

Media Source: Domain Property Review
Date of Publication: September 6th 2009
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Is it hot in here or is it just me?

What a year. What a crazy unpredictable, unbelievable year for the Melbourne property market. Not 12 months ago, as the fallout from the global financial crisis toppled corporate titans and sharemarkets haemorrhaged, the outlook was grim: properties would be worth less than the mortgages they secured, forced sales would skyrocket, and the great Australian dream of home ownership would slide event further out of reach.

But it didn't happen and just months later, warning bells are sounding again but for a very different reason. This time its because Melbourne's property market is getting so hot that it could lead to the formation of a dangerous, unsustainable "price bubble".

Now we're heading into a spring market that could be tighter and more fiercely contested than any before or since the heady boom days of 2007.

Prices are on the rise again, and low interest rates and the boosted first Home Owners Grant has seen a record number of Victorians become first-home buyers. "It has probably been the most extraordinary year in real estate, with what's happened with the global and local economy, the financial crisis, the stockmarket, everything," says Enzo Raimondo, chief executive of the Real Estate Institute of Victoria.

"I think a lot of people thought the property market was going to stay subdued for a number of years, it would just bob along without too much activity and without too much by way of price movement," Mr Raimondo says. "But in fact its proved to be the opposite."

Just look at the auction market, which is as much a barometer for judging consumer confidence as a method for selling property. The clearance rate for the year to date is 81 per cent, second only to the record setting run of 2007 - and then not by much. In late November it bottomed out at 51 per cent. By the first week of August it had risen to a near all-time high of 88 per cent.

Although auction stock levels have been low, the number of private sales negotiated this year has set a record. The past few months has seen moderate to strong price growth return virtually market wide, event spreading into top-end areas that had been brutally battered by the global financial crisis.

Cameron Kusher, research analyst at RP Data, says the market's performance is radically different between the last half of 2008 versus the first half of 2009.

"We've seen very strong growth throughout Melbourne for the first six months of the year," Mr Kusher says. "The first-home buyer market was performing quite well and there's knock-on effects from that. We've seen the \$500,000 to \$700,000 market starting to improve and ... now the premium market."

The recent gains are reversing some of the damage inflicted during the 2008 downturn. The REIV reports that Melbourne's metropolitan house price fell 4.69 per cent to \$442,000 between mid July 2008 and mid July 2009. That the drop wasn't far more severe is thanks to the powerful and sustainable demand for less-expensive properties.

"When you halve mortgage rates it has a phenomenal effect on the market," says Matthew Bell, an economist at Australian Property Monitors (which is owned by Fairfax Media, the publisher of this newspaper), "The government stimulus has (also) worked exactly in the way it should have."

The consensus among analysts and agents seems to be that this massive intervention by federal and state governments and the Reserve Bank of Australia is what saved the market from sliding off a cliff.

At the metropolitan level, activity and price growth for the cheapest 25 per cent of houses across the city - which made up the bulk of sale transactions this year - offset the sharp price losses witnessed in the top quarter of the market.

In a dramatic turnaround on historic trends, nearly every suburb in the REIV's list of top 10 performers for the year were located in middle and outer areas, none of which had a median house price over \$351,000.

The local government areas of Hume, Casey, Melton and Whittlesea dominated the list, with suburbs such as Lalor, Narre Warren, Burnside and Broadmeadows seeing growth rates of 10.9 per cent to 17.9 per cent.

This is the heartland for prospective first home buyers, who were able to become house-owners in greater numbers than at any other time since records began in 1991. "the rent-versus-buy equation has never been better for many would be home owners," says Hocking Stuart director Scott McElroy. "It's opened a window of opportunity for people to get into the market well ahead of when they otherwise would have."

Apartments proved even more resilient. The metropolitan unit price fell just 0.7 per cent to \$377,300 from July 2008 to July 2009 - thanks, again to strong demand for more affordable properties.

One trend to come out of the first-home buyer rush is the new interest in apartments from those who don't want to live in traditional mortgage belt areas. Instead, agents and analysts say, they're snapping up older apartments in middle and inner suburbs where they couldn't afford a house.

While the middle and outer areas operated as the city's engine of growth, most of the worst performers came from inner, bayside or coastal areas, whose inhabitants were hardest hit by the global financial crisis and sharemarket wipe-outs.

In these regions, median house prices ranged from \$577,500 to \$1.44 million, and prices fell 15 per cent to 25.1 per cent. Worst hit was Mentone, followed by Kew, Middle Park, Sorrento, and Albert Park.

So, coming into spring, what does the future hold for a market that has already surprised, if not stunned, veteran Property watchers? Will it sizzle or fizzle? The most common refrain from agents and buyers' advocates is that the market will continue to run strong as long as supplies stay at current near-historic lows, at least in the auction market.

"There's still between three and five buyers at every auction I go to," says buyers' advocate Michael Ramsay. "You wont exhaust the buyers with the spring season's properties. But I don't know where its all going to end because (demand) is just too strong, its unsustainable at these levels. For the most part there doesn't seem to be any logic for the sort of prices that are being paid."

Aggravating the shortage is Melbourne's record population growth, which is seeing about 1500 people added to the city each week at a time when there is already a serious shortfall of new housing supply. The intense competition and surging growth in prices could prove to be a weakness for the long-term health of the market.

Craig Dres, director of mortgage brokers Alliance Financial Group, says the market's heat is acting as a "double-edged sword".

"Vendors realise that they could sell and maybe make 20 or 30 per cent above reserve, but they also know that they are going to have to buy back into a market for that same 20 or 30 per cent," Mr Dres says.

The low interest rates have also encouraged vendors to hold on to their properties as mortgage repayments have declined. That reluctance to sell means there are more and more buyers competing for far fewer properties than are needed to satisfy demand.

No wonder that Reserve Bank governor Glenn Stevens recently warned that a shortage of housing supply in a time of strong population growth and cheap credit could create the conditions for a housing bubble to form.

"I don't think we're there yet, but maybe if we get another couple of quarters of strong (price) growth it might be time to worry," says APM's Mr Bell.

Analysts and agents expect competition to ease somewhat as the First Home Owners Grant is wound back from September to December.

“I think it would be the higher-priced properties which do well, and demand for the more affordable-priced properties will probably come back a bit because they’ve been going so strong,” says RP Data’s Mr Kusher.

The biggest threats to the market are expected to be lingering uncertainty over whether the economic crisis is, in fact, over, the potential for unemployment to rise, and what will happen to interest rates.

The Reserