CONTENTS

EXECUTIVE SUMMARY ............................................................... 03
ABOUT THIS REPORT ............................................................ 04
QUARTERLY UPDATE ............................................................. 06
PART ONE .......................................................... 12
  ECONOMIC FUNDAMENTALS .................................... 13
  KEY HOUSING MEASURES ......................................... 20
  HOUSING AFFORDABILITY ........................................ 26
  CREDIT STANDARDS AND RESTRICTIONS .......... 35
  JOBS & EMPLOYMENT .................................................. 43
  POPULATION & DEMOGRAPHICS ............................... 48
  HOUSING VS ALTERNATIVE ASSET CLASSES ..... 51
  STATES & TERRITORIES: KEY POINTS .................. 54
PART TWO .......................................................... 67
  QUARTERLY THEME: NEGATIVE GEARING .......... 67
  RISK DEFINITIONS ...................................................... 76
EXECUTIVE SUMMARY

HOUSES RISK MAP

NT
- Affordability
- Low Population Growth
- Economic Fundamentals

QLD
- Net Interstate Migration
- Mortgage Defaults

NSW
- Economy, Population Growth
- Credit Restrictions
- Potential Tax Changes

ACT
- Clearance Rates
- Nothing of Significance

TAS
- Affordability
- Economic Growth

VIC
- Capital Growth
- Credit Restrictions
- Potential Tax Changes

SA
- Low Building Approvals
- Economic Fundamentals

WA
- Affordability
- Low Population Growth
- Economic Fundamentals

UNITS RISK MAP

NT
- Rental Return
- Low Population Growth
- Areas of Oversupply

QLD
- Interstate Migration
- High Supply in Some Areas

NSW
- Economy, Population Growth
- Areas of Oversupply
- Credit Restrictions
- Potential Tax Changes

ACT
- Employment
- Nothing of Significance

TAS
- Affordability
- Small Market
- Economic Growth

VIC
- Population Growth
- Areas of Oversupply
- Credit Restrictions
- Potential Tax Changes

SA
- Affordability
- Areas of Oversupply

WA
- Affordability
- Areas of Oversupply
ABOUT THIS REPORT

Welcome to the December 2018 edition of the Residential Property Risks & Opportunities Report by RiskWise Property Research. Our objective is to provide you with a risk heat map of the residential property market and a comprehensive review of the major risk factors.

The report covers 30 risk factors, grouped into seven categories: economic fundamentals; key housing measures; housing affordability; lending standards and restrictions; jobs & employment; population & demographics; and alternative investment options. The report is structured using a top-down approach commencing at the State level, followed by a category-level analysis and down to the individual level.

We have taken this approach in order to simplify the measurements for overall risk and major drivers, whilst still provide detailed information. This is an effective tool that enables you to ascertain the context for each factor (such as population growth) and how the risk factors impact the property market. The report is broken into two parts:

1. The Risk & Opportunities Report
2. Quarterly Theme - An overview of the Labor Party’s proposed changes to Negative Gearing and Capital Gains Tax and their impact on the entire property market

IMPORTANT NOTICE

This report has been prepared at a time when the housing market has entered 'uncharted territory'. This requires close monitoring as these are unprecedented times. The magnitude of a variety of factors, the frequency that they are changing and the very sudden impact they are having on the property market are phenomenal, whether this is the impact of the downtown of GDP growth, the huge potential significance of a slump in dwelling commencements, or the downward plunge of auction clearance rates following leadership spill.

The report is based on three major assumptions that form the basis for the risk assessments and projections. Further, the changes for many of these factors, such as dwelling prices, dwelling commencements and the potential adverse impact on Australian GDP growth, have been very sharp.

It is very possible that during the first half of 2019 there will be dramatic developments and volatile changes that might have further impact on our risk rating and projected returns. Those include an unexpected win by the Coalition in the Federal elections, major measures to boost demand and an interest rate cut by the RBA. Therefore, RiskWise will continue to monitor any potential changes and their impact on risks and projected returns, and these will be assessed and reported in the next Quarterly report or before.

A summary of the risks across each of the seven categories can be found in the table in the next page.
<table>
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Grim times ahead for property market  
Forecast gloomy without regulator intervention

A combination of a unique set of circumstances will shape the entire landscape of residential property in 2019 and 2020. Since the second half of 2017, the major risks associated with the residential property market have significantly increased.

Tighter lending standards, the results of the Royal Commission, the fear of the potential changes to negative gearing and capital gains tax, political uncertainty, unit oversupply on one hand and a sharp drop in dwelling commencements on the other hand have all had, and will continue to have, a major impact on residential property in Australia.

The weakness in the property market and significantly increasing risks have resulted in a situation where the majority of current property purchases are depreciating assets with a high level of risk. Further, during 2019, the majority of future property purchases will also depreciate in their values in the short term.

Without intervention by the regulator or state and federal governments to boost demand for dwellings, we can expect a tough couple of years for most the property market in Australia, with only a relatively small number of opportunities across the country.

As of 15 November 2018, RiskWise makes three major assumptions:

1. Credit standards and restrictions will be either tightened further or remain at the current level. Lenders, particularly banks, will therefore take into account that they are lending against depreciating assets as well as the risks associated with the potential impact of changes to negative gearing and capital gains tax.

2. There is an 80 per cent likelihood the Australian Labor Party (ALP) will win the upcoming Federal election and introduce changes to negative gearing and capital gains tax, although not until the 2020 Budget. Once the policy is implemented and its effects absorbed by the market there will be a new, lower, equilibrium point for dwelling prices.

3. The RBA will not increase interest rates at least until the second half of 2020. It is also unlikely, but possible, that the RBA will cut interest rates during the second half of 2019 mainly due to lower GDP growth. This means that property buyers should factor into their decision-making an interest rate increase at a later point of time, probably from 2021, as it will result in higher out-of-pocket costs and lower interest in property purchases. This is particularly the case if the proposed taxation changes are implemented and investor sentiment is low.
The Risks:

Credit restrictions and Banking Royal Commission

The initial recommendations by the Banking Royal Commission were implemented by the banks in the second half of 2018 in relation to scrutinising loan applications. The result of these restrictions, with an expected reduction in the volume of loans of around 10 per cent and borrowing capacity of around 20 per cent, have had a direct impact on dwelling prices, due to the smaller number of qualified buyers as well as those buyers having a smaller budget. The final report will be published on February 1, 2019, with potential recommendations of radical reforms across the industry which will impact the property market. The major banks, in particular, are expected to further tighten their lending standards.

APRA has recommended banks limit lending above six-times loan-to-income ratio. Therefore, with borrowing capacity reduced by as much as 20%, investors have found it more difficult to secure access to credit.

The combination of tighter credit standards and potential taxation changes have had a direct impact on buyer sentiment. Buyers perceive residential property, particularly in Sydney and Melbourne, as a depreciating asset. Other areas that are greatly impacted are WA and the NT, whose housing markets that had been experiencing a continued weakness following the end of the mining boom, suffered further price reductions.

While APRA has recently removed the 30 per cent interest-only lending cap, the removal of this restriction is unlikely to have a material impact on the housing market. Banks are likely to continue tightening credit standards due to the Royal Commission’s findings. They will also continue to mitigate the risks associated with interest-only loans in a market where the majority of the properties that are purchased or re-financed are depreciating assets.

Self-Managed Super Funds (SMSFs): Many major lenders are no longer approving lending for residential properties against SMSFs and this will have a direct impact particularly on new properties as a large proportion of investments are made through advisors and accountants and concentrated in new dwellings, meaning there should be fewer off-the-plan investors, and thus a lower volume of pre-sales and sales.

Restrictions on foreign investor activity and fund transfers: The Foreign Investor Duty Surcharge (FIDS) is a duty charged to foreign investors which is impacting their participation in the property market. In addition, the Chinese government has cracked down on capital leaving the country which has stemmed the tide of investment into Australia.
Changes to negative gearing (NG) and capital gains tax (CGT)

It can already be demonstrated that fears of the proposed changes by a Labor government (to limit negative gearing to new rental dwellings and to halve the CGT tax discount from the current 50 per cent to 25 per cent) have already impacted the market. Price reductions accelerated over the last quarter following the day of the Liberal leadership spill of Malcolm Turnbull by Scott Morrison on August 24. In addition, auction clearance rates have dropped below 50 per cent in both Sydney and Melbourne, where in some weeks less than four in every 10 homes sold at auction.

The next Federal election is likely to take place in May 2019 and the current probability that the ALP will win is 80% (based on betting odds) with the likelihood the changes will be implemented in the 2020 Budget. The impact of these changes on the housing market is likely to last well into 2021. The risk of price reductions should remain very high at least until the second half of 2020. This adds uncertainty and impacts buyer sentiment. Strong reduction in investor activity and sentiment indicates that investors are now ‘timing the market’ – they only have to wait for the election results and the implementation of the taxation policy, and once a new low equilibrium point is reached can act. Investors now have a very clear notification well in advance regarding potential increases to out-of-pocket expenses due to the taxation changes, the equivalent to a significant and sudden interest rate increase of 1.15 per cent in the Sydney unit market.

Further, the increased risk associated with the changes will require banks to use ‘forward-looking information’ to assess provisions for bad debt, and to also integrate the potential impacts of the proposed changes into their credit assessments, for example, requiring lower LVR (i.e. higher deposit).

Australia’s three major asset classes have the lowest returns in a quarter of a century

Based on available data from CoreLogic since 1981 (the earliest point when valid data is available), 2018 is the first year in 37 years that two major asset classes (residential property and shares) delivered annual negative returns at the same time. In addition, government bonds only delivered less than 2 per cent return.

This means in 2018 major asset classes delivered either negative or poor returns, well below the return of at least 5 per cent, as expected by investors under typical circumstances.
Unit oversupply and dwelling commencements:

There are a number of high-risk areas experiencing unit oversupply, while many unit building approvals are suffering poor and often negative capital growth. Brisbane CBD and Perth are prime examples of this. This has also significantly increased the settlement risk for off-the-plan units, particularly in large unit blocks.

The three-month aggregate of dwelling approvals for the current period of 51,406 was the lowest since August 2014, which was 50,588. This is in contrast to its peak which was 60,345 in June 2016. Meanwhile, there are 255,333 units in the pipeline in the next 24 months in Australia equating to 9.8 per cent of current stock, while the HIA New Home Sales report shows the number of sales during the three months to October was down by 10 per cent compared with the same time last year.

With reduced borrowing capacity for buyers, developers are preferring house-and-land packages which are more appealing to families, rather than units which are failing to achieve presales and sales targets. This means it will take longer for the large supply of new units to be absorbed into the market. While some owner-occupiers do buy new off-the-plan units, it is a small proportion and it is extremely unlikely that the current stock will be absorbed with the very slow demand we see from investors.

Key risk indicators for dwelling commencements that provide 6-12 months lead in to the market are: failure to meet pre-sales and sales targets by developers; lower sales volume and less focus by some property marketers on units in areas that are harder to sell; very low developer confidence; more conservative approaches and thorough risk-management practices by developers; very low risk appetite and conservative risk-management practices by lenders; lending restrictions and ‘black list’ areas by lenders for both residential lending and construction loans; the ‘pipeline’ of available funds shrinking; significantly lower LVR (i.e. higher deposit) for property developments and very high rate of pre-sales as a condition to proceed to commencements; and difficulties getting finance from alternative financiers.

More conservative risk-management practices by both construction lenders and developers are likely to result in a significant reduction of new units, at least until the end of 2019. It is likely that dwelling commencements will continue trending lower until there is clarity regarding the actual implementation of the taxation changes as well as absorption of the large stock of units. With a large number of development approvals not proceeding to construction commencement, this area should be closely monitored.

Although there is a reduction in dwelling commencements, the reduction in the current stock will take time, particularly in areas with very high levels of supply of rental properties that only target investors. For example, smaller units not suitable for families or owner-occupiers, are likely to experience low demand and increased risk. The proposed changes to NG add an additional layer of complexity.
State-by-State Overview

In **New South Wales**, the combined effects of unaffordable housing, poor investment serviceability ratio and lending restrictions have led to a quick reduction in house and unit prices. In addition, there has been a significant reduction in investor activity. Fear from potential changes to NG and CGT are already taking effect. The leadership spill in August 2018, saw a sudden reduction in auction clearance rates with Sydney consistently falling below the 50 per cent mark. Overall, Sydney is likely to experience continuous price reductions over the next couple of years, with an estimated annual reduction of 4-6 per cent in each of the years 2019 and 2020. Some regional areas, however, are likely to hold well.

**Victoria** attracts the highest population growth across all states and territories. The state also enjoys a solid economy and a healthy job market. However, like NSW, dwelling prices in VIC have fallen, although at a more modest pace than NSW, as have auction clearance rates, also below 50 per cent. Again, this fall can be attributed to the same factors as that of NSW - lending restrictions, significantly lower investor activity, fear of changes to the current taxation regime and expectations of price reductions. Therefore, over the next couple of years, the prospect for the Melbourne housing market is negative with price reductions in the order of 4-7 per cent for each of the years 2019 and 2020. However, a number of regional areas, in particular Geelong, present only a low level of risk and are projected to deliver solid capital growth both in the short and long term.

The **Australian Capital Territory** also delivered good economic growth and experienced the second largest population growth rate in the country, delivering solid capital growth and a healthy property market. While growth rates have decelerated in recent months, dwellings in the ACT present a relatively low level of risk for price reductions and are projected to deliver modest capital growth in the next couple of years. Houses are still enjoying, and likely to continue to do so, healthy capital growth while the unit market remains reasonable, although these do carry a higher degree of risk to deliver negative growth in the short term, particularly due to their reliance on investor activity.

Meanwhile, the modest growth pace in the **Queensland** housing market remains the same as in recent years. For units, it remains poor or negative. However, it must be noted that the economy, demand for dwellings and housing market strength greatly vary across the state. Some areas, particularly in South-East QLD including the Gold Coast and the Sunshine Coast, enjoy good population growth and healthy demand for houses. Other areas, such as Central QLD, are still experiencing poor demand for dwellings, very high vacancy rates and a very soft property market. Also, overall a large number of areas in Queensland, particularly inner Brisbane, are experiencing a very weak unit market often accompanied by oversupply. These areas are particularly susceptible to the impact of potential taxation changes.

The **South Australian** economy has shown some improvement. However, SA still has a high-effective unemployment rate which leads to a very low population growth and soft housing demand. Therefore, due to the modest demand level, only modest capital growth is forecast for houses. However, houses in popular areas, such as Adelaide Central and Hills carry a low level of risk and projected to deliver solid long-term return. Many areas in SA are experiencing weakness in the unit market, however, with some facing significant oversupply, Adelaide CBD in particular. Thus, poor growth is forecast for SA units.
In **Western Australia**, lending restrictions introduced across Australia had the most impact in this market than other areas in the country thanks to its weaker economy. Perth prices, which had stabilised, once again started falling. The impact is expected to increase if a blanket approach is also taken when implementing the proposed taxation changes. While WA’s economy has returned to positive growth, a combination of a very high effective unemployment rate, low population growth and a significantly below-average economic activity level has resulted in negative capital growth for both houses and units. Units carry a very high level of risk due to the combination of oversupply, lending restrictions and low demand, particularly in central Perth.

**Tasmania** leads the country in investment serviceability with its high median rental returns and low average dwelling price. The state delivered consistent capital growth as well as strong rental returns for both houses and units. However, its outstanding growth rate is already showing signs of price growth deceleration. A significant increase in dwelling prices in recent years, less affordable housing, decelerated price growth, fewer people turning up to open home inspections and fewer inquiries on listings, indicate that housing affordability has made an impact and that the growth rate was unsustainable. It is projected to significantly decelerate in 2019 and further into 2020.

The **Northern Territory** experienced poor population growth resulting in negative dwelling growth and a very soft property market. Poor demand for dwellings and price reductions, combined with a relatively high median household income have resulted in its exceptionally low price-to-income ratio, the lowest in the country. However, the housing market is projected to remain soft, particularly for units. Furthermore, it is likely that the NT housing market will be a victim of unintended consequences from the blanket implementation of potential taxation changes.

Thank you for your interest in this quarterly update. Please register on our website if you wish to subscribe to our next release.

**Doron Peleg, CEO**
PART ONE
RISK & OPPORTUNITIES REPORT

ECONOMIC FUNDAMENTALS ........................................ 13
KEY HOUSING MEASURES ........................................... 20
HOUSING AFFORDABILITY .......................................... 26
CREDIT STANDARDS AND RESTRICTIONS ................. 35
JOBS & EMPLOYMENT .................................................. 43
POPULATION & DEMOGRAPHICS ................................. 48
HOUSING VS ALTERNATIVE ASSET CLASSES ............. 51
STATES & TERRITORIES: SUMMARY .......................... 54
ECONOMIC FUNDAMENTALS

Economic fundamentals are a group of major measures that are used to assess the overall growth of the economy and to provide state-by-state analysis in order to assess the projected likelihood of sustainable capital growth.

Sustained economic growth is strongly correlated to solid capital growth across the property market, particularly in a low interest rate (i.e. low economic growth) environment. Economic growth is also strongly correlated to population growth, and vice versa.

CASH RATE ................................................................. 14
ECONOMIC GROWTH .............................................. 15
PRIVATE NEW CAPITAL EXPENDITURE .... 16
GOVERNMENT EXPENDITURE ............................. 17
CONSUMER SENTIMENT ................................. 18
HOUSEHOLD SPENDING .............................. 19

Risk Rating
<table>
<thead>
<tr>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
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The official cash rate (OCR) is the term used in Australia for the bank rate and is the rate of interest which the central bank charges on overnight loans to commercial banks. A low cash rate means that the interest rate for residential properties is low. Therefore, decisions made by the RBA regarding changes to the cash rate not only have an impact on the immediate cash rate but also on market expectations regarding dwelling prices.

CURRENT STATE

- The Cash Rate has remained at a record low of 1.5 per cent for the 27th consecutive month.
- A key driver of the low cash rate is the poor wage growth experienced across Australia, as well as the low consumer price index which is just within the RBA target of 2-3 per cent. While inflation has increased slowly from the end of 2016 (only 1.2 per cent), currently it is 1.9 per cent, which is below the target.
- Another reason behind the stagnant cash rate is the high household debt level. An interest rate rise would impact cashflow and therefore consumption. In other words, low household spending means low GDP growth.
- This is already demonstrated by the slowdown in the current Australian annual GDP growth to 2.8%, caused by the weak 0.3% growth in the September 2018 quarter. This low growth can be attributed to weak household spending.

PROJECTION

- While there has been a noticeable reduction in the effective unemployment rate that has led to a slightly higher wage growth, a cash rate increase is highly unlikely, at least until the second half of 2020. This is due to lower dwelling prices that are likely to have an impact on household spending, significant reduction in new dwellings under construction in the next two years, low inflation and slow retail trade.
- Inflation is likely to remain low at least until the end of 2019.
- However, there is a 20 per cent chance that the RBA will be forced to cut the cash rate in 2019 should the property market experience significant price reductions combined with poor growth in consumer spending and major reduction in construction activity, as these may have an adverse impact on GDP growth and employment.
- Looking ahead to 2020, unless there are major policy changes by the regulator or significant incentives to first home buyers by either the federal or state governments to stabilise the housing market, a cash rate increase is unlikely at least until the second half of 2020.

Source: RiskWise, RBA
ECONOMIC GROWTH

Our economic growth measurement utilises gross state product (GSP) data from ABS. The volume measure of GSP, is the headline measure of state economic activity across each state and territory. These estimates are essentially a dissection of the Australian estimates contained in the Australian System of National Accounts. GSP provides a strong indication of overall economic strength. However, other measures, such as private new capital expenditure and unemployment, should be analysed alongside GSP.

CURRENT STATE

- Currently, Australian annual GDP growth rate has slowed down to 2.8%, caused by the weak 0.3% growth in the September 2018 quarter. This is the weakest quarterly growth in 2 years.
- However, QLD, TAS and ACT delivered excellent growth well above the benchmark. This directly translates to more new jobs and a low unemployment rate and thus population growth.
- While WA’s economy is back in positive growth, it is still significantly below the 10-year benchmark. This is closely related to high unemployment and low population growth in WA.

PROJECTION

- Following the surprisingly low quarterly GDP growth, the risk for an unexpectedly lower annual economic growth appears to be high.
- NSW & VIC are likely to deliver ongoing economic growth which will be driven by population growth.
- QLD will continue its transition from a largely mining-based economy. This will be driven by strong internal migration.
- Particular risks that could reduce economic growth include reduction in household spending (due to continuous dwelling price reduction) and a significant reduction in construction of residential property.

Source: RiskWise, ABS
PRIVATE NEW CAPITAL EXPENDITURE

Private New Capital Expenditures is a measure of the total investment by private businesses across each state and territory. This provides a good indication of the business’s attractiveness, opportunities and the projected demand for labour. The measurement is strongly correlated to economic growth which, in turn, impacts the strength of the property market.

CURRENT STATE

- WA and QLD experienced the greatest losses of private capital expenditure in comparison to the 10-year average, as a result of the decline of the mining industry.
- NSW and VIC have been recipients of a consistent flow of private investment over the past 10 years. This has been a key contributor to their strong employment measures.
- ACT and SA also received consistent levels of private capital expenditure, that is well above the 10-year benchmark.

PROJECTION

- Private investment is set to improve over the medium to long term in correlation with gradual improvement to the national labour market and wage growth.
- QLD is likely to attract increased private investment as a result of the state government’s effort to strengthen its economy following the end of the mining boom.
- WA is likely to experience slow improvement to private expenditure as its economy continues to adjust to the post-mining era.
- The risk of a reduction in residential property dwelling commencements might have an adverse impact on private investment.

Source: RiskWise, ABS
GOVERNMENT EXPENDITURE

Government spending or expenditure includes all government consumption, investment and transfer payments in each state and territory. This measurement has a similar sentiment to private new capital expenditure and provides an indication of employment market changes, wage growth expectations and spending initiatives that may impact the property market.

**CURRENT STATE**
- Across all states and territories, spending by each government is above the benchmark.
- NSW is undertaking a large number of major projects which is illustrated by its high capital expenditure. This investment is likely to be an engine for economic growth.
- The QLD Government also has a strong focus on infrastructure and job growth. This is illustrated by initiatives such as Advance Queensland, which seeks to bring the best of Australian business to the Sunshine State.

**PROJECTION**
- Overall, government expenditure across all states and territories is likely to continue to increase in the short to medium term. This will be driven by the federal, state and territory governments seeking to mainly improve infrastructure and to drive stronger economic growth in their respective areas.
- These government investments are likely to stimulate the employment market, provide support to an ongoing steady trend of wage growth and generally contribute to economic growth.

* Based on a 10-year average

Source: RiskWise, ABS
CONSUMER SENTIMENT

Consumer sentiment is an economic indicator of the overall health of the economy as determined by consumer opinion. Consumer sentiment takes into account an individual's feelings toward his or her own current financial health, the health of the economy in the short term and the prospects for longer-term economic growth. Consumer sentiment has a direct impact on consumer spending which is typically around 70 per cent of GDP.

CURRENT STATE

- Per the Westpac Melbourne Institute Consumer Sentiment Index, the overall index rose 2.8% from 101.5 in October to 104.3 in November.
- Regarding housing, its 'time to buy a dwelling' index has shown improvement. However, after falling 7.4% in October, consumer expectations for house prices fell 2.3% further in November to its lowest-ever point. The biggest drops are in NSW and VIC, which means that consumers, particularly in those two states, expect further falls in house prices.
- Further, an October 2018 survey by ANZ/Roy Morgan finds consumer confidence falling 6% to its lowest level since last year due to rising fuel prices and declining housing prices.

PROJECTION

- It is projected that consumer sentiment in relation to housing will remain low at least until 2020, with the current credit restrictions and fears over the changes to NG and CGT having a major impact on consumer expectations. Therefore, once the market starts to stabilise following the expected implementation of the taxation changes, consumer sentiment in relation to housing prices will move to positive territory.
- Poor consumer sentiment in relation to housing is likely to have, during 2019, a flow-on effect on the overall consumer sentiment and a negative impact on consumer consumption and consequently on GDP growth.

Source: RiskWise, Westpac
Household consumption relates to household economic wellbeing in that it measures the acquisition of goods and services used for the direct satisfaction of individual or collective wants and needs. This measure is useful for determining how willing households are to spend disposable income on items such as food, clothing, electricity and restaurants. The graph below depicts the quarterly growth in household spending (in percentage).

**CURRENT STATE**
- NSW, VIC, TAS and ACT have delivered higher household spending growth relative to their 10-year benchmarks. This is a good sign of the strength of the economy in those states.
- Meanwhile, all other states produced lower or similar household spending growth compared to their 10-year averages, WA and QLD in particular.
- Furthermore, the September monthly, seasonally-adjusted retail sales figures have risen just 0.2 per cent, which is below market expectations.

**PROJECTION**
- Due to slow wage growth and significant reduction in dwelling prices, it is likely that household spending will only show a modest growth, with a risk for lower growth level in NSW and VIC.
- It should be noted that continued reductions in dwelling prices might have an adverse impact on household spending.

---

Source: RiskWise, ABS
This section provides a small snapshot of what is happening in the housing market, particularly around supply and demand. It should be noted that the RiskWise algorithm used in the creation of reports contains dozens of housing variables. Furthermore, please note that while the analysis is performed on the state level, data at the capital city level is used when applicable and relevant.

Overall, oversupply of dwellings has a significant impact on capital growth and has been flagged as a high-risk area for the property market by lenders. It has a direct impact on specific lending restrictions. The current credit restrictions and the projected impact of the Royal Banking Commission have increased the risk for units, particularly those unsuitable for families. The risk of oversupply has been realised particularly around the CBDs of Brisbane, Perth, Adelaide and Melbourne. Property demand is indicated by both price growth rates and auction clearance rates.

### PRICE GROWTH RATES

### HOUSES UNDER CONSTRUCTION

### UNITS UNDER CONSTRUCTION

### DWELLING SUPPLY TO POPULATION GROWTH

### AUCTION CLEARANCE RATES
Price growth rates give a strong indication of historical housing demand in a particular area and help to assess changes in the property market. Demand could be informed by a variety of factors including migration, jobs, affordability or lifestyle factors. For example, dwellings in affordable areas with good access to the city typically deliver strong growth rates, particularly in unaffordable markets such as NSW.

**Price Growth Rates**

Price growth rates for houses and units are shown in the graphs below. The charts display the percentage change in property prices over the past 3 months, 12 months, and 3 years.

### Price Growth for Houses

- **NSW**: 29% (3-Month), 36% (12-Month), 26% (3-Year)
- **VIC**: 18% (3-Month), 22% (12-Month), 19% (3-Year)
- **QLD**: 8% (3-Month), 10% (12-Month), 8% (3-Year)
- **SA**: 6% (3-Month), 10% (12-Month), 4% (3-Year)
- **WA**: 10% (3-Month), 18% (12-Month), 5% (3-Year)
- **TAS**: 0% (3-Month), 0% (12-Month), 8% (3-Year)
- **NT**: -9% (3-Month), -1% (12-Month), -9% (3-Year)
- **ACT**: -5% (3-Month), -2% (12-Month), -3% (3-Year)

### Price Growth for Units

- **NSW**: 12% (3-Month), 18% (12-Month), 4% (3-Year)
- **VIC**: 6% (3-Month), 10% (12-Month), 2% (3-Year)
- **QLD**: 8% (3-Month), 10% (12-Month), 6% (3-Year)
- **SA**: 0% (3-Month), 0% (12-Month), 2% (3-Year)
- **WA**: -16% (3-Month), -1% (12-Month), -1% (3-Year)
- **TAS**: -16% (3-Month), 0% (12-Month), 16% (3-Year)
- **NT**: 0% (3-Month), 2% (12-Month), 0% (3-Year)
- **ACT**: 8% (3-Month), 2% (12-Month), 2% (3-Year)

### Current State

- NSW and VIC have delivered negative price growth, with price reductions accelerating in Sydney and Melbourne in the past quarter.
- WA and NT are the weakest markets having delivered continuous negative growth in recent years for both houses and units, where units delivered very material losses.
- Houses in QLD delivered reasonable growth over the past three years. However, units carry high risk and are likely to experience negative price growth in some areas.

### Projection

- Dwelling prices in Sydney and Melbourne are likely to experience continuous price reductions until changes to NG and CGT are absorbed into the market.
- Units, particularly off-the-plan, carry a high level of risk of significant price reductions. Areas with high unit oversupply carry a very high risk.
- NT and WA remain soft markets, particularly for units, and changes to NG and CGT will further impact property prices. At this point of time, there are not significant growth drivers in these states, where demand for units, particularly off-the-plan, remains low.

Source: RiskWise, Corelogic
HOUSES UNDER CONSTRUCTION

The number of houses under construction helps to create a forward-looking view around supply and demand. The supply of houses in a particular area may be greater than what the market can absorb, often leading to poor returns. An example of this includes the oversupply of houses in mining towns, inflicting significant losses on investors. Increasing numbers of houses under construction can also be an indication of strong economic conditions in a particular area meaning that high supply should not be analysed in isolation of other statistics.

CURRENT STATE

- The current number of houses under construction is, overall, relatively low, with an addition of 0.6% to 1.3% to the current stock - well below the rate of population growth.

- The latest ABS data shows that house building approvals fell to their lowest level in almost 5 years.

- The combined effects of tighter credit restrictions, the Royal Commission and falling house prices mean that residential builders are facing hard times, which is expected to last for another 2 to 3 years.

Source: RiskWise, ABS
UNITS UNDER CONSTRUCTION

The number of units under construction helps to create a forward-looking view around supply and demand. The supply of units in a particular area may be greater than what the market can absorb, often leading to poor returns. An example of this includes the oversupply of units in Brisbane and Perth, inflicting significant losses on investors. Increasing numbers of units under construction can also be an indication of strong economic conditions in a particular area meaning that high supply should not be analysed in isolation of other statistics.

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
<th>SA</th>
</tr>
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<td>Mar Qtr 18</td>
<td>67,452</td>
<td>49,694</td>
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<td>% of Existing Supply:</td>
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</table>

* Based on 10-year average

CURRENT STATE

- With a very high level of units still under construction, units in many areas carry a very high risk of significant price drops, unless measures are taken to boost demand.

- In particular, off-the-plan units in most of Australia have high settlement risk due to falling unit prices.

- Banks have also stopped lending to Self-Managed Super Funds (SMSFs) so there should be fewer off-the-plan buyers.

PROJECTION

- The current record level of unit supply presents high risk for both buyers and developers. It could take several years for units in the pipeline to be absorbed into the market.

- In the next two years, it is highly likely that new unit commencements will fall sharply. The risk of unit oversupply likely remains high until stock levels significantly decline and the market fully absorbs the impact of potential taxation changes.

- With a large number of development approvals not proceeding to commencement, this area should be closely monitored.

Source: RiskWise, ABS
The dwelling supply to population growth ratio is a useful measure to assess supply and demand. The metric provides an indication of the number of dwellings required to service population growth and therefore provides an indication as to what changes in capital growth property investors can expect. For example, a high ratio indicates that there is an increased likelihood of dwelling oversupply.

**CURRENT STATE**

- NSW, WA and SA and ACT have delivered an increase in dwelling supply over the past 12 months. In those states, supply fluctuates between two and three times that of population growth. These supply increases have often delivered capital growth losses, particularly for off-the-plan properties (the dwelling supply is nearly three times population growth).
- The current number of building approvals is significantly higher than the population growth rate.
- WA, TAS & ACT are showing a slight stabilisation of their dwelling supply to population growth ratio.

**PROJECTION**

- It is highly likely for a significant reduction in dwelling construction to take place in the next couple of years. This will reduce the ratio of dwelling supply to population growth, particularly for units.
- With a large number of development approvals not proceeding to commencement, this area should be closely monitored.

*Based on 100% being the equilibrium point between supply and demand

Source: RiskWise, ABS
The Auction Clearance Rate (ACR) is the percentage of properties on the market that have been sold. The rate is typically measured weekly and give the public, property professionals and decision-makers a good indication as to the current market conditions. A high clearance rates would typically indicate high buyer confidence and a strong residential property market. Therefore low clearance rates would typically indicate a strong buyers’ market and a high clearance rate would mean a strong sellers’ market.

### CURRENT STATE
- Auction clearance rates in all states have fallen in 2018. In NSW, they have fallen below the 50 per cent benchmark with VIC just above 50 per cent.
- Auction clearance rates in both Sydney and Melbourne have shown a significant decline from the second half of 2017 due to the following factors:
  - The lending restriction on investors
  - The cooling property market

### PROJECTION
- Credit restrictions and the impact of the Royal Commission are likely to result in further credit tightening.
- In addition, following the Liberal Party’s leadership spill and the increasing probability of potential taxation changes, it is likely that auction clearance rates will decrease further.
- It is highly likely that the number of properties that are sold under auction will decline with a larger proportion of properties sold under ‘private treaty’.

* NSW & VIC are set at 60% given their status as traditional markets. The rest are 10-year averages

Source: RiskWise, CoreLogic
The measures in this category assess different aspects of housing affordability, the price of dwelling against household income and a variety of serviceability measures. These are: dwelling price-to-income ratio; discounted variable interest rates; investor serviceability ratio; median rental yields; and securitised mortgage arrears rates. Furthermore, please note that while the analysis is performed on the state level, data at the capital city level is used when applicable and relevant.

The less affordable dwellings are, the greater the likelihood for slow / poor capital growth, and vice versa. Affordability measures significantly differ among the states and territories.

HOUSE PRICE-TO-INCOME RATIO ........................................ 27
UNIT PRICE-TO-INCOME RATIO ........................................... 28
MORTGAGE SERVICEABILITY RATIO - HOUSES ...... 29
MORTGAGE SERVICEABILITY RATIO - UNITS .......... 30
DISCOUNTED VARIABLE INTEREST RATES .............. 31
INVESTOR SERVICEABILITY RATIO - HOUSES .......... 32
INVESTOR SERVICEABILITY RATIO - UNITS .............. 33
MEDIAN RENTAL YIELDS ......................................................... 34
**HOUSE PRICE-TO-INCOME RATIO**

Dwelling Price-to-Income Ratio is a measure that illustrates the affordability of a particular property market. This ratio is measured by comparing the mean household income to the median price of dwellings in a particular area. For example, a high ratio indicates an unaffordable property market relative to the average wage in that area (such as NSW & VIC in the graph below).

![Graph showing dwelling price-to-income ratio for NSW, VIC, QLD, SA](image1)

![Graph showing dwelling price-to-income ratio for WA, TAS, NT, ACT](image2)

<table>
<thead>
<tr>
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<th>Proj.</th>
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<td>ACT</td>
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*Our research suggests that a benchmark of 5 is an affordable ratio

**CURRENT STATE**

- Houses in NSW are the most unaffordable in Australia. However, the market is cooling, which is illustrated by the slightly lower price-to-income ratio.

- While VIC has also been unaffordable for people on an average income, there are many suburbs in the Greater Melbourne area offering affordable investment opportunities.

- QLD, WA, SA, TAS & NT are affordable relative to the NSW & VIC markets. As a result, QLD, in particular, has become increasingly popular among investors and home-buyers.

**PROJECTION**

- In the next 2 years, the continuing price reductions from top to bottom in the order of 15 to 20 per cent in Sydney and Melbourne, combined with an annual wage growth in the order of 2-2.5 per cent, will significantly improve housing affordability. The proportion of owner-occupiers and, in particular, first home buyers is expected to increase.

- Should the Labor Party form government next year and change NG and CGT policies, further short-term moderate improvement of housing affordability is likely at least until the second half of 2020.

Source: RiskWise, ABS, CoreLogic
UNIT PRICE-TO-INCOME RATIO

Dwelling Price-to-Income Ratio is a measure that illustrates the affordability of a particular property market. This ratio is measured by comparing the mean household income to the median price of dwellings in a particular area. For example, a high ratio indicates an unaffordable property market relative to the average wage in that area (such as NSW & VIC in the graph below).

*Our research suggests that a benchmark of 5 is an affordable ratio

CURRENT STATE

- Units in NSW are the most unaffordable in Australia. However, the market is cooling, which is illustrated by the slightly lower price-to-income ratio.
- While VIC has also been unaffordable for people on an average income, there are many suburbs in the Greater Melbourne area offering affordable investment opportunities.
- QLD, WA, SA, TAS & NT are affordable relative to the NSW & VIC markets. As a result, QLD, in particular, has become increasingly popular among investors and home-buyers.

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- Should the Labor Party form government next year and change CGT policies, further short-term moderate improvement of housing affordability is likely at least until the second half of 2020.

Source: RiskWise, ABS, CoreLogic
MORTGAGE SERVICEABILITY RATIO - HOUSES

The Mortgage Serviceability Ratio (MSR) is the ratio between the median household income and the amount that is required to service a discounted variable loan, based on an 80 per cent loan-to-value ratio (LVR). The ratio details the affordability, and therefore demand, of residential properties among owner-occupiers, i.e. the higher the ratio, the less affordable a mortgage becomes.

CURRENT STATE
- In NSW, the combination of very high house prices and lending restrictions have led to the highest MSR across Australia for houses. This has had a significant impact on owner-occupier demand, resulting in high interstate migration from NSW to other states.
- While VIC has also been unaffordable for people on an average income, there are many suburbs in the Greater Melbourne area offering affordable houses for owner-occupiers.
- Most affordable houses in Australia in terms of MSR are in the NT, which is likely to remain consistent over the short to medium-term due to falling house prices in the NT.

PROJECTION
- In the next 2 years, the continuing price reductions from top to bottom in the order of 15 to 20 per cent in Sydney and Melbourne, combined with an annual wage growth in the order of 2-2.5 per cent, will improve housing affordability, especially in NSW and VIC. The proportion of owner-occupiers and, in particular, first home buyers is expected to increase.
- Should the Labor Party form government next year and change NG and CGT policies, short-term improvement of housing affordability is likely.

Source: RiskWise, ABS, CoreLogic
The Mortgage Serviceability Ratio (MSR) is the ratio between the median household income and the amount that is required to service a discounted variable loan, based on a 80 per cent loan-to-value ratio (LVR). The ratio details the affordability, and therefore demand, of residential properties among owner-occupiers, i.e. the higher the ratio, the less affordable a mortgage becomes.

**CURRENT STATE**
- In NSW, the combination of very high unit prices and lending restrictions have led to the highest MSR across Australia for units. This has had a significant impact on owner-occupier demand, resulting in high interstate migration from NSW to other states.
- While VIC has also been unaffordable for people on an average income, there are many suburbs in the Greater Melbourne area offering affordable units for owner-occupiers.
- Most affordable units in Australia in terms of MSR are in the NT, which is likely to remain consistent over the short to medium-term due to falling unit prices in the NT.

**PROJECTION**
- In the next 2 years, the continuing price reductions across the country combined with a high level of supply of new dwellings and an annual wage growth in the order of 2-2.5 per cent, will improve housing affordability, especially in NSW and VIC. The proportion of owner-occupiers and, in particular, first home buyers is expected to increase.
- Should the Labor Party form government next year and change NG and CGT policies, short-term improvement of housing affordability is likely.

Source: RiskWise, ABS, CoreLogic
DISCOUNTED VARIABLE INTEREST RATES

A discounted variable interest rate loan is a loan in which the interest rate charged on the outstanding balance is discounted (the actual interest rate) and varies as market interest rates change. As a result, your payments will vary as well (as long as your payments are blended with principal and interest). Different interest rates typically apply to owner-occupiers and investors, particularly if there are lending restrictions.

Discounted Variable Interest Rates (By Owner-Occupiers and Investors)

CURRENT STATE

- Despite the RBA standing pat, Big Four banks have raised their variable interest rates out-of-cycle. Smaller banks have followed suit.
- However, to attract new customers, banks have also offered special discounted rates and other promotions for new borrowers and refinancers.
- Currently, there is a significant gap between the discounted variable interest rate offered to owner-occupiers and investors. This gap of 0.6 per cent is reflective of the increased lending restrictions on investors.

PROJECTED

- As projected, lending restrictions have been slightly lifted by APRA (in particular, the 10 per cent cap on investment lending growth). The lifting of further restrictions is likely to occur if price growth falls to very low levels.
- However, the potential impact of increased scrutinisation of loan applications will likely have a similar effect as credit restrictions.
- Any reduction of discounted variable interest rates for investors is likely to be only to attract new borrowers.

Source: RiskWise, RBA
INVESTMENT SERVICEABILITY RATIO - HOUSES

The Investment Serviceability Ratio (ISR) is the ratio between the gross rental return and the amount that is required to service a discounted variable loan, based on a 80 per cent loan-to-value ratio (LVR). The ratio details the profitability, and therefore demand, of residential properties among investors, i.e. the higher the ratio, the more serviceable a loan becomes. The lower the ratio, the higher the out-of-pocket expenses for property investors.

NSW, VIC, QLD, SA

WA, TAS, NT, ACT

CURRENT STATE

- In NSW & VIC, the combination of low rental returns, higher interest rates for property investors and new lending restrictions have led to the lowest serviceability ratios across Australia for houses. This has had a significant impact on investor demand, resulting in low / negative capital growth across areas in Sydney and Melbourne.
- WA also performed poorly due to its relatively low rental returns across the state in comparison to the 10-year benchmark.
- TAS delivered an exceptional ratio that should be viewed very favourably among investors.

PROJECTION

- It is projected that rental returns will remain largely unchanged over the short to medium term for all states and territories.
- With projected price reductions, particularly in Sydney and Melbourne and potentially rent increases at the inflation rate, it is likely that the investor serviceability ratio will improve. However, the potential taxation changes will have a material negative impact on investor serviceability and in some cases, e.g. Sydney, these changes are equivalent to an interest rate increase of 1.15 per cent.

Source: RiskWise, ABS, CoreLogic
The Investment Serviceability Ratio (ISR) is the ratio between the gross rental return and the amount that is required to service a discounted variable loan, based on a 80 per cent loan-to-value ratio (LVR). The ratio details the profitability, and therefore demand, of residential properties among investors, i.e. the higher the ratio, the more serviceable a loan becomes.

**CURRENT STATE**
- As with houses, in NSW & VIC, the combination of low rental returns, higher interest rates for property investors and new lending restrictions have led to the lowest serviceability ratios across Australia.
- This has had a significant impact on investor demand. WA also performed poorly due to its relatively low rental returns across the state.
- TAS delivered an exceptional ratio that should be viewed favourably among investors.

**PROJECTION**
- It is projected that rental returns will remain largely unchanged over the short to medium-term for all states and territories.
- With projected price reductions for units, particularly in Sydney, Melbourne and Brisbane and potentially rent increases at the inflation rate, it is likely that the investor serviceability ratio will improve. However, the potential taxation changes will have a material negative impact on investor serviceability and in some cases, e.g. Sydney, these changes are equivalent to an interest rate increase of 1.15 per cent.

Source: RiskWise, ABS, CoreLogic
MEDIAN RENTAL RETURN

Rental return is the rental income as a percentage of the property’s value. In this instance, it is calculated as a gross percentage, before expenses are deducted. Median rental returns across a particular area give a broad indication of the rental potential of a particular market. For example, a high rental return would indicate a property market in high demand.

NSW, VIC, QLD, SA

<table>
<thead>
<tr>
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<th>Units</th>
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<td>QLD</td>
<td>4.8%</td>
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<td>SA</td>
<td>4.9%</td>
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WA, TAS, NT, ACT

<table>
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<td>4.5%</td>
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<td></td>
</tr>
<tr>
<td>NT</td>
<td>5.2%</td>
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<td>ACT</td>
<td>4.3%</td>
<td>5.5%</td>
<td>4.5%</td>
<td></td>
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</tbody>
</table>

* Based on research conducted by RiskWise Property Research

CURRENT STATE

- NSW and VIC have consistently underperformed the benchmark, particularly for houses. This is largely due to the significant price growth in those property markets over the past five years and only minor changes to weekly rent.
- QLD and SA both delivered good rental return for both houses and units. South-East QLD, in particular, has become an attractive destination for property investors.

PROJECTION

- While improving, median rental returns are likely to remain low, particularly for houses (but also for units) in NSW and VIC in the short to medium-term.
- Rental returns in QLD, SA, TAS and ACT are likely to remain strong as a result of low housing and high demand. These areas should be targeted by investors seeking affordability and high rental returns in the housing rental market. However, gradual price increases for houses particularly in South-East QLD are likely to result in declining rental return in the short to medium-term across some suburbs.
CREDIT STANDARDS & RESTRICTIONS

Credit Standards & Restrictions are:

1. Measures in relation to residential mortgage lending that are set by APRA (Australian banking regulator) or voluntarily by the lenders to mitigate the financial risks in the Australian property market. These include, among others, ‘black lists’ of areas with potential oversupply of dwellings, a smaller proportion of interest-only loans and a limited growth rate of lending for property investors.

2. Legislation, regulation and tax regimes dictate what property buyers are able to do. These encourage or discourage buyer activity and have a major impact on investor activity in the form of negative gearing and reduced capital gains tax for investment properties.

LEGISLATION, REGULATIONS & TAX REGIMES .......... 36
VOLUNTARY CREDIT RESTRICTIONS .......................... 37
INVESTOR AND HOME-BUYER ACTIVITY .................... 38
STATE & TERRITORY INVESTOR ACTIVITY .................. 39
LENDING VOLUME .................................................. 40
STATE/TERRITORY INCENTIVES AND FOREIGN INVESTOR RESTRICTIONS ........................................ 41
INTEREST-ONLY HOUSING LOANS ............................. 42
LEGISLATION, REGULATIONS & TAX REGIMES

Legislation, regulations and tax regimes dictate exactly what property buyers are able to do. These legal frameworks determine things like who can invest, the funds that can be borrowed and how an investment impacts your tax position. As these laws and regulations are constantly changing, property buyers should be aware of all the challenges and benefits.

CURRENT STATE

- Increased lending scrutinisation as a result of the Banking Royal Commission will likely further cool the property market.

- Foreign buyers are generally required to apply for approval before purchasing residential properties in Australia. Government policy indicates that foreign investment should be channeled into new dwellings.

- Favourable policies around NG have continued to support property investors across Australia.

- The combination of credit restrictions, the Royal Commission and potential taxation changes have already had a major impact on buyer sentiment with consumer housing price expectations hitting their lowest-ever level, as per Westpac's survey (see Customer Sentiment).

PROJECTION

- Recommendations from the Banking Royal Commission to tighten lending could lead to some areas and property types carrying high levels of risk. High-rise off-the-plan units are likely to be the worst impacted property types. Price growth for areas experiencing oversupply and low demand would also likely decline.

- Should the Labor Party form government at the next Federal election, investors should expect changes to NG and the CGT discount. Please see Part 2 Quarterly Theme section for further detailed discussion of this topic.

Source: RiskWise, ATO, Westpac
Banking Credit Restrictions & Standards are based on two factors. First, specific credit restrictions are determined by each lender and go beyond regulatory requirements. Second, credit standards policies and procedures in relation to loan applications, such as scrutinisation of loan applications as required by the Banking Royal Commission. These standards are applied to both investors and owner-occupiers and are often used by banks to respond to market changes. One of their common forms is to have a significantly higher interest rate for investors.

CURRENT STATE

- Major banks have tightened their lending policies. E.g. Banks have stopped lending to Self-Managed Super Funds (SMSFs) so there should be fewer off-the-plan buyers.
- The major lenders have applied significantly higher interest rates on investors. The discounted variable interest rate for investors is currently 0.6 per cent higher than for owner-occupiers.
- Since March 2017, Big 4 banks have slashed their interest-only loans from 40% to 28% of total home loans. This also contributes to reduced investor activity due to significantly higher mortgage repayments, which means significantly higher out-of-pocket funds to service the loan.
- The major banks have already started implementing the loan application scrutinisation standards demanded by the Banking Royal Commission. E.g. Westpac requires disclosure of all debts and has tightened its household expenditure assessment process.
- Due to the Banking Royal Commission, there is very low growth in housing finance, driven by a low volume increase with around a 20 per cent reduction of borrowing capacity.
- There is a sharp rise in home loans issued by non-banks, as major lenders face increased regulatory scrutiny.

PROJECTION

- Credit restrictions targeting investors are likely to tighten, in particular, across inner-city suburbs as the risk of unit oversupply is fully realised.
- The rising non-bank lending trend is likely to continue in 2019 as banks increase their ‘voluntary’ lending standards in preparation for potential changes to NG and CGT.
- While this has some positive market impact, growth in the non-bank sector will not offset the broader lending restrictions by the banks and therefore will not offset the slowdown in credit growth and house prices.

Source: RiskWise, ATO, Westpac
INVESTOR AND HOME-BUYER ACTIVITY

Investor and home-buyer activity is the aggregated value of loan commitments they undertake. The measure checks the proportion of investors and home-buyers. When investor activity is high, it is likely that prices will increase, the number of first home buyers will decline and government policy will change (such as Labor’s plans to restrict NG to new dwellings).

CURRENT STATE
- Total housing finance has fallen to $29.1 billion, the lowest level since August 2014. Owner-occupier loans have posted the largest drop since July 2015.
- Investor lending has also declined to its lowest level since July 2013. Currently, loans to investors only form 33 per cent of total lending.
- This drop is due to the credit restrictions and deteriorating customer sentiment on housing.

PROJECTION
- As the property market produces lower returns for investors, particularly in NSW, lending values among investors are expected to continue their decline. This will likely happen alongside a general cooling of the market. However, lending value may experience a gradual increase among investors in QLD.
- The volume of first home buyers is predicted to increase over the short to medium-term due to ongoing lending restrictions targeting investors.

Source: RiskWise, ABS
Investor and home-buyer activity is the aggregated value of loan commitments they undertake. The measure checks the proportion of investors and home-buyers. When investor activity is high, it is likely that prices will increase, the number of first home buyers will decline and government policy will change (such as Labor’s plans to restrict NG to new dwellings).

**Current State**
- Investor activity has been falling across Australia in recent months. This has been driven by increased lending restrictions specifically targeted at decreasing the number of property investors in the market.
- NSW & VIC has delivered a significant fall in the number of property investors in the market over the past 12 months and, consequently, Sydney and Melbourne have been experiencing continuous price reductions.
- QLD & SA also delivered a slow-down, but to a lesser extent when compared to NSW & VIC.

**Projection**
- With ongoing lending restrictions and cooling property markets, particularly in NSW & VIC, investor lending is likely to remain low over the short to medium term.
- It is likely that QLD will show some increase over the medium term due to its relative affordability and its increasing recognition as a growing investment market for the future.
LENDING VOLUME

Lending volume is the number of new loan commitments signed within a set period. The ABS collects the data on a monthly basis which can be tracked to see the number of new loans approved within any given month. This data is a useful measure to obtain an insight into factors like consumer confidence and market strength.

Based on 10-year average

Source: RiskWise, ABS

CURRENT STATE

- While NSW and VIC delivered constant lending volume growth above the 10-year benchmark, lending volumes have decreased due to credit restrictions and lower demand by home buyers.
- Lending volume in WA has fallen since the end of the mining boom. This change correlates with falling house prices and increasing mortgage arrears rates.
- With an expected reduction of lending volume and reduced borrowing capacity, house prices could be impacted (as seen in the UK which had a 9 per cent drop in volume due to the 2014 Mortgage Market Review).

PROJECTION

- Lending volumes are projected to deliver only moderate growth over the short to medium term. This is a result of the end of the Sydney and Melbourne housing boom and a transition to more moderate growth, as well as declining growth in Melbourne.
- The increasing strength of the QLD economy is likely to attract higher lending demand as investors look to capitalise on the local property market.
- There will be a reduction in activity in areas and property types that require investors to heavily rely on cash flow. For example, off-the-plan units.
The governments of all Australian states/territories provide incentives for first home owners in the form of monetary grants and/or stamp duty exemptions/concessions. On the other hand, they also create restrictions for foreign investors who wish to buy properties in Australia. The following is the list of first home owner incentives and foreign investor restrictions.

<table>
<thead>
<tr>
<th>State/Territory</th>
<th>First Home Owner Grant</th>
<th>First Home Owner Stamp Duty Exemption/Concession</th>
<th>Foreign Investor Restriction</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACT</td>
<td>$7,000</td>
<td>Available on new or substantially renovated properties valued at less than $562,000</td>
<td>0.75% land tax surcharge</td>
</tr>
<tr>
<td>NSW</td>
<td>$10,000</td>
<td>Exemptions from transfer duty on new homes valued up to $650,000 and concessions for new homes valued between $650,000 and $800,000</td>
<td>Stamp duty surcharge of 8% and 2% land tax surcharge</td>
</tr>
<tr>
<td>VIC</td>
<td>$10,000 - $20,000</td>
<td>Exemptions from stamp duty on new homes valued below $600,000 and concessions for new homes valued between $600,000 and $750,000</td>
<td>Stamp duty surcharge of 7% and 1.5% land tax surcharge</td>
</tr>
<tr>
<td>QLD</td>
<td>$15,000</td>
<td>Exemptions from stamp duty on homes valued below $500,000 and concessions for homes valued below $550,000</td>
<td>Stamp duty surcharge of 7% and 0.25% land tax surcharge</td>
</tr>
<tr>
<td>WA</td>
<td>$10,000</td>
<td>Exemptions from stamp duty on homes valued below $430,000 and concessions for homes valued below $530,000</td>
<td>Stamp duty surcharge of 4% (from 1 Jan 2019)</td>
</tr>
<tr>
<td>SA</td>
<td>$15,000</td>
<td>Available on new or substantially renovated units, capped at the stamp duty payable on a $500,000 valued apartment</td>
<td>Stamp duty surcharge of 7%</td>
</tr>
<tr>
<td>TAS</td>
<td>$20,000</td>
<td>No concessions or exemptions from stamp duty</td>
<td>Stamp duty surcharge of 3%</td>
</tr>
<tr>
<td>NT</td>
<td>$26,000</td>
<td>Full concession on the initial $500,000 value of the home</td>
<td>No stamp duty surcharge</td>
</tr>
</tbody>
</table>

Source: RiskWise, online sources
INTEREST-ONLY HOUSING LOANS

As the name suggests, an Interest Only Loan is exactly that, a mortgage whereby your repayments only cover the interest on the amount you have borrowed, during the interest only-period. This type of loan is very popular among investors but it does come with increased risk and costs significantly more in the long-run.

New Interest-Only Loans to Total Residential Loans

CURRENT STATE

- Interest-only loans have become an increasingly popular lending product among investors (around 30 per cent of total leading).

- Lending criteria has the most significant impact on the uptake of interest-only housing loans.

- In March 2017, APRA clamped down on interest-only loans in an effort to cool the property market. The regulator issued that these loans must be restricted to 30 per cent of new residential mortgage loans. This has had a significant impact on the investment housing market.

- The banks have since taken steps to implement these new restrictions, with many lenders applying voluntary measures to further reduce interest-only residential lending (significantly beyond regulatory expectations).

PROJECTION

- It is highly likely that potential further tightening of lending restrictions will further decrease the amount of interest-only loans.

Source: RiskWise, RBA
The jobs & employment category measures the overall health of the labour market in Australia and in each of the states and territories. These measures are: unemployment; underemployment; effective unemployment; and wage growth.

A strong employment market with many employment opportunities triggers stronger migration, higher wage growth and stronger demand for housing. On the other hand, areas that suffer from poor employment opportunities experience poor and often negative property capital growth.
UNEMPLOYMENT

The unemployment rate is calculated as a percentage by dividing the number of unemployed individuals by all individuals currently in the labour force. During periods of recession, an economy usually experiences a relatively high unemployment rate. Unemployment is strongly correlated to poor economic growth.

**CURRENT STATE**

- Australia’s unemployment rate has fallen significantly from 5.5% last year to 5.0%, the lowest level since April 2012.
- The reduction in unemployment is driven mainly by the decline in the size of Australia’s labour force while the increase in new jobs was relatively modest.
- The ACT has consistently delivered low unemployment, largely due to the high supply of government jobs in Canberra. As a result, it is highly unlikely that unemployment in the ACT will rise without a major economic downturn.
- The unemployment rate is still above the benchmark in QLD, WA and the NT.

**PROJECTION**

- Unemployment rates across Australia are predicted to gradually improve in 2019. However, QLD, WA and the NT are still projected to have an unemployment rate above the 10-year benchmark.
- The economy is generally strengthening and is likely to produce stable job growth over the medium to long term.
- However, in the event of declining global economic conditions, expect Australian unemployment to increase, particularly in centres more exposed to economic fluctuations, such as NSW.

*Note:* Unemployment provides limited insight into the job market. To truly understand the health of the job market, underemployment, effective unemployment and wage growth must also be considered.

Source: RiskWise, ABS
UNDEREMPLOYMENT

Underemployment is the under-use of a worker due to a job that does not fully utilise the worker’s skills, is part-time or leaves the worker idle. Examples include holding a part-time job, despite desiring full-time work, and over-qualification where the employee has education, experience or skills beyond the requirements of the job. Underemployment has a similar impact as unemployment.

CURRENT STATE
- The ACT delivered relatively low levels of underemployment compared to the other states. This is largely driven by the strength of the bureaucratic employment hub in Canberra.
- NT also experienced traditionally low underemployment. However, this is unlikely to remain at its impressively low level.
- The underemployment rates in TAS, WA and SA have been high in recent years, due to unfavourable economic conditions that have led to poor job and wage growth.

PROJECTION
- Overall, a stable improvement in the job market is likely to lead to a lower underemployment rate.
- The unemployment rate in QLD, SA and WA are likely to remain above the 10-year benchmark in 2019.
- Underemployment in NT is likely to increase slightly. With growing part-time employment, declining job vacancies and moderating wage growth, labour conditions may suffer in the short to medium-term.
EFFECTIVE UNEMPLOYMENT

The effective unemployment rate is an aggregate of the unemployment rate and measured work hours of underemployment. The measure provides a more accurate picture of the number of people not employed at their full workforce potential.

**CURRENT STATE**

- While effective unemployment across Australia remains above the benchmark, NSW, VIC and the ACT have seen a drop below their 10-year benchmarks. This is good news for the two biggest property markets in Australia.

- While the Australian economy is generating a large number of jobs (306,000 in FY 2017-18), the majority of them are part-time, resulting in high effective unemployment in many states.

- QLD and SA will likely continue the decline of their effective unemployment rates as a result of projected economic growth, which is set to drive employment and wage growth.

**PROJECTION**

- The trend for effective unemployment is likely to improve over the short to medium term. However, this is expected to be slower than anticipated due to high job vacancy levels across Australia.

Source: RiskWise, ABS
**WAGE GROWTH**

Wage growth is the percentage change in weekly income. This data is captured quarterly and shows the movement in wage growth over a 10-year period. Wage growth has a significant impact on housing affordability and median rent. Wage growth has a major impact on inflation and therefore cash rate and interest rates.

![Graphs showing wage growth trends for different regions]

**CURRENT STATE**

- Nationally, the current annual wage growth rate is 2.3%, the highest in 3 years.
- However, all states and territories across Australia still experienced slow wage growth below the 10-year benchmark average.
- In real terms, slow wage growth has continued in the past quarter despite a moderate increase in the demand for labour.
- The public sector consistently outperforms the private sector around wage growth due to moderate demand for working hours by the private sector. Mining wage growth was the poorest performer.

**PROJECTION**

- Lower effective unemployment and a strong Australian economy are likely to deliver a gradual increase of wage growth in the short to medium-term. However, wage growth is very unlikely to reach the 3% a year. Therefore, an interest rate increase is very unlikely at least until the second half of 2020.
- NT and WA are likely to remain the worst wage growth performers as a result of their weaker economies.

*Based on 10-year average

Source: RiskWise, ABS
The population & demographics category measures the overall population growth as well as its components (net overseas migration, net interstate migration and natural increase).

Population growth is a key driver in demand for residential properties by both home buyers and renters, and has a strong correlation with capital growth.
**POPULATION GROWTH**

Population growth provides a good indication of the likely changes in demand within a particular property market. This assists with determining what will could happen regarding growth and return rates for property investors. For example, if population rates decrease, demand and, therefore, returns are likely to stagnate or decline.

- The annual population growth rate for Australia for the year ended 31 March 2018 is 1.6 per cent. This is one of the highest growth rates in the world.
- VIC has delivered exceptional population growth which will likely bring strong long-term demand for the expanding state.

**NATURAL INCREASE (BIRTHS/DEATHS)**

The rate of natural increase is the crude birth rate minus the crude death rate. This rate excludes population increase from immigration and emigration. This metric provides a strong indication of how demographic changes may impact housing demand.

- NSW has shown steady decline likely due to the large number of young families and couples migrating to other states or territories.
- The natural increase rate is likely to fall across all states due to Australia’s ageing population.

Source: RiskWise, ABS
NET MIGRATION: OVERSEAS

Net overseas migration is the net gain or loss of population through immigration to Australia and emigration from Australia. It is an important metric to anticipate property demand at the state and territory level.

- The total number of overseas migrants has declined by 9% annually due to the government's visa changes in 2017.
- NSW and VIC remain the most dominant states for attracting overseas migrants, eclipsing each of the other states and territories.

NET MIGRATION: INTERSTATE

Net interstate migration is the net gain or loss of population through the movement of people from one state or territory of usual residence to another. It is an important component required to calculate Australia’s estimated resident population at the state and territory level.

- Affordability has been the key driving force behind interstate migration. High median house prices relative to the median income in NSW has been causing net migration losses.
- VIC and QLD have dramatically outperformed all other states and have continually been the states of choice for those already living in Australia.

Source: RiskWise, ABS
The objective of this section is to assess the attractiveness of the residential property market against the top two investment alternatives.

For that, the two measures that best reflect the attractiveness of these types of investments are term deposits and the ASX 200. Lack of attractive investment alternatives increases investors’ demand for property, drives prices up, and vice versa. The risk ratings below are based on short-term risk.

<table>
<thead>
<tr>
<th>TERM DEPOSIT RATES</th>
<th>52</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P/ASX 200</td>
<td>52</td>
</tr>
<tr>
<td>AUSTRALIA’S THREE MAJOR ASSET CLASSES HAVE THE LOWEST RETURNS IN 37 YEARS</td>
<td>53</td>
</tr>
</tbody>
</table>
**TERM DEPOSIT RATES**

A term deposit is an investment of cash placed with a financial institution for a fixed period of time, known as the term, with a fixed interest rate for your return at the end of the term. Term deposits typically range from 6 months to 5 years, and deliver a different interest rate depending on the length of term. When there is high volatility and poor returns, the property market is favoured.

<table>
<thead>
<tr>
<th>Current</th>
<th>Projected</th>
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<tbody>
<tr>
<td>Health:</td>
<td>B. Average</td>
</tr>
</tbody>
</table>

- Term deposit rates have consistently declined throughout the post financial crisis period.
- As an alternate investment option, term deposits have produced very poor returns across the major banks.
- Term deposit rates are likely to remain consistently low over the medium to long term in a low interest-rate environment.

