

Media Source: Domain Property Review
Date of Publication: 13th December 2009
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House Calls: what to expect in 2010

Drama

Between the boom of 2007, the global financial crisis of 2008 and the shock recovery of 2009, drama is just about the only thing that hasn't been in short supply for the property market.

Prices, interest rates, demand, confidence. They've all soared, tanked and then (mostly) soared again, following wild trajectories that have stumped consumers and market watchers. But, with the economic outlook stable, and strong fundamentals underlying the Melbourne market, there's growing consensus that 2010 just might herald a return to a little stability.

Prices

After the calamitous end to last year and the limp start to this year, no one expected prices would hit levels close to those seen in 2007 - and many of these driving factors will still be in play in 2010.

RP Data-Rismark reports that Melbourne property values grew by 14.9 per cent in the year to October, the strongest increase recorded in any metropolitan area in the country.

This surge has been attributed to a combination of the first home-owners grant, low interest rates, strong population growth (around 1700 people emigrate to Melbourne each week), a persistent shortfall in the number of properties in established suburbs.

Property analysts consulted by Domain expect the growth rate of Melbourne's metropolitan house price to slow in 2010 as the interest rate increase and the federal first homeowners grant is cut back.

"We can't continue these 4 and 6 per cent quarterly growth rates," said Matthew Bell, economist with Australian Property Monitors, which is owned by Fairfax. "I think growth will be positive but moderating probably throughout the year."

Melbourne's (relative) affordability compared to other cities, its strong population of growth and the likelihood of an ongoing stock shortage are all good indicators that prices will continue to rise, albeit at a more modest and measured pace.

"We have projected that capital growth rates (for 2010) would be single digit rather than double digit going forward," said Christopher Joye, managing director of Rismark International.

BIS Shrapnel senior analyst Angie Zigomanis estimates metropolitan prices will rise 5 to 7 per cent over next year. "We think that some of the activity falling off at the bottom end (in the first homeowners market) will reduce some of the impetus for people to upgrade ... but it won't be dramatic".

On January 1, the first home-owners grant is due to be cut back to pre-crises levels, with \$7000 available for both new and existing homes. Victorians spending less than \$600,000 are eligible for an additional \$2000 for an existing home or \$11,000 for a new home from the State Government.

The drop-off in the number of new home buyers is likely to ease competition below the \$600,000 price level, which has been intense for most of the last 12 months.

"There'll be a plateauing of prices. I think there will be some areas where there are price falls where it's been bid up too high. Broadly, I think we'll see a bit of slowing in activity, which is inevitable given so much purchasing was brought forward," Mr Bell said.

Supply vs Demand

This year's market was defined by a shortage in the number of properties available for sale in established inner and middle suburbs - witness the 81 per cent clearance rate for the year to date - and this trend is likely to continue.

"There's been a lot of confusion among homeowners in 2008 and 2009 about what was happening in the housing market. People who don't have to sell aren't voluntarily selling," said Mr Joye. "There may also be a dynamic that people who are interested in selling are worried they won't be able to find something because nearly everything that comes on the market sells pretty quickly."

While there is expected to be a small increase in the number of "distress sales" as interest rates rise, it could take some time before the market sees any noteworthy increase in stock - let alone at a level that can meet existing demand.

"There are already a lot of unsatisfied buyers in the marketplace across all price brackets," said buyer's agent Janet Spencer of Buyer Solutions. "Migration levels and changes to foreign investment laws are also adding to demand."

In the short term, this means prospective home buyers will need to be cautious about just how much they are spending.

"In many cases, we've seen buyers overpaying for property - especially poorly located property - in a bid to beat competition and secure a home," said buyer's agent Catherine Cashmore of JPP Buyer Advocates.

Interest Rates

With the economy on the mend, the big question in 2010 is just how high the interest rate is going to rise.

The RBA has already demonstrated its determination to swiftly move the rate above the "emergency" level of 3 per cent, using an unprecedented three sequential rises of 0.25 per cent between October and December. Analysts are tipping the cash rate will hit between 4.25 per cent and 5 per cent by the end of 2010, depending on the strength of the economic recovery and pace of inflation.

Mr Joye said this would be mortgage lending rates at 7 to 8 per cent, still significantly lower than the 9.6 per cent level before the global financial crisis. "As the cash rate increases, that's a headwind in the housing market. (But) even another 1 to 2 per cent worth of increases won't have a materially adverse impact on housing demand."

Existing mortgage holders who kept their repayments at the level they were before the interest rate began falling in 2008 will be in the best position to weather the rises. But the experience will be different, even painful, for those who entered the market at or near the point when the rate bottomed out.

While lenders typically factor in a 2 per cent rate increase when calculating a borrower's ability to repay, a growing number of households will struggle to absorb such sharp increases over such a short period.

Monthly repayments on a standard 25-year \$300,000 loan have already jumped \$138 following the three RBA hikes starting in October. If the cash rate rises to 4.25 to 5 per cent by next December, it will add another \$95 to \$241 to the monthly mortgage bill. That would represent a total increase in repayments of \$233 to \$379 a month - or 12 to 20 per cent - between last September and next December.

"For your bread and butter consumer, that's a lot of money to come out of the household budget very quickly," said Craig Dres. "It's one thing to say the interest rate needs to return to 'normal' but something completely different to see it happened like that."

And this is likely to be the best case scenario. The x-factor in 2010 will be just how much more commercial lenders will load on top. The big banks have signalled they plan to make independent rises to improve their bottom line, with Westpac near doubling the latest RBA increase already.

"The market has a fair amount of momentum going into 2010, so it's not going to stop in its tracks," said Robert Papaleo, research director at Charter Keck Cramer.

"But rate rises have an impact that goes just beyond money, they can introduce an element of uncertainty that affects confidence and confidence in the economy is still a little bit fragile."