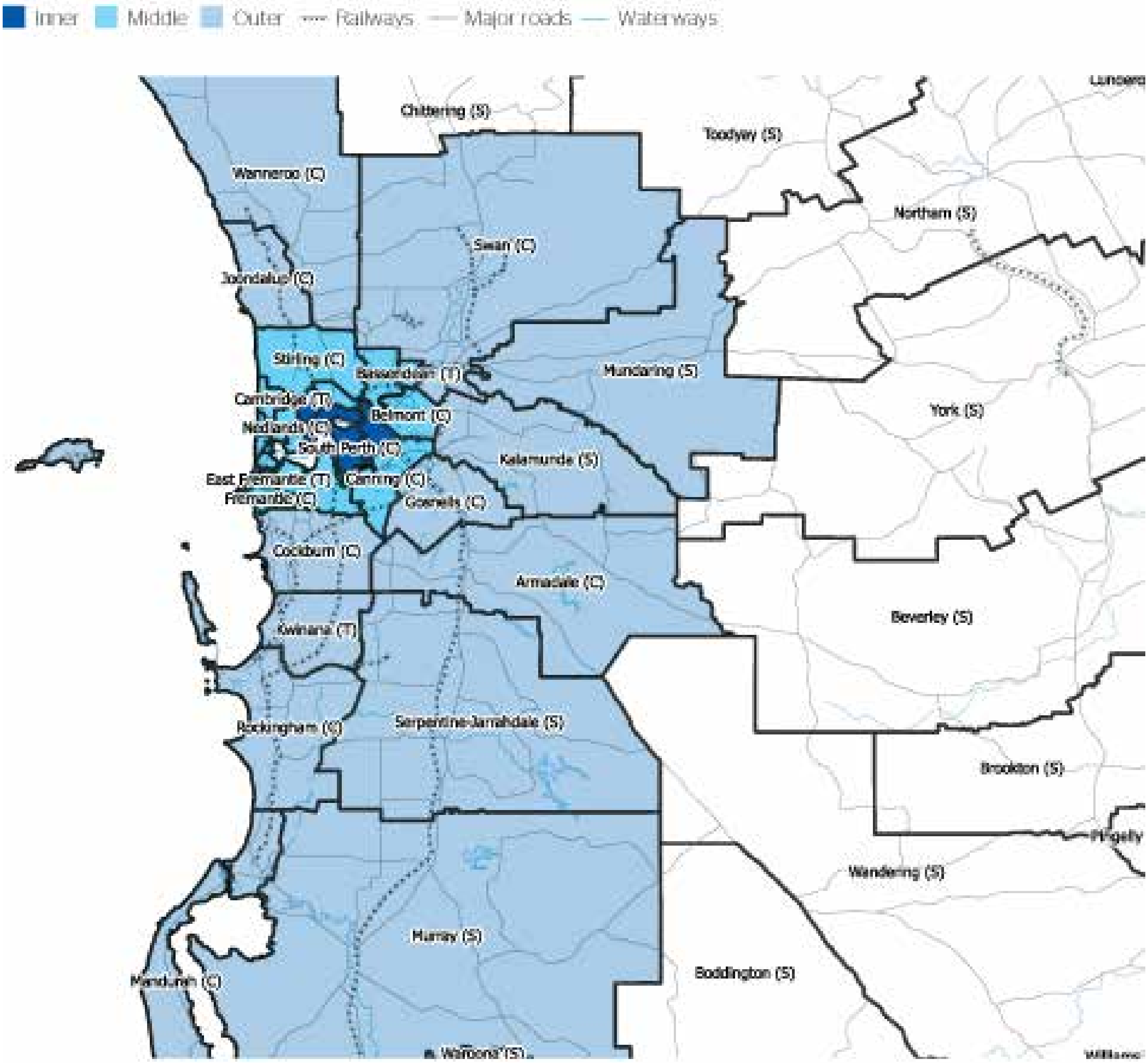
Source: State Government State Revenue Offices, BIS Shrapnel

Chart 28: Perth dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 29: Perth regions



8.9 Hobart

House market

The expiry of first home buyer incentives for purchasers of established dwellings in 2014 saw first home buyer demand decline. First home buyer demand has since bottomed out and is now in a recovery phase. Loans to first home buyers increased by an annual 6% in 2015/16, and the rising trend has been accelerating, with loans to first home buyers in June quarter 2016 being 24% higher than the same period a year earlier. It is likely that some of this demand stems from increased interstate migration. In contrast, purchase activity by upgraders and downsizers has been easing, with loans to non-first home buyers having fallen by 4% in 2015/16.

Demand from investors has also been decreasing, with the total value of loans to investors having fallen by an annual 13% in 2015/16. As with the other states, tightened lending policy by the banks is containing investor demand, although the decline in 2015/16 has been lower than the national decline. Rental growth has been largely flat and vacancy rates are close to balance at just under 3% through 2015/16. House prices in Hobart were flat in 2014/15, but picked up in 2015/16, with the median house price increasing by 5.2%. Tasmania's net interstate migration outflow has been steadily declining since peaking in 2011/12, and interstate migration is on track to record a net inflow in 2015/16. Part of the driver of this recovery is likely to be increased "tree changers" downsizing from the more expensive mainland capitals, while there are also likely to be many returnees from the mining states who contributed to the higher net interstate migration outflows of recent years.

House price growth has been unevenly spread across the Local Government Areas of Hobart. Median house price growth has been particularly strong in Hobart (10.1%), Clarence (8.4%) and Kingborough (6.9%). Glenorchy (1.1%) and Brighton (2.8%) saw more moderate house price growth while Sorell (-3.3%) experienced a decline in its median house price. The overall Greater Hobart median grew 5.2% over 2015/16.

Table 12: Median house price growth in Hobart by region, per cent, year to June quarter 2016

	BRIGHTON	CLARENCE	GLENORCHY	HOBART	SORELL	KINGBOROUGH	MEDIAN
Annual % increase	2.8	8.4	1.1	10.1	-3.3	6.9	5.2

Source: APM PriceFinder, BIS Shrapnel

The Tasmanian economy has been weak in recent years. A high Australian dollar and slow population growth have added to general economic weakness. However, improved household spending, non-residential building activity and improving exports suggest a stronger economic recovery. The weakening Australian dollar should support growth in tourism while the agricultural and mining industries should also benefit. The state unemployment rate fell from 7.8% at March 2014 to 6.6% at March 2016. Greater Hobart has a lower unemployment rate than the rest of the state, having fallen from 6.7% to 6.1% over the same period. Greater Hobart has also been the main destination for migrants from overseas, interstate and the rest of Tasmania, with its population rising by 0.8% in 2014/15 while the population of the rest of Tasmania was flat.

On the supply side, completions at the state level have continued to rise while underlying demand has been slow. This has seen Tasmania's dwelling surplus climb from 4,800 dwellings to an estimated 5,300 dwellings at June 2016. Given the disparity between population growth, it is likely that the oversupply is greater in regional Tasmania.

Reflecting lower income levels and fewer drivers of employment, Hobart has the lowest median house price compared to the other state capitals. Its relative affordability compared to other capital cities is a significant driver of demand as interstate migrants seek a more affordable market. The current low interest rate environment is expected to improve affordability and spur purchaser demand. Poor affordability in Melbourne and Sydney is expected to fuel further migration to Tasmanian cities already evident with the net interstate inflow forecast to increase further to 1,000 persons in 2016/17 and 2017/18.

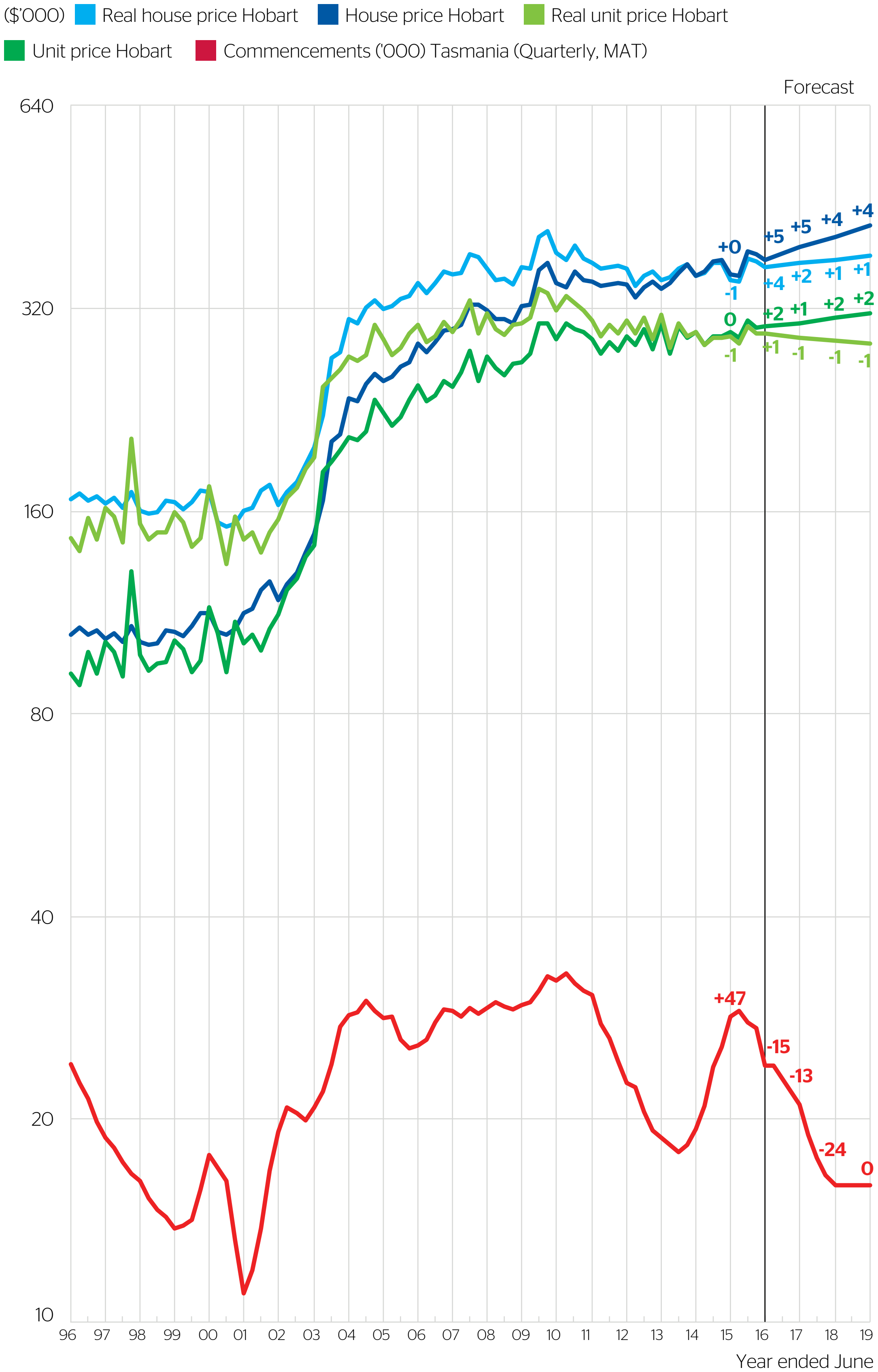
Overall, the gradual recovery in the local economy and interstate migration is expected to underpin price growth, while the presence of an excess dwelling stock at the state level will likely limit price growth to more moderate levels. Hobart's median house price is forecast to rise from $377,900 at June 2016 to $425,000 by June 2019, reflecting growth of around 4% per annum or a cumulative 12.5%.

Unit market

With a significantly smaller unit market and thus a smaller sample of sales volumes to measure the median, movement in the median unit price in Hobart can be much more volatile from quarter to quarter. Overall, however, median unit prices have been in a gradual decline since its peak median price of $420,000 in June 2011.

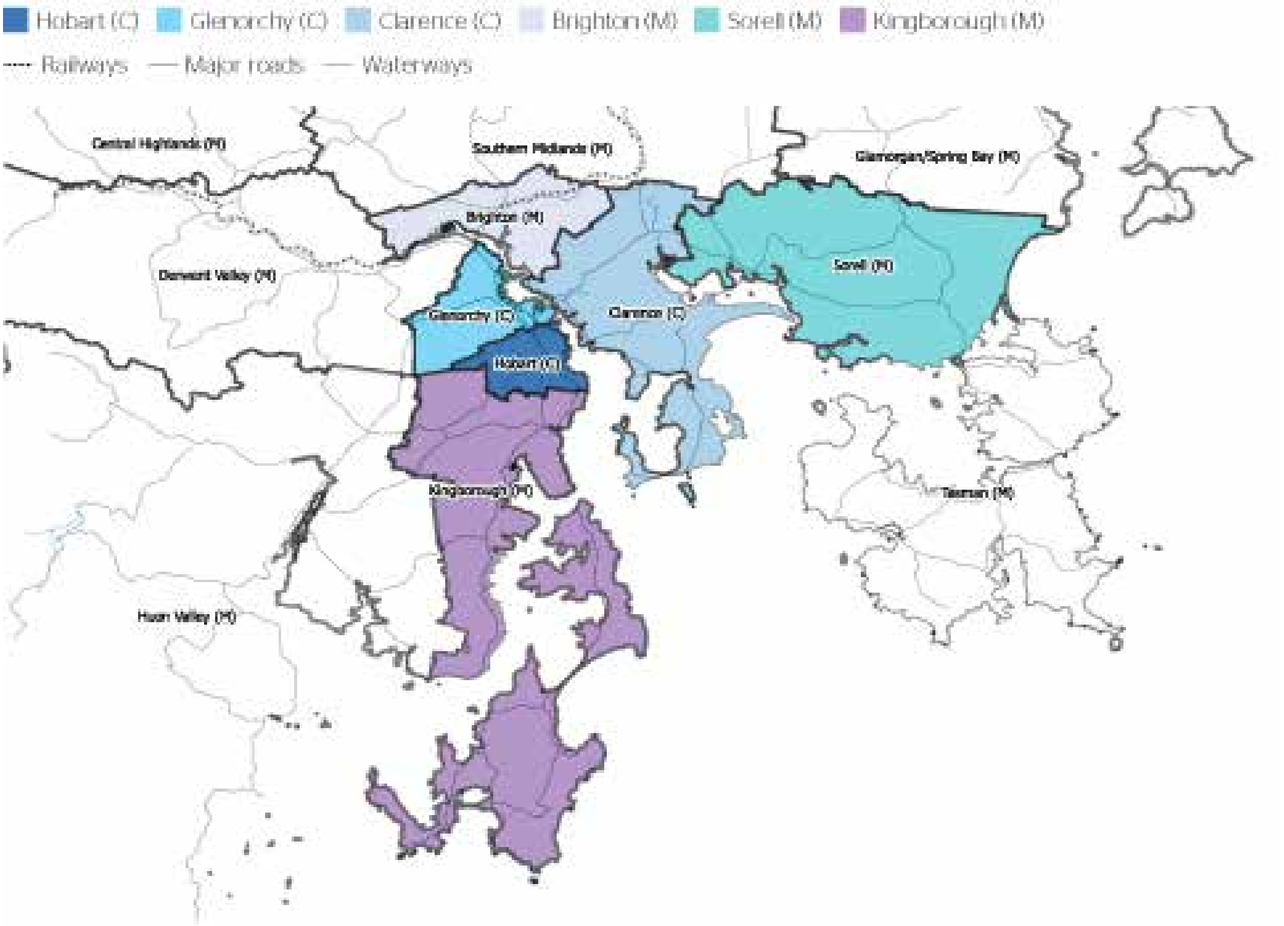
With falling investor demand, the unit market could experience the greatest impact as investor purchasers have traditionally been more prevalent buying units. This softness is expected to continue to dampen demand, limiting median unit price growth to a forecast 1%-2% per annum through to 2018/19. This is forecast to push the median unit price to $315,000 at June 2019; a cumulative growth of 4.5% over the forecast period.

Chart 30: Hobart dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 31: Hobart regions



8.10 Canberra

House market

Dwelling commencements have risen rapidly in Canberra as part of a long term construction boom in the post Global Financial Crisis period. Record dwelling completions saw the stock deficiency eroded by 2011/12, and the emergence of a significant stock surplus estimated at almost 7,500 at June 2016.

Dwelling commencements over this period have been heavily focussed in the apartment market with unit completions at record highs, averaging 2,700 dwellings per annum in the five years to 2015/16 compared to the long term average of 1,000 completions in the preceding fifteen years. Completions of separate houses in comparison escalated at a more moderate rate. Completions have averaged 1,600 dwellings per annum in the five years to 2015/16 marginally higher than the average of 1,300 dwellings per annum in the preceding fifteen years. Importantly, new house completions are trending downwards and are likely to fall to around 1,200 dwellings in 2016/17; below the long term average.

Underlying demand over this period has also remained flat as population and employment growth has been largely unchanged. As the Australian Capital Territory experienced cuts to public sector employment, it began to see an outflow of interstate migration amounting to an estimated 500 persons in 2015/16. Overseas migration has also been fairly flat at an estimated inflow of 2,300 persons in 2015/16; unchanged from a similar level of inflow the previous year.

The consistent surplus has put pressure on rental growth and vacancy rates. Rents have declined over the past three years, and fell by 0.5% in 2015/16. In contrast vacancy rates have tightened since being 4.2% in June 2014. The tightening in vacancy rates conflicts with expectations based on other indicators, although could be the result of a more recent surge in population not yet captured by the latest population statistics. Lower vacancy rates may also be the result of the decline in rents pulling population out of larger rental households or from the family home into the rental stock.

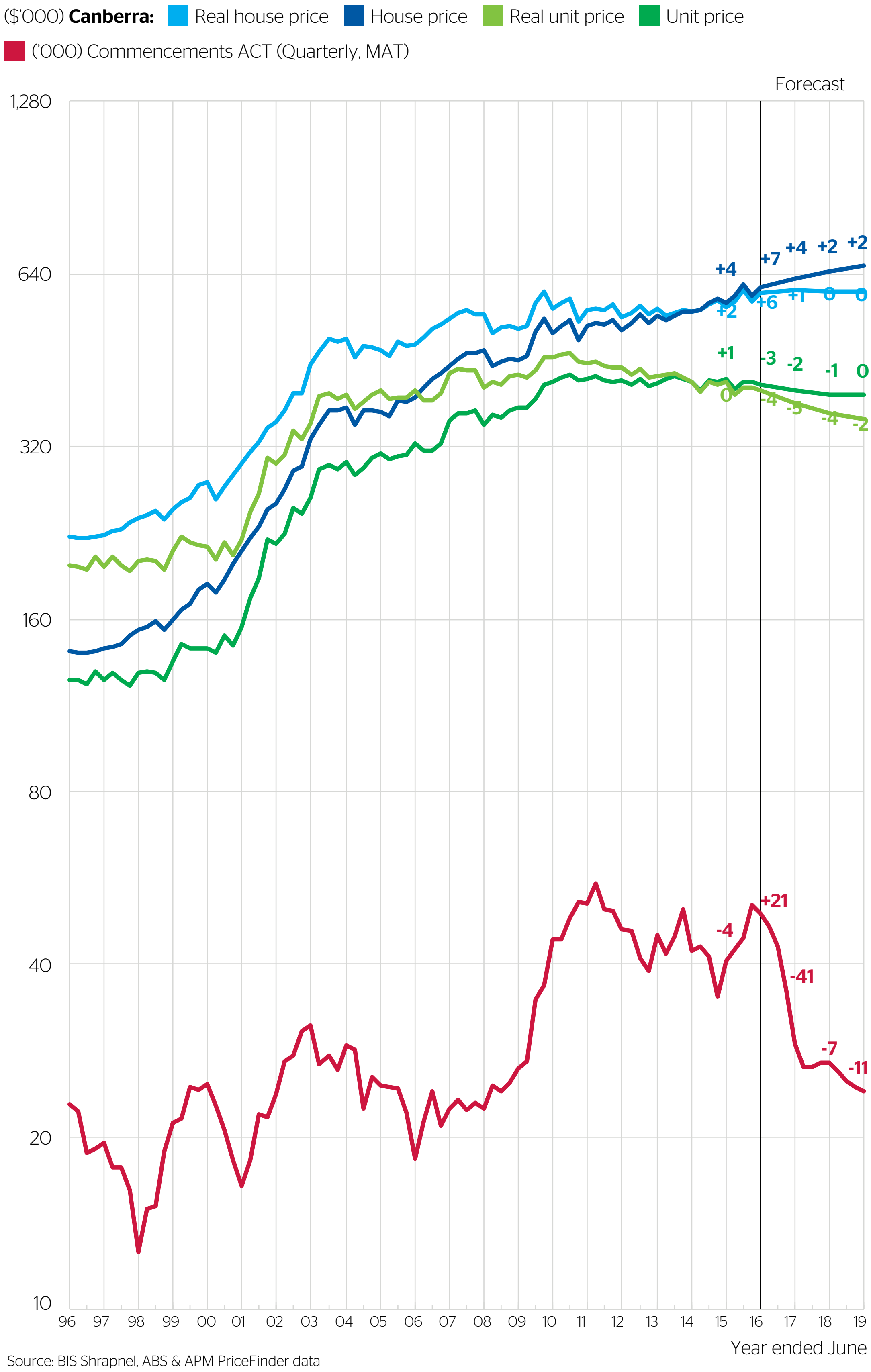
The disparity between new house construction (which is now below the long term average) and unit construction (which is a record highs) means the estimated excess dwelling supply in the Australian Capital Territory is expected to be concentrated in the unit sector. The house market is likely to be tighter, and this is reflected in the 7% rise in Canberra's median house price in 2015/16. Canberra also benefits from higher household incomes than the other states, with housing relatively affordable in comparison. Consequently, moderate price growth is forecast to continue, with Canberra's median forecast to rise by 3.5% in 2016/17, followed by further growth of 2.4% and 2.3% in the subsequent two years to reach $660,000 at June 2019.

Unit market

The surge in unit construction over the last five years has seen the unit market run into significant oversupply. Over this period, unit completions have accounted for an average of 63% of total dwelling completions; far outpacing supply delivered to the separate house market. In contrast to the growth seen in Canberra's median house price in 2015/16, the median unit price in 2015/16 fell by 2.6%.

While an aggregate oversupply is present, weaker unit prices may attract some purchaser demand from houses to units, putting a floor under unit prices (while also placing a ceiling on house price growth). Canberra's median unit price of $410,300 at June 2016 is 4% below its December 2010 peak, while in real terms prices have declined by 14%. Further downside totalling 4% is forecast in 2016/17 and 2017/18, by which point the Australian Capital Territory dwelling oversupply is estimated to have peaked and will be beginning to be absorbed. The median unit price is forecast to stabilise in 2018/19, to be $395,000 at June 2019.

Chart 32: Canberra dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

8.11 Darwin

House market

The relatively small size of the Darwin residential market makes it more volatile with median data more susceptible to swings from quarter to quarter. Nevertheless, broader trends are still able to be identified. Darwin also has a normally higher and more variable vacancy rate, a consequence of lower population and responds to even small changes to net migration.

The median house price in Darwin declined by a 1.7% in 2014/15, to $610,000 at June 2015, following strong price growth in the preceding three years brought on by the peak in mining investment. Mining investment has now peaked, and Darwin's median house price has started to retreat, falling 5.6% to $576,000 in the year to June 2016.

Dwelling completions in Northern Territory have remained at elevated levels since 2013/14 peaking at 2,386 completions in 2014/15 before falling back to 1,835 in 2015/16. Supply has been concentrated in the unit sector and is a product of increasing investor demand for apartment stock in the state, as well as meeting demand from the inflow of temporary residents with employment associated with the mining sector.

Economic conditions in Darwin are becoming increasingly challenging. Lower commodity prices have resulted in some mines being closed or being placed on 'care and maintenance' programs until commodity prices recover. The major Icthys LNG project is also past its peak level of work done, with the number of people working on the project now declining. There are also few projects in the pipeline to sustain future growth.

Net overseas migration inflows have fallen from a peak of 5,000 in 2012/13, to an estimated 900 persons in 2015/16. Net interstate migration outflows have also risen from 1,200 in 2012/13, to an average 3,000 per annum in the three years to 2015/16.

Weakening underlying demand, due to soft economic conditions and slow population growth, and elevated dwelling completions have seen the Northern Territory stock surplus increase to around 3,000 dwellings at June 2016, or over two years underlying demand. The rising surplus is placing pressure on vacancy rates and rents. Rents declined by 6.4% in 2015/16, while Darwin's vacancy rate peaked at 8.9 in December 2015.

Darwin's median house price declined by 5.6% in 2015/16 with the inner suburbs and Northern Suburbs showing more moderate declines of 2.7% and 2.8% respectively. The more affordable suburbs of Palmerston experienced a more substantial decline with Palmerston's median house price falling by 8.5%. With further downsides expected from an economic and population perspective, Darwin's median house price is forecast to decline by a further 6.3% to be $540,000 at June 2019.

Table 13: Median house price growth in Darwin by region, per cent, year to June quarter 2016

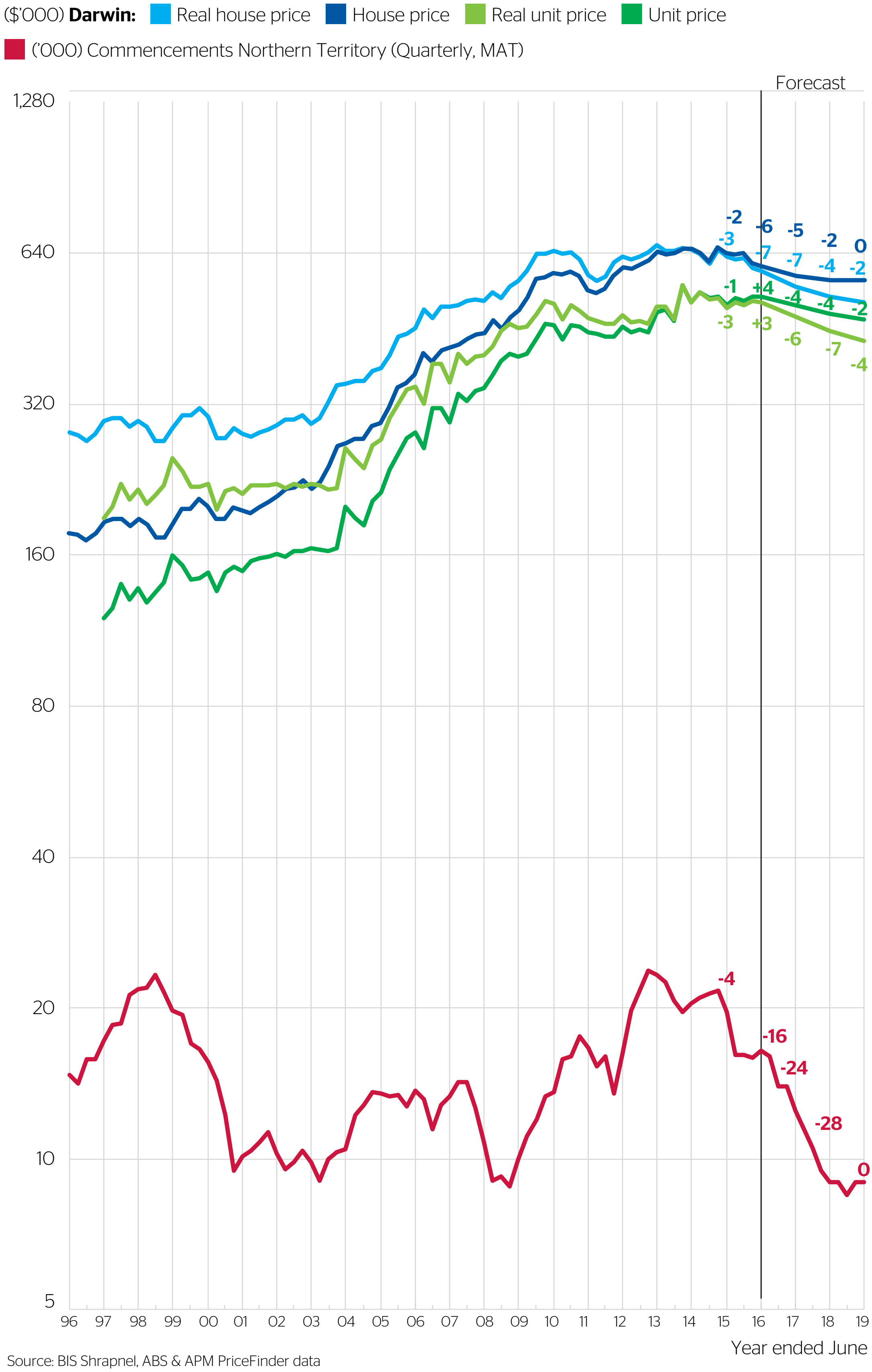
	INNER	NORTHERN SUBURBS	PALMERSTON	MEDIAN
Annual % increase	-2.7	-2.8	-8.5	-5.6

Source: Real Estate Institute of Australia, BIS Shrapnel

Unit market

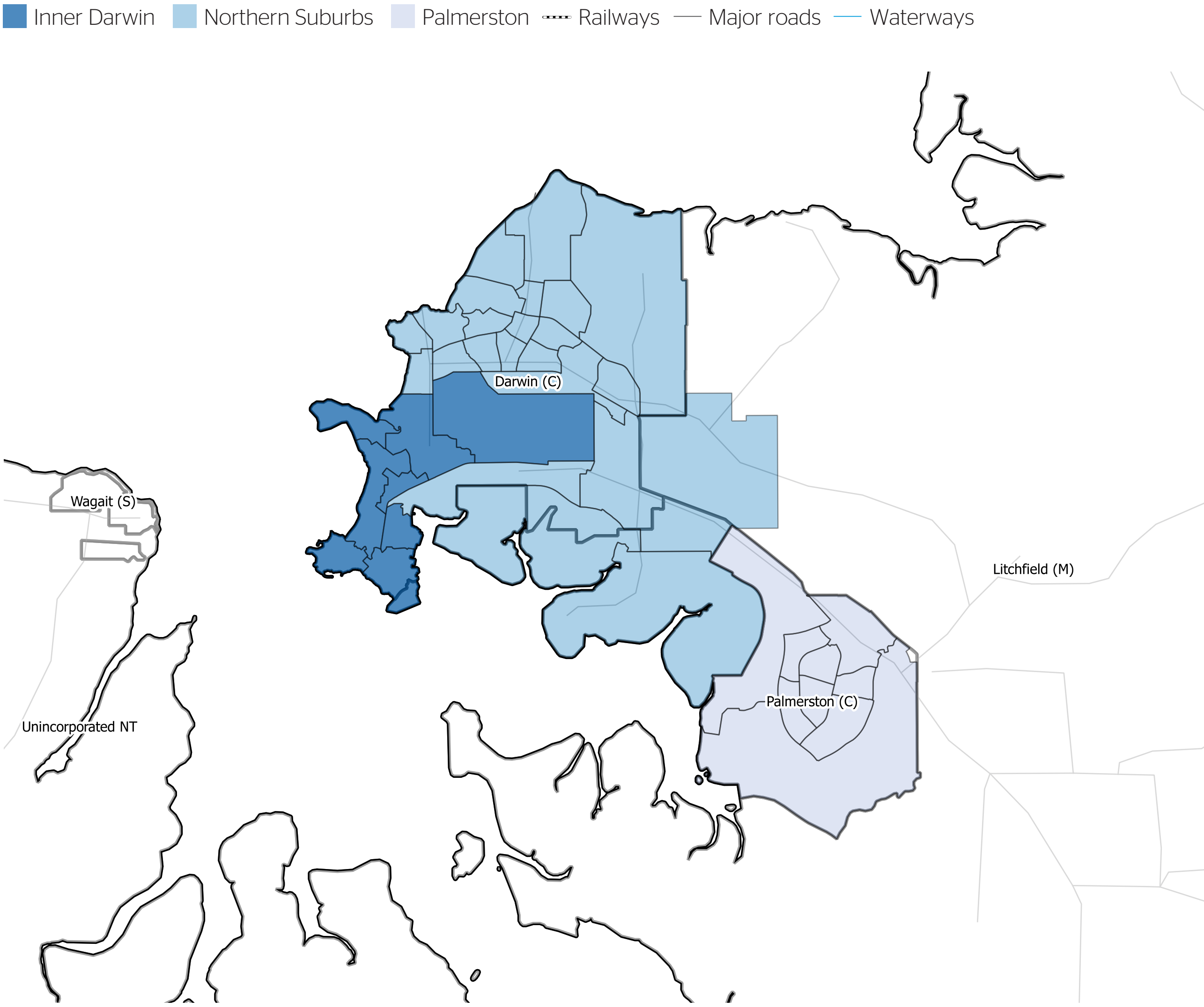
The unit market has seen escalating completions in the three years to 2015/16. This growth stemmed from the rising prices created by the inflow of population associated with booming resource sector investment, which in turn attracted significant off-the-plan investment for new apartments. However, as this boom period comes to a close, the high level of units under construction means they are being delivered in a rapidly weakening housing market. Recent changes to investor lending guidelines is also expected to take a toll adding further drag to investor demand. As a result, median unit prices are expected to decline by 4% in 2016/17 followed by further declines of 4% and 2% in subsequent years to take the median unit price 10% lower to $450,000 by June 2019.