**ASX 200**

The ASX 200 index is a market capitalisation weighted and float-adjusted stock market index of Australian stocks listed on the Australian Securities Exchange from Standard & Poor’s. The index provides a good insight into the strength of Australia’s largest companies on the stock market. When there is high volatility and poor returns, the property market is favourable.

<table>
<thead>
<tr>
<th>Current</th>
<th>Projected</th>
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<tbody>
<tr>
<td>Health:</td>
<td>Volatile</td>
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</table>

- Shares and government bond yields achieved the lowest returns in a quarter of a century.
- The ASX 200 delivered significant volatility over the past few years. This has reduced its popularity among ‘mum and dad’ investors relative to ‘brick & mortar’ investments.
- Due to ongoing volatility and uncertainty, investment in equities is a higher risk investment.

Source: RiskWise, RBA, ASX
AUSTRALIA’S THREE MAJOR ASSET CLASSES HAVE THE LOWEST RETURNS IN MORE THAN 37 YEARS

CURRENT STATE

Based on available data from CoreLogic since 1981 (the earliest point when valid data is available), 2018 is the first year in 37 years that two major asset classes (residential property and shares) delivered annual negative returns at the same time. In addition, government bonds only delivered less than 2 per cent return.

This means in 2018 major asset classes delivered either negative or poor returns, well below the return of at least 5 per cent, as expected by investors under typical circumstances. These markets have been impacted by uncertainty in the financial markets, ultra-low interest rates, negative growth in many areas due to lending restrictions, particularly in Sydney and Melbourne, the Banking Royal Commission’s findings, restrictions on foreign investments, poor consumer sentiment and investor fears of taxation changes.

PROJECTION

This is likely to have a flow-on effect on the housing market during 2019 on overall consumer sentiment with ongoing weak wage growth, low household spending and consequently on GDP growth. 2019 is projected to be a year of political uncertainty and economic volatility. The outlook is not expected to improve in the immediate future with investors facing another tough two years across major asset classes, with the majority of properties likely to be depreciating assets in the short term.

Shares also show volatility and uncertainty and this is now even more of a territory for professional investors and fund managers. As more volatility is expected in the financial markets for 2019-2020, uncertainty around international major global events such as the US trade war with China, low interest rates and low growth, it was likely the trend of low returns would continue for the immediate future.

However, there are property markets that carry a lower level of risk and are projected to deliver good overall return (i.e. capital growth and rental return) both in the short and long term, at a variety of price ranges. These include houses in areas that enjoy high demand mainly in southeast QLD and regional areas in Victoria such as Geelong, which achieved 15.1 per cent capital growth for houses in the past 12 months. Another example where houses enjoy strong demand is Queensland’s Sunshine Coast that delivered 6.5 per cent capital growth in the past 12 months and 35.2 per cent in the past five years.
The NSW market, particularly Sydney, enjoyed a very strong property boom until mid-2017, with solid investor activity a key driver behind the outstanding price growth.

However, since then, a combination of unaffordable housing, poor investment serviceability ratio, lending restrictions by APRA, scrutinising of loan applications following the Royal Commission and additional voluntary lending restrictions by the major lenders have led to a quick reduction in dwelling prices, mainly driven by a significant drop in investor activity. According to CoreLogic, dwelling prices in Greater Sydney have declined by 8.1% in the past 12 months. Furthermore, Sydney’s auction clearance rates have consistently fallen below the 50 per cent mark for the past three months.

Overall, Sydney is likely to deliver negative growth over the short to medium term. In particular, Sydney is likely to experience further price reductions over the next couple of years, with an estimated annual reduction of 4-6 per cent in 2019 and 2020. Some regional areas in NSW, however, are likely to hold well.

**PROJECTION**

While overall the NSW market is forecast to deliver weak / negative capital growth for houses and units, the growth is projected to greatly vary across the state. The risk and the potential growth should be assessed suburb-by-suburb and based on the property type and configuration.

**Houses vs Units**

Very low rental returns for houses in Sydney have had a major impact on investor activity and borrowing capacity. In addition, investors are afraid of potential taxation changes that are likely to make houses a depreciating asset in the short term. Traditionally, the Sydney housing market is greatly sensitive to investor activity, therefore, this lack of strong sentiment from investors reduces the overall demand. Furthermore, it has a flow-on effect on auction clearance rates and demand from owner-occupiers. Owner-occupiers no longer fear missing out, so are becoming more conservative acknowledging the fact that the majority of the properties that change hands are likely to depreciate in the short term. They are therefore fearful of ‘paying too much’.
Lending restrictions and scrutinising loan applications have had a major impact on the size and volumes of the loans. Consequently, the high end of the NSW housing market is experiencing stronger price reductions and carries a higher risk in the short term. Examples include Sydney – Inner West and Sydney – Northern Beaches areas, where house prices have declined by 9.4% and 8.1% in the past year, respectively.

However, more affordable areas still show resilience. In particular, some regional areas such as Hunter Valley and Richmond - Tweed still deliver annual capital growth for houses of 9% and 8%, respectively. These areas enjoy very strong demand and carry a lower risk, particularly in the short term.

A large proportion of units in NSW and particularly in Sydney are bought by investors. While the rental return for units is higher than for houses and investors enjoy some taxation benefits from newly built units, oversupply in many areas particularly in Sydney is likely to cause them to become depreciating assets in the short term. Examples of areas in Sydney with unit oversupply include Baulkham Hills - Hawkesbury with 3,810 units in the pipeline (37% increase to the current stock) and Blacktown with 5,951 units in the pipeline (36% increase to the current stock). For these areas, the unit market will become less attractive than houses.
The VIC market, particularly Melbourne, enjoyed a strong property boom until November 2017 due to the combination of the highest population growth across all states, a strong economy and solid investor activity.

However, since then, a combination of unaffordable housing, poor investment serviceability ratio, lending restrictions by APRA, scrutinising of loan applications following the Royal Commission and additional voluntary lending restrictions by the major lenders have led to a quick reduction in dwelling prices. According to CoreLogic, dwelling prices in Greater Melbourne have declined by 5.8% in the past 12 months. In addition, there has been a significant reduction in investor activity. Furthermore, Melbourne’s auction clearance rates have consistently fallen below the 50 per cent mark for the past eight weeks.

Overall, many areas in VIC are likely to deliver poor / negative growth over the short to medium term. In particular, Melbourne is likely to experience further price reductions over the next couple of years, with an estimated annual reduction of 4-7 per cent in 2019 and 2020.

**PROJECTION**

While overall the VIC market is forecast to deliver weak / negative capital growth for houses and units, the growth is projected to greatly vary across the state. The risk and the potential growth should be assessed suburb-by-suburb and based on the property type and configuration.

**Houses vs Units**

Very low rental returns for houses have had a major impact on investor activity and borrowing capacity. In addition, investors are afraid of potential taxation changes that may make houses a depreciating asset in the short term. Traditionally, the Melbourne housing market is greatly sensitive to investor activity, therefore, this lack of strong sentiment from investors reduces the overall demand. Furthermore, it has a flow-on effect on auction clearance rates and demand from owner-occupiers. Owner-occupiers no longer fear missing out, so are becoming more conservative acknowledging the fact that the majority of the properties that change hands are likely to depreciate in the short term. They are therefore fearful of ‘paying too much’.
Consequently, the high end of the VIC housing market is experiencing stronger price reductions and carries a higher risk in the short term. Examples include Melbourne – Inner East and Inner South areas, where house prices have declined by 7.6% and 8% in the past year, respectively.

However, more affordable areas still show resilience. In particular, some regional areas with good access to Melbourne CBD such as Geelong and Ballarat still deliver annual capital growth for houses of 15.1% and 13.7%, respectively. Thus, houses in these areas carry a lower risk in the short and long term.

A large proportion of units are bought by investors. While the rental return for units is higher than for houses and investors enjoy some taxation benefits from newly built units, oversupply in many areas will cause them to become depreciating assets in the short term. Examples of areas in Melbourne with unit oversupply include Melbourne - West with 9,007 units in the pipeline (18.6% increase to the current stock), Melbourne – North East with 7,009 units in the pipeline (16.9% increase to the current stock) and Melbourne – Inner with 24,817 units in the pipeline (10.7% increase to the current stock). For these areas, the unit market will become less attractive than houses.
In recent years, the QLD market has delivered modest capital growth for houses and very poor capital growth for units. Overall, the demand for units among owner-occupiers in QLD is low. Also, in addition to APRA's lending restrictions, units in some suburbs in QLD are also subject to voluntary lending restrictions by the major lenders, such as lower loan-to-value ratio.

The QLD market greatly varies between its high and low-performing areas. This includes the mining towns in Central and North QLD versus houses in popular beachside suburbs on the Gold Coast and the Sunshine Coast that have delivered strong capital growth and houses in popular areas in Greater Brisbane such as Brisbane - West and Brisbane - North, that have delivered a reasonable capital growth in the range of 4% to 5.2% in the past 12 months.

The property markets in Sydney and Melbourne are weak. These markets are also experiencing continued (while improving) issues in relation to housing unaffordability. On the other hand, South-East QLD enjoys good population growth and healthy rental returns. It has become an attractive market for both home-buyers and property investors. However, units, particularly those that are located in the inner-city, continue to perform badly and carry a high level of risk.

**PROJECTION**

**Houses vs Units**

Houses enjoy strong demand in South-East QLD. It should be noted that even areas with a relatively high level of supply of new houses absorb the new stock easily into the market and also deliver capital growth. These include the Sunshine Coast with 6,748 houses in the pipeline (6.2% increase to the current stock) and the Gold Coast with 6,639 houses in the pipeline (4.9% increase to the current stock).

It should also be noted that there are a variety of markets in QLD with the mining towns still presenting a relatively high investment risk due to a very large proportion of investors with negative equity and insufficient growth drivers. For example, the median house price in the QLD – Outback declined by 5.8% in the past 12 months and the area has experienced a weak property market in recent years.

Under normal conditions, it is expected that houses in South-East QLD will enjoy strong capital growth. However, a combination of credit restrictions and potential taxation changes take a lot of energy from this market. Therefore, in South-East QLD, only modest capital growth for houses is expected in the short term.
QUEENSLAND

Units, overall, across QLD carry a high level of risk. In particular, units in inner-city Brisbane which have the highest level of risk with a very large number of properties in the pipeline and increased rates of defaults for off-the-plan units. In addition, in QLD, houses are traditionally considered the more popular dwelling option. So, usually the demand for units is relatively low by comparison.

Furthermore, some areas in QLD are flagged as 'danger zones' by lenders and therefore present a major financing barrier with a high deposit required. Also, fears of taxation changes have a potential impact on property investors. Weak markets (e.g., mining towns) and areas with unit oversupply are particularly susceptible to the impact.

Therefore, units in QLD, in particular off-the-plan units, carry a high level of risk that should be further assessed during and following the potential implementation of taxation changes as well as the absorption of the current supply into the market in the next two years and the reduction in unit commencements.
In recent years, the SA market has delivered modest capital growth for houses and poor capital growth for units. While the labour market has significantly improved in the past couple of years, the effective unemployment rate in SA is still above 8% and the employment market is still relatively soft. This has a strong connection with low population growth (only 0.7% per annum) and, therefore, low demand for dwellings in SA.

Further, overall the demand for units among owner-occupiers in SA is low. Also, in addition to APRA’s lending restrictions, units in some suburbs of SA are also subject to voluntary lending restrictions by the major lenders, such as lower loan-to-value ratio (i.e. higher deposit).

However, the housing market is showing some evidence of recovery, particularly with its steady recent price growth rate and high levels of public and private expenditure. The state also offers a healthy rental return for both houses and units.

**PROJECTION**

SA is projected to continue its economic growth improvement, however, this is a slow process and is unlikely to result in significant changes to the demand in the short to medium term.

**Houses vs Units**

The demand for houses is projected to remain moderate and, therefore, only moderate capital growth is forecast. However, the growth rate is projected to vary greatly across SA. For example, houses in areas close to the Adelaide CBD such as Adelaide Central and Hills are likely to deliver better growth. Meanwhile, houses in areas that do not enjoy good growth drivers are likely to deliver poor / negative capital growth. For example, according to CoreLogic, the median house price in the SA – Outback area declined by 7.4% in the past 12 months and the area has experienced a weak property market in recent years.

While overall the demand for houses is reasonable, particularly among owner-occupiers, the demand for units in SA is low. Units are not considered a popular dwelling option among families. Further, in some areas, there is unit oversupply. The Adelaide Central and Hills area has the highest rate of unit oversupply in SA with 5,378 units in the pipeline (a 17% increase to the current stock). This unit oversupply led to negative capital growth of -0.5% in the past year. Overall, units in SA are likely to deliver poor capital growth. In particular, off-the-plan units in high rises, which are unsuitable for families, carry the highest level of risk.
The WA economy has started to rise from the doldrums. There are good signs that the mining sector has begun to recover, which bodes well for a mining-dependent state like WA. For example, mining exports of LNG and coal have hit record figures. Plus, the number of heavy industry projects in WA has significantly increased. As the economy gets back on track, it should bode well for the local property market.

However, overall, the economic activity in WA is well below its 10-year average and WA’s effective unemployment is still significantly above the 10-year benchmark. Consequently, its population growth of 0.83% is very low, the third lowest nationally. As a result, the housing market, particularly units, has experienced continued weakness in recent years. According to CoreLogic, house and unit prices in Perth have declined by 3.8% and 5.8% in the past year, respectively. WA is still in a long transition process from a mining-oriented economy to a more diverse economy.

PROJECTION

While its economy has recently improved, WA is projected to deliver low economic growth, a soft job market and low population growth. Also, due to APRA’s lending restrictions, units in some suburbs of WA are subject to voluntary lending restrictions by the major lenders, such as lower loan-to-value ratio (i.e. higher deposit).

In addition, the WA government has introduced a new tax on overseas investors. Starting from 1 January 2019, foreign buyers are required to pay a 4% surcharge on all residential property purchases. This tax is expected to decrease demand at a time when the WA property market desperately needs measures to boost supply following the adverse impact that the lending restrictions have on this market.

Furthermore, mortgage arrears in WA are at an alarming level. This number has grown over the course of several years and is now well above the Australian average.

Lending restrictions introduced across Australia had the most impact in this market than other areas in the country thanks to its weaker economy. Perth prices, which had stabilised, once again started falling. The impact is expected to increase if a blanket approach is also taken when introducing the proposed taxation changes.
Houses vs Units

While Perth is very affordable, the overall demand for both houses and units is low and the risk associated with units is even higher than the risk associated with houses. While there is a small number of suburbs where houses have delivered reasonable or good capital growth in recent years, these are exceptions only. Overall, houses carry a high level of risk due to the economic conditions in WA.

Units carry a very high level of risk to deliver poor or negative capital growth, due to the combination of oversupply, lending restrictions and low demand. The Perth - Inner area has the highest rate of unit oversupply in WA with 3,769 units in the pipeline (a 9.4% increase to the current stock).
Houses in TAS have delivered exceptional capital growth in recent years, particularly in 2017. This is driven by low supply, affordable houses and an exceptionally high investor serviceability ratio. Therefore, houses in TAS have delivered both strong capital growth and rental returns.

While units have also delivered strong growth, they carry a higher level of risk due to the relatively high number in the pipeline compared to population growth. The relatively high proportion of units that are investment properties also increases the risk associated with such properties.

**PROJECTION**

**Houses vs Units**

It is likely that houses in TAS will deliver solid capital growth in the short term, however, a decrease in the growth rate has already started and this is highly likely to continue decelerating. For instance, according to CoreLogic, the annual price growth for houses in Hobart is 9.7% compared to 13.4% last year.

Houses carry a low risk level as approximately 86 per cent of the houses in TAS are owner-occupied. Also, houses in high-demand areas, particularly affordable houses, still present very low risk. Furthermore, unlike some other states, lending restrictions have not yet impacted the TAS market.

However, as TAS house prices continue to rise, they are becoming less affordable due to the low median household income in TAS. Less affordability means less demand, which affects the price growth. Currently, TAS is the third least affordable state/territory in Australia with a house price to income ratio of 6.4.

While units are also projected to deliver solid capital growth in the short term, they carry a higher level of risk due to the relatively large number in the pipeline. There are a number of risk factors that may have a negative impact on units in the medium to long term. For example, off-the-plan units carry significantly a higher level of risk.

Furthermore, the unit-to-house price ratio in TAS is high. Our research shows that, statistically, if the unit-to-house ratio exceeds 65 per cent it makes houses a much better investment option for buyers with significantly higher capital growth. Conversely, if it falls below 45 per cent, units are preferred. In Greater Hobart, the median unit price is $391,000, while the median house price is $481,000, placing the unit-to-house ratio at 81 per cent.
The NT has experienced negative capital growth in recent years due to very low population growth, which is the lowest in Australia. While dwelling supply in relation to population growth is low and dwellings are very affordable, the low demand for housing makes the NT a risky area. The major reason behind the low demand is a low level of private investment that is significantly below the growth levels during the mining boom. The end of the mining boom has had a detrimental effect on the population growth, and therefore on the overall demand for residential properties. Combined with a relatively large supply of units, it has resulted in negative capital growth for units and, to a lesser extent, for houses in recent years.

PROJECTION

With low population growth and below average economic indicators, the NT still carries a high level of risk. However, improved housing affordability slightly reduces the risk associated with houses from medium-high to medium.

It is likely that houses in the NT will deliver poor or negative capital growth in the short term although houses also carry a low level of risk since more than 68 per cent of the houses in NT are owner-occupied.

The current supply of units, while not considered high in relation to population growth, still exceeds the low demand for them, particularly in areas with a high concentration of off-the-plan units, such as Darwin with 1,853 units in the pipeline (9.3% increase to the current stock). Therefore, units carry a high level of risk and are projected to continue delivering negative capital growth in the short term.

Furthermore, should the Labor Party form the next government, it is likely that the NT housing market will be a victim of unintended consequences from the blanket implementation of taxation changes.

**Houses vs Units**

Houses have been slightly upgraded from medium-high risk to a medium level of risk.

Units carry a very high level of risk to deliver negative capital growth, due to the combination of oversupply, lending restrictions and low demand.
Houses in the ACT have delivered solid capital growth in recent years. While this growth is more moderate since the second half of 2017, the current growth is still solid. This is largely driven by solid economic growth and a relatively low level of effective unemployment.

Units, however, have delivered only a 7.6% capital growth rate in the past 3 years, mainly driven by low demand combined with a large number of new units.

PROJECTION

While overall houses in the ACT market carry a relatively low level of risk in the short term and are projected to deliver solid capital growth, particularly in the medium to long term, the growth is forecast to greatly vary across the Territory. The risk and the potential growth should be assessed suburb-by-suburb and based on the property type and configuration.

The ACT has consistently delivered strong economic growth. Its growth rate at 4 per cent eclipses the rest of the country and provides a strong indication of its future. This is supported by healthy levels of both private capital expenditure and government expenditure.

These conditions are favourable for a strong housing market and make it an attractive destination for property buyers. ACT also enjoys a high investor serviceability ratio. This has significantly benefited investors who have found it easy to service their loans relative to the rest of the property market.

However, the unit market in the ACT suffers from a large number of new dwellings relative to its population growth. Combined with an overall preference for houses over units, this presents a greater risk for units.

**Houses vs Units**

Houses, particularly affordable houses, still present relatively low risk due to high demand from first home buyers and owner-occupiers at the lower end of the market.

However, the risk associated with units is higher, particularly in high-supply areas such as Kaleen and Weetangera. In particular, off-the-plan units that are unsuitable for families carry the highest level of risk. Premium units that appeal to small numbers of buyers also carry a high level of risk due to projected lower demand from both investors and owner-occupiers.
PART TWO

QUARTERLY THEME:

IMPACT ANALYSIS: NEGATIVE GEARING, CGT & AUSTRALIA’S RESIDENTIAL PROPERTY MARKETS

This section includes an overview of the Labor Party’s proposed changes to Negative Gearing and Capital Gains Tax and their impact on the entire property market.
ALP proposed negative gearing and capital gains tax policies won’t achieve all their objectives

The Australian Labor Party (ALP) proposed in 2016 to reform negative gearing (NG) and the capital gains tax (CGT) discount with the stated intention being to increase accessibility to home ownership, improve housing affordability, and to strengthen the Budget position through reducing subsidies.

From the second half of 2017, the risks associated with the residential property market increased significantly. Credit restrictions have had a direct impact on the Australian housing market. As a result, dwelling prices in Sydney and Melbourne showed a decelerating growth rate, followed by price reductions in Sydney and, to a lesser extent, Melbourne. In a relatively short period of time, the landscape of residential property in Australia changed significantly.

Key Findings

In the body of this report we have detailed the key results arising from our modelling and market analysis. Key findings, supported by modelling and evidence compiled from comprehensive housing market data, include:

Dwelling prices to decline / growth to decelerate: in the short term, dwelling prices will decline (or price growth will decelerate), and significantly so in some cities and regions.

Varied degree of impact: our modelling considered all of Australia’s states, territories and Statistical Areas (SA4s) by dwelling type. SA4s with a high proportion of investors and units will be among the most significantly impacted, although in some cases house prices will experience even more material declines.

We modelled the potential impact for houses and units across all states and territories, while accounting for the reality that investment properties and owner-occupier dwellings are not fully substitute products. The state level impacts on price growth are tabulated below, though it should be noted that the results for houses and units differ greatly across the SA4s. The housing market risks and impacts also vary greatly across the SA4s, with our findings based upon aggregation analysis.

<table>
<thead>
<tr>
<th></th>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
<th>WA</th>
<th>SA</th>
<th>TAS</th>
<th>ACT</th>
<th>NT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Houses</td>
<td>-9%</td>
<td>-9%</td>
<td>-6%</td>
<td>-7%</td>
<td>-6%</td>
<td>-3%</td>
<td>-6%</td>
<td>-7%</td>
</tr>
<tr>
<td>Units</td>
<td>-9%</td>
<td>-6%</td>
<td>-7%</td>
<td>-10%</td>
<td>-6%</td>
<td>-2%</td>
<td>-2%</td>
<td>-10%</td>
</tr>
</tbody>
</table>

Housing affordability - short-term and medium-term impacts: while there will be some moderate improvement in housing affordability in the most expensive housing markets in the short term, over the medium term the impacts of the proposed policies on housing affordability will be limited once a new equilibrium has been reached. In more affordable housing markets where demand is already weaker, the policies will dampen demand further, so mitigating policies may be required in some regions.
Dwelling commencements and supply: the proposed policies will result in a reduction in dwelling commencements as prices decline unless measures are taken to encourage new supply, particularly in Sydney and Melbourne where the demand for rental housing is presently strongest. The sharp increase in dwelling prices in Sydney and Melbourne partly reflects the fact that the supply of housing has been unable to keep pace with strong demand. Housing affordability cannot be adequately addressed without increasing the supply of housing. Although middle-ring capital city suburb development has increased in recent years, including for high-rise apartments, the supply of family appropriate, medium-density housing must be increased. This imbalance in dwelling construction has been a contributory factor to housing affordability challenges in the two most populous capital cities.

Primary and secondary markets: the proposed changes will result in the creation of two types of properties from a prospective investor’s perspective. There will be a primary market comprising new properties that qualify for negative gearing tax concessions and a secondary market, comprising second-hand dwellings that do not. The different status of these properties will have a significant impact on both buying and selling decisions by property investors with a flow-on effect to dwelling prices.

Rental affordability: impacts on the rental market will be significantly varied across the capital cities and SA4s. In some locations there may be instances of rising rents in the short term where imbalances and shortages of rental properties arise, and dwelling commencements experience a slowdown, although these imbalances may take 12 to 24 months to become evident.

Fiscal challenge: while there may be some initial adverse impacts on stamp duty receipts and company tax receipts through the reduction of investor activity in the market, the proposals will partly achieve the objective of improving the Budget deficit.
Following the findings detailed in this report, a variety of measures should be considered, to be implemented at the SA4 level. The following recommendations are only a high-level overview of some measures that should be undertaken as part of a detailed action plan.

The proposed recommendations below relate to measures to increase dwelling supply and, by doing so, address housing affordability issues in the medium and long term. They also address demand-related measures to mitigate unintended consequences or material dwelling price corrections that may lead, in some SA4s, to a sustained weakness in the property market.

While the supply-related measures tend to be aligned with conventional proposals, the demand-related measures are, at times, unconventional, their objective being to minimise unintended consequences in some SA4s.

**1 Supply-related measures**

**1.1 Plan to address appropriate dwelling supply**

The proposed ALP policies will see dwelling commencements slow as prices and investor demand decline. A co-ordinated strategy needs to be put in place to encourage construction of owner-occupier appropriate dwellings in the middle-ring suburbs, including local government area (LGA) targets benchmarked against projected demand.

Key emphasis should be put on delivering more medium-density dwellings in the middle-ring suburbs. As there is a consistent undersupply of residential properties suitable for families in the Sydney and Melbourne markets, without a strategic and comprehensive solution it is likely that the current supply and demand patterns will once again lead to escalating prices.

To address this issue, we advocate increasing density in middle-ring and outlying areas of the cities, provided there are adequate transport solutions to access employment. Development in middle-ring suburbs has increased in recent years, especially in Sydney, however today’s record levels of housing construction are the bare minimum needed to meet the elevated level of population growth in the two major capital cities, which is being driven by net overseas migration.