Chart 33: Darwin dwellings, prices and activity



Source: BIS Shrapnel, ABS & APM PriceFinder data

Chart 34: Darwin regions



9. Appendix

9.1 Median house price forecast comparison

Chart 35 shows the forecast record of the Australian Housing Outlook since the inaugural 2002 report, comparing the forecast national median house price in each report over the three years of the forecast period with the actual movement in the national median house price. The national median is derived from a weighted median of each capital city forecasts. Up until 2014, the report was based on median price data provided by the Real Estate Institute of Australia. The historical forecasts up to 2014 have been re-indexed to be consistent with the current series, based on data from APM PriceFinder.

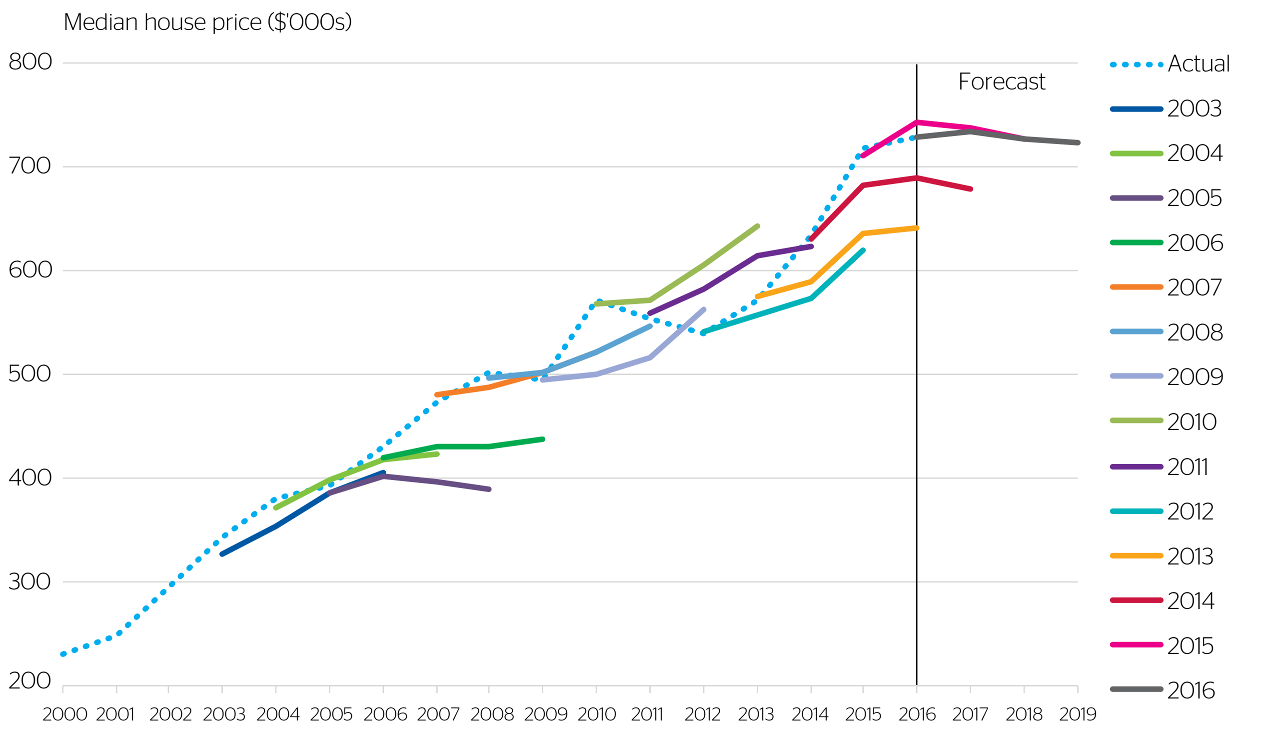
The median house price forecasts have typically been more conservative than the actual median price rises over most three-year periods. Through the middle of the decade, the sharp rises in prices over 2007 and 2008 were not anticipated. At the time, the interest rate rises were expected to have had a greater dampening effect on price growth.

Forecasts made over 2007 to 2009 were generally on track in terms of total growth over the three-year forecast period, despite the challenging economic conditions and the negative expectations at the time, which made forecasting difficult.

The forecast of the national median house price in the 2010 edition of the Australian Housing Outlook was more optimistic than eventual growth. The forecast national median house price was 12% above the actual June 2013 median of $572,300. Subsequent publication of Census data indicated household formation rates, and therefore underlying demand, were lower than expected, leading to a lower dwelling deficiency in most areas and therefore less pressure on prices.