Both the New South Wales and the Victorian state governments acknowledge the supply issue, and there are strategic initiatives to address them. In New South Wales, the Low Rise Medium Density Housing Code allows one and two-storey dual occupancies, manor houses and terraces to be carried out under a fast-track complying development approval scheme. The Victorian government has formed the Precinct Structure Planning system to deal with strategic planning in relation to the development of growth area land and add certainty to the timing of development. There is a risk that these programs will not be sufficient to address the prevailing challenges and significantly improve housing affordability.

Therefore, a more comprehensive approach should be considered, including measures at the state level, particularly in relation to planning, greenfield land releases, rezoning and a more co-
ordinated approach between the states and local governments in relation to those matters. In addition, a mechanism should be considered from the Federal to the State Governments and from the states to the local governments, where there is an incentive for meeting pre-approved development targets and increasing dwelling supply.

1.2 Zoning for key transport corridors

Following the 'plan to address appropriate dwelling supply' above, special attention should be placed on a strategic plan for re-zoning in key transport corridors and train lines. A significant increase to dwelling density along already existing transport corridors is less costly and can be delivered more efficiently than the development of new transport corridors and train lines. In addition to re-zoning, measures need to be implemented to accelerate the planning and approval processes and to incentivise local governments that development meet pre-agreed targets in relation to dwelling supply. The highest priority areas are middle-ring suburbs that experience strong demand.

1.3 Transport infrastructure plan - a co-ordinated plan to improve public transport accessibility to key employment markets. The 2018 Federal Budget allocated significant funding to infrastructure upgrades in many urban and regional areas. This will likely have a positive impact on dwelling supply to local property markets that will benefit from the infrastructure upgrade. These include major projects such as the Melbourne North East Link (Victoria's largest ever transport project is set to progress with the Federal Government committing $1.75 billion), the rail upgrade in Monash (the City of Monash is set to receive a major transport upgrade with $475m allocated to the planning and pre-construction work required for the proposed Monash rail link), and the first stage of the North South Rail Link, connecting two of the busiest commuter rail lines in Sydney. However, additional infrastructure upgrades are still required, particularly in Sydney, to improve public transport accessibility to the Sydney CBD, with a high proportion of service sector jobs being created in central urban locations.

1.4 Land supply

Governments should be encouraged to increase land supply release and development through co-ordinated strategies and targets. While land supply in Sydney and to a lesser extent Melbourne is limited in the inner and middle-rings, there is a certain level of supply in surrounding suburbs. Much of this greenfield development in Melbourne is less than 30 kilometres from the CBD; in Sydney it tends to be more than 40 kilometres from the CBD.

Land releases in the outer suburbs are essential, particularly in Sydney, to support the other supply-related measures that have been detailed above. The outer suburbs are significantly more affordable, and they provide an opportunity for first home buyers to enter the property market.

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1 Similar recommendations have been made by John Daley and Brendan Coates in the Grattan Institute Report regarding housing affordability, March 2018.


3 Similar recommendations have been made by John Daley and Brendan Coates in the Grattan Institute Report regarding housing affordability, March 2018.
2 Demand-related measures

Some of the SA4s, such as Mackay⁴, are likely to experience further sustained weakness in the housing market should the proposed changes be implemented. Therefore, to minimise an unintended consequence of the proposed measures in the form of severe price corrections, the following measures should be considered:

2.1 Stamp duty exemptions for first home buyers and downsizers

We recommend that stamp duty exemptions for first home buyers and downsizers be introduced in some SA4 regions. Stamp duty concessions for first home buyers have proven to be an effective measure to increase demand and the share of first home buyers and to minimise price reductions.

Some states and territories provide exemptions or concessions on stamp duty for first home buyers on eligible properties under a certain amount. However, in South Australia stamp duty concessions for first home buyers are available on off-the-plan apartments only and Tasmania offers no concessions.

Yates (1999) and the Productivity Commission (2004) have demonstrated growing accessibility problems among younger age groups and concerns have been raised about how stamp duties are adding to the cost of buying a home, especially for first home buyers. The 2008 Senate Select Committee on Housing Affordability recommended that ‘all state and territory governments consider stamp duty exemptions for first home buyers’. In fact, state governments have in recent years taken steps to address accessibility issues by raising duty free thresholds and making bonuses available to first home buyers.

In 2012, the ACT Government began a 20-year program to abolish inefficient and unfair taxes, such as duty on property transfers and insurance premiums. In addition, according to the Treasury, removing stamp duties would also improve the supply of housing, as well as reduce a range of other adverse impacts on the housing market.⁵ Therefore, it is recommended that in order to support the demand for dwellings in some SA4s, stamp duty exemptions for first home buyers and downsizers should be introduced.

2.2 First home buyer incentives

While first home buyer incentives are generally considered to have an adverse impact on housing affordability over time, incentives should be considered in relation to regions and SA4s where affordability challenges are not acute and where markets are expected to experience significant declines if the proposed policies are implemented. As detailed below, first home

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⁴ Mackay has been experiencing a weak property market following the end of the mining boom with dwelling prices decreasing significantly over the past 5 years.

buyer incentives are commonly used in Australia and have been proven to be an effective measure to increase demand and activity of first home buyers.\(^6\)

The First Home Owner Grant (FHOG) scheme was introduced on 1 July 2000 to offset the effect of the GST on home ownership. While a national scheme, it was funded and administered by the states and territories. The scheme facilitated a one-off grant to first home owners provided they satisfied certain eligibility criteria, the amount dependant upon where the first home buyer was based.

A report by the RBA showed that there have been around 110,000 first home buyers who had purchased houses with debt, on average, each year since the mid-1990s, with the total number peaking in 2001 at 187,000 following the introduction of the First Home Owner Grant (FHOG).\(^7\)

The report stated that “The introduction of the Commonwealth Additional Grant (CAG), which operated between March 2001 and June 2002 would also have contributed to the bringing forward of some first homeowner purchases into the qualifying period ... More recently the unwinding of these effects has contributed to a decline in the number of first-home buyers to quarterly levels of around 30,000, or a little below the medium-term average. This decline has occurred at a time when financing for repeat buyers has been growing very rapidly and, as a result, the share of first-home buyers in total finance approvals for owner-occupied housing (excluding refinancing) has fallen sharply”.

Data on FHOGs shows the average price paid by first home buyers is lower than the median metropolitan house price. The RBA report states this includes apartments and that first home buyers tend to choose more affordable areas. In addition, according to the ABS in March 2018: “The number of first home buyer commitments as a percentage of total owner-occupied housing finance commitments recorded strong growth from July 2017 to November 2017. The increase has been driven mainly by changes to first home buyer incentive programs in New South Wales and Victoria”.\(^8\) Therefore, FHOGs can be used as an effective measure to support demand, as required.

### 2.3 Build to rent

Due consideration should be given to incentives for institutional investors to develop affordable rental housing. While Australia is yet to introduce such a policy, Build to Rent (BTR) solutions, whereby multi-unit residential dwellings are designed and built to be rented out by a longer-term single owner, could not only positively assist with the rental market, according to research by JLL, it could also help address housing affordability. JLL states government incentives to

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improve the feasibility of BTR for social and affordable housing schemes may assist in addressing this complex issue”.\(^9\)

JLL further projects that if changes to the taxation legislation cause private sector investment in housing to drop, that BTR may prove critical in replacing private investment with institutional investment to ensure continued growth in the availability of rented accommodation. In other words, the scheme could boost the development of large-scale affordable rental housing.

### 2.4 Non-resident investors

Figures from the Foreign Investment Review Board (FIRB) have shown that non-resident investors have played a significant role in stimulating new dwelling supply through this cycle. Recently implemented surcharges and duties for non-resident buyers have slowed transactions significantly and, in the prevailing environment, will have the unintended consequence of a slowdown in dwelling commencements. We recommend that surcharges are removed for non-resident buyers, as required, to support demand for some property types in SA4s that are likely to be significantly impacted by the proposed changes.

The surcharges and duties for non-resident buyers are generally justified on the basis they reduce foreign competition for residential property, which in turn alleviates pressure on prices. Queensland has also introduced an Absentee Land Tax, Victoria an Absentee Owner Surcharge and NSW imposes a land tax surcharge. Furthermore, the Federal Government in this year’s Budget handed down in May 2018, introduced an annual charge to foreign investors if their property was not occupied or available to rent for at least six months of the year.

“The new charge builds on the Government’s existing foreign investment regime which seeks to increase the number of houses available for Australians to live in. The charge provides a financial incentive for the foreign owner to make their property available on the rental market if they do not intend to reside there.”\(^10\)

The government Budget reported that it has also stopped foreign and temporary tax residents from claiming the main residence CGT exemption when they sell property in Australia. It has increased the foreign resident CGT withholding regime by increasing the withholding rate from 10 per cent to 12.5 per cent, as well as increasing the number of foreign residents caught by the regime by reducing the threshold from $2 million to $750,000. This is aimed at reducing the risk that foreign residents avoid paying the CGT liability they owe in Australia.

As noted above, the surcharges and duties for non-resident buyers have created a significant reduction in activity in the property market and, as a result, the unintended consequence of which is apartment projects failing to secure sufficient pre-sales to satisfy financiers, and in turn a forthcoming slowdown in dwelling commencements. Therefore, the removal of the surcharges for non-resident buyers should be considered, as required, to increase demand in some SA4s.

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For the full version of IMPACT ANALYSIS: NEGATIVE GEARING, CGT & AUSTRALIA'S RESIDENTIAL PROPERTY MARKETS, please contact:

clynton.robertson@riskwiseproperty.com.au
**EQUITY RISK DEFINITIONS FOR OVERALL HOUSE AND UNIT PRICE REDUCTIONS**

**Equity Risk:** the risk of purchasing a property that will decrease in value or will deliver a lower return compared to the long-term capital growth projections.

<table>
<thead>
<tr>
<th>RISK RATING</th>
<th>DEFINITIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>1. Unless there is a significant slowdown in the property market, there is only a low risk that properties in this area will not return an increase, on average, of at least 3% a year in the next two years.</td>
</tr>
<tr>
<td></td>
<td>2. There is high demand for this area in any market condition. It is likely to be easy to sell and achieve the property market value, even in a weaker market, so providing a good return against a low risk.</td>
</tr>
<tr>
<td>Low-Medium</td>
<td>1. There is a risk that the value of properties in this area will not return an increase, on average, of 3% a year in the next two years.</td>
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<tr>
<td></td>
<td>2. It is unlikely that the price of properties in this area will be reduced in the next two years. Any price reduction over this period will probably not be more than 5% below the original purchase price.</td>
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<tr>
<td></td>
<td>3. Overall, there is a relatively high demand for this area. However, in a weaker market, properties in this area may take longer to sell, and a small discount, around 5%, might be required.</td>
</tr>
<tr>
<td>Medium</td>
<td>1. It is possible that property values in this area will not increase by an average of 3% a year in the next two years, creating a risk of a poor return. This would be particularly the case in a weaker market.</td>
</tr>
<tr>
<td></td>
<td>2. It is unlikely, but possible, that the price of properties will be reduced by 5-10% in the next two years, particularly if sold in a weaker market.</td>
</tr>
<tr>
<td></td>
<td>3. Demand for this area could be relatively low and unless the market is ‘strong’, it is possible that properties in this area will take longer to sell and may require a price discount of 5-10%.</td>
</tr>
<tr>
<td>Medium-High</td>
<td>1. It is possible there will be no capital growth on properties in this area over the next two years, creating a risk of a poor return.</td>
</tr>
<tr>
<td></td>
<td>2. There is a risk that the property values across the area will decrease by 10% or more in the next two years.</td>
</tr>
<tr>
<td></td>
<td>3. There could be a low demand for this area and it is possible that it will be difficult to sell at the market value, even after some time on the market.</td>
</tr>
<tr>
<td>High</td>
<td>1. It is possible that the value of properties in this area will decrease by 10% or more in the next two years, creating a significant risk of a poor return.</td>
</tr>
<tr>
<td></td>
<td>2. It is possible that there will be little demand for this area and it will be very difficult to sell without absorbing a loss.</td>
</tr>
<tr>
<td>Extreme</td>
<td>1. Unless there is a sudden and unexpected outstanding demand for similar properties in the area, it is unlikely that there will be any capital growth in the foreseeable future. Property prices in this area are likely to remain unchanged or significantly decrease. This creates a significant risk of zero or negative return.</td>
</tr>
<tr>
<td></td>
<td>2. It is likely that it will be very difficult to sell properties in this area due to the following: There will be a very limited number of serious buyers; Buyers will be struggling to get the needed loan from a lender.</td>
</tr>
<tr>
<td></td>
<td>3. A significant discount (of 10-20% or more) from the 'market value' might be required during the negotiation.</td>
</tr>
</tbody>
</table>
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