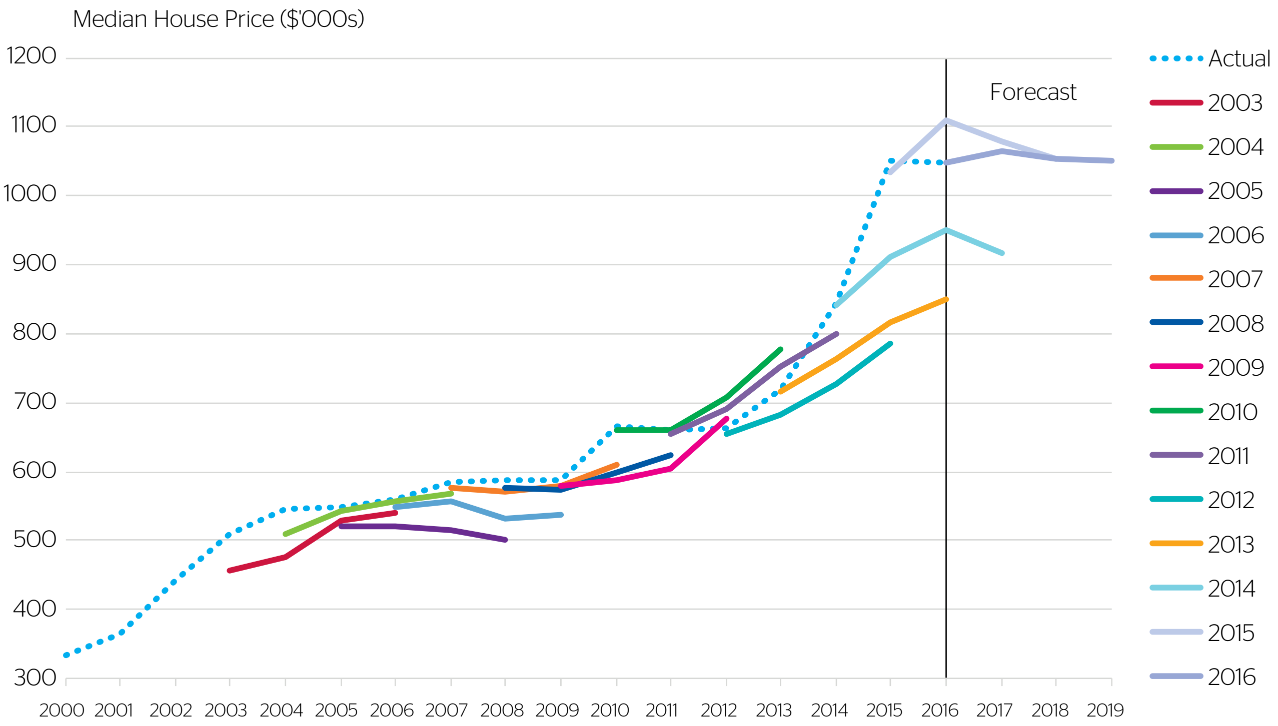
The 2011 edition forecast for 2014 was 2% below the actual figure and the 2015 forecasts in the 2012 to 2014 reports also underestimated actual growth in the subsequent years. The strength of growth in Sydney and Melbourne house prices, which have a large impact on the national median, has been underestimated, although price growth forecasts across the other capital cities have been more accurate. So far, the 2016 forecast in the 2015 report has overstated the price rise.

Chart 35: Comparison between actual and three year forecasts, national weighted median house price



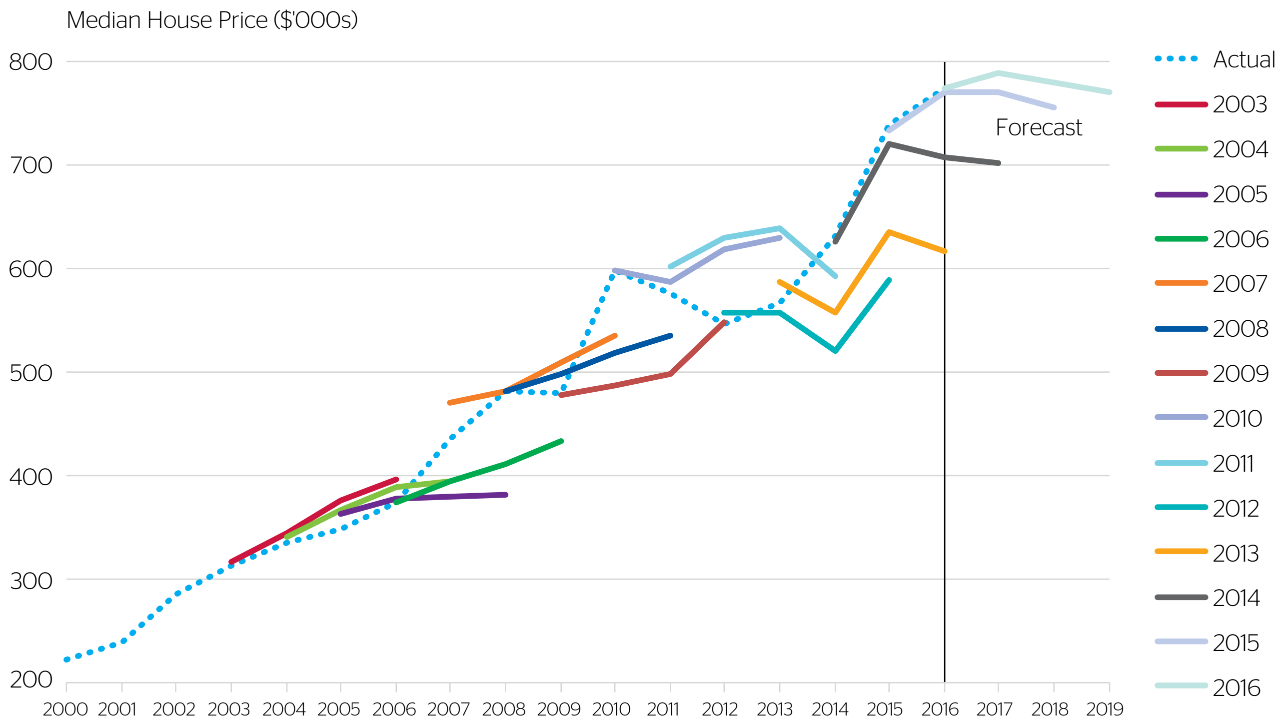
Source: Australian Bureau of Statistics, Real Estate of Australia, Forecasts: BIS Shrapnel

Chart 36: Comparison between actual and three year forecasts, Sydney median house price



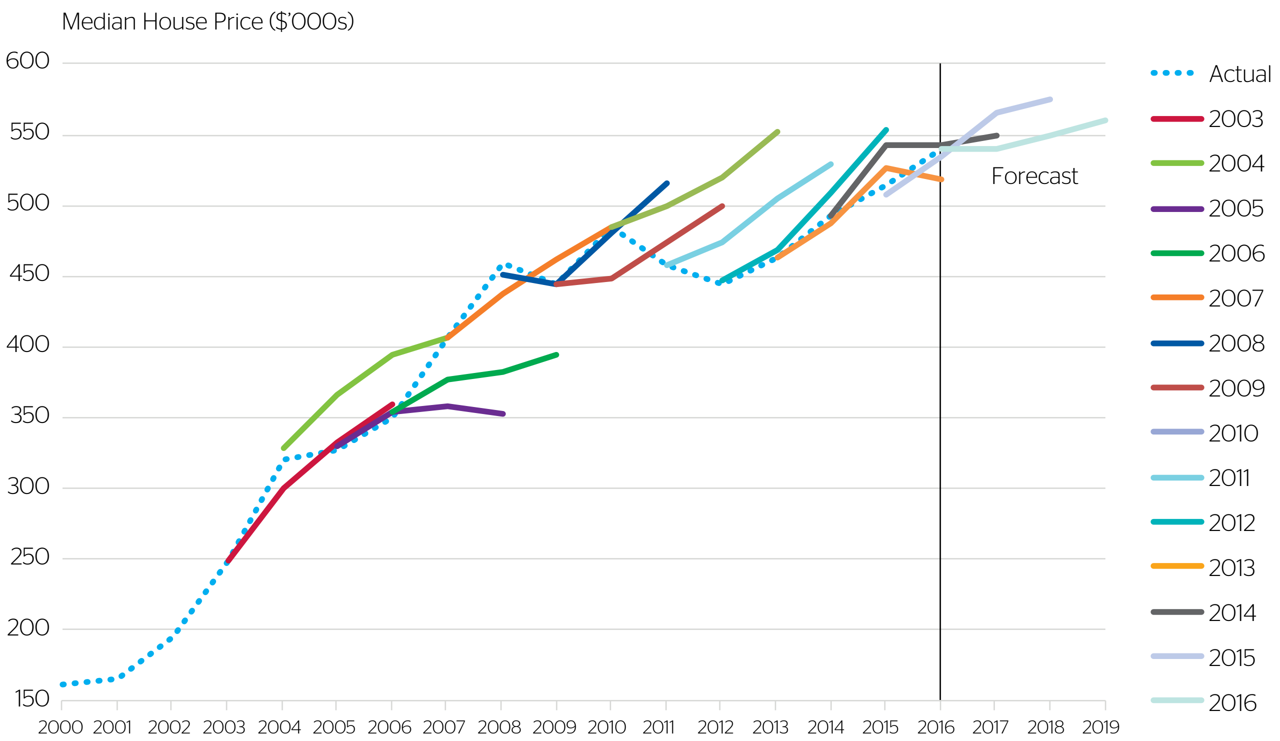
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 37: Comparison between actual and three year forecasts, Melbourne median house price



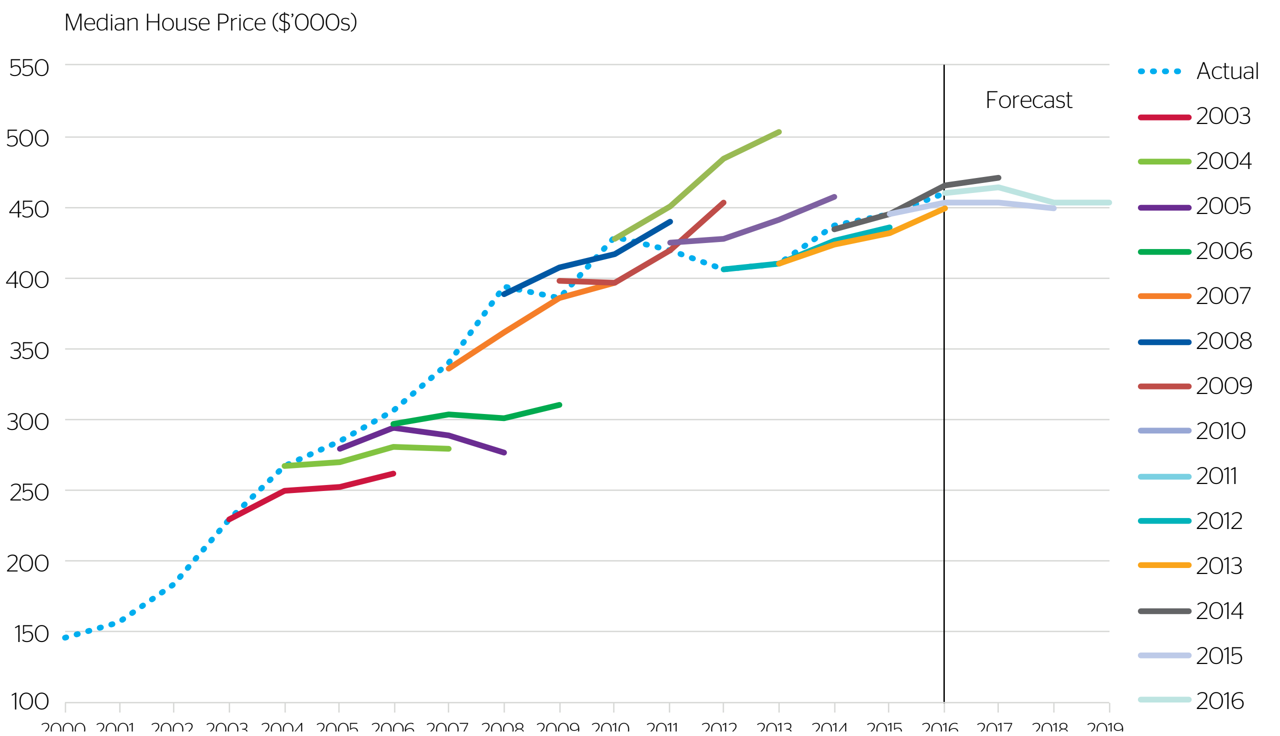
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 38: Comparison between actual and three year forecasts, Brisbane median house price



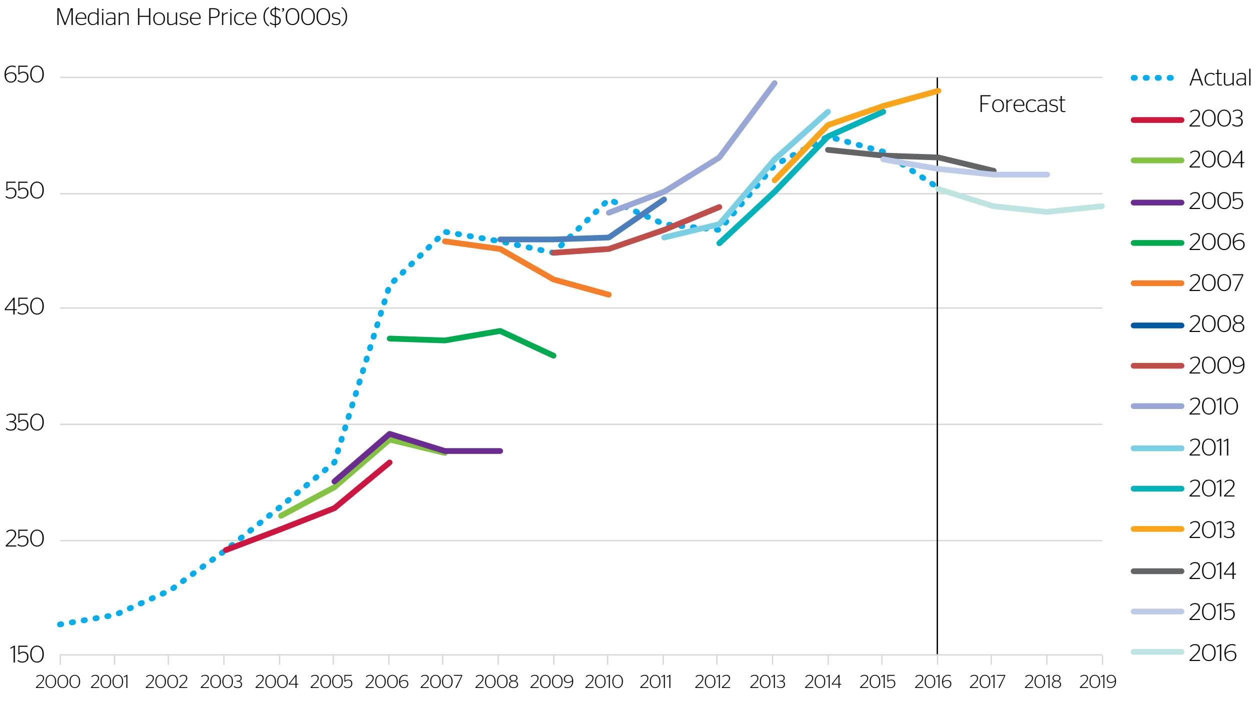
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 39: Comparison between actual and three year forecasts, Adelaide median house price



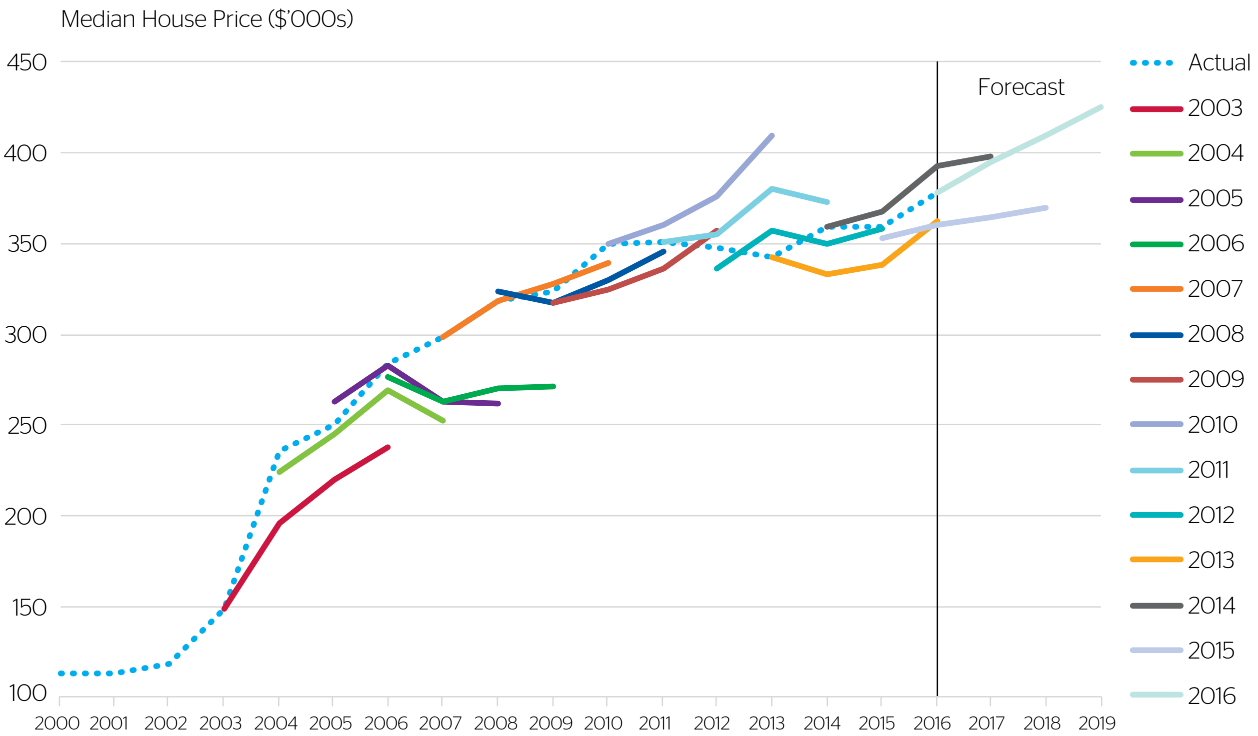
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 40: Comparison between actual and three year forecasts, Perth median house price



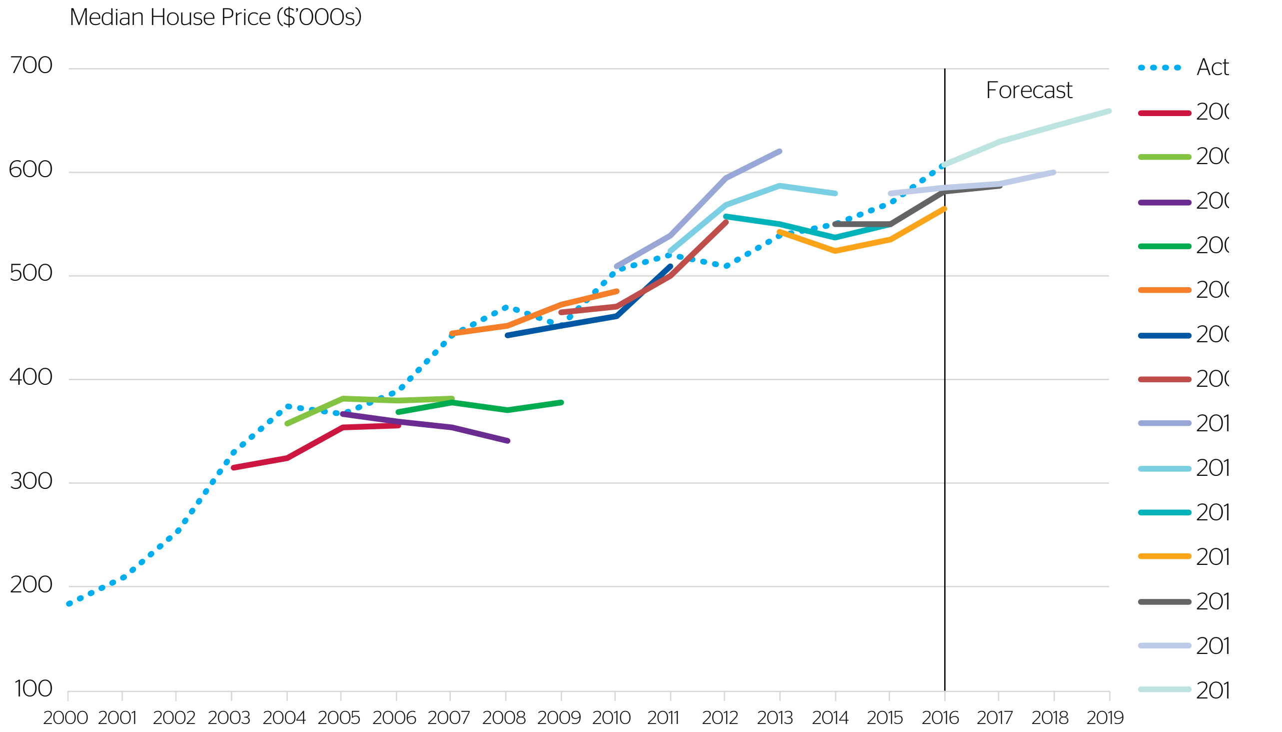
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 41: Comparison between actual and three year forecasts, Hobart median house price



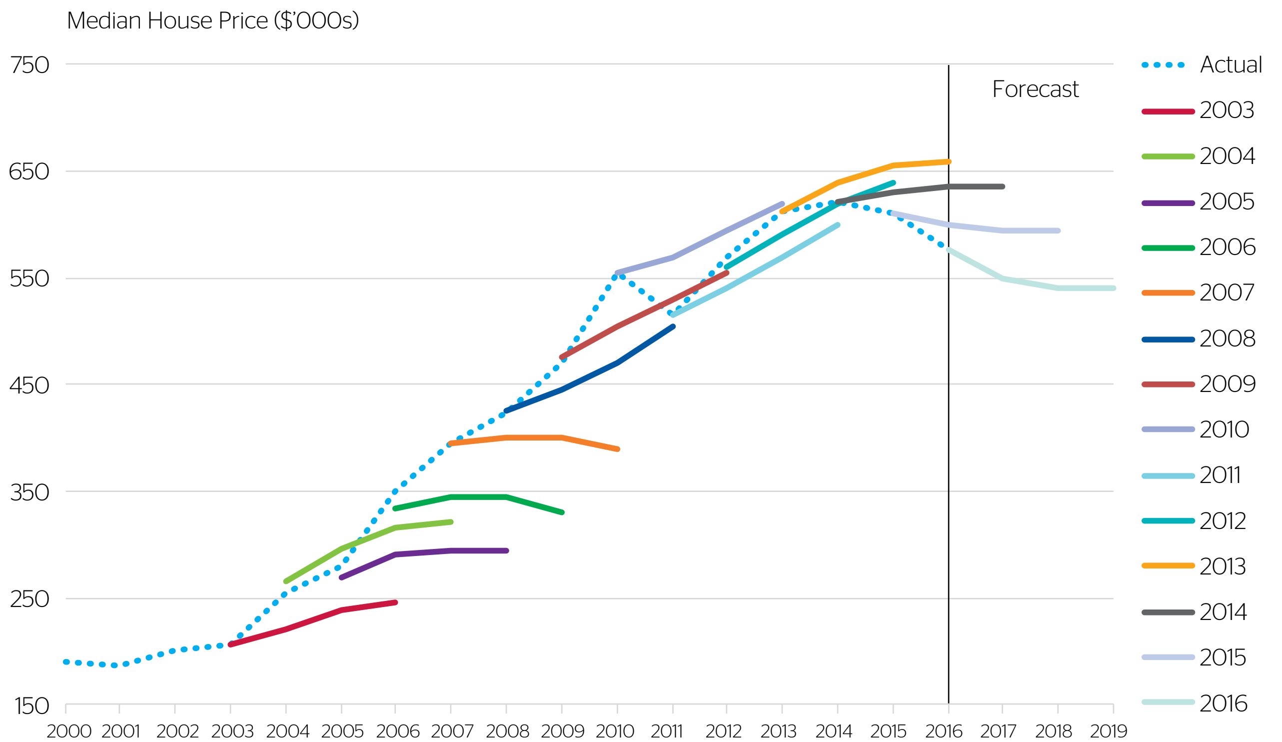
Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 42: Comparison between actual and three year forecasts, Canberra median house price



Source: Real Estate Institute of Australia, BIS Shrapnel

Chart 43: Comparison between actual and three year forecasts, Darwin median house price



Source: Real Estate Institute of Australia, BIS Shrapnel

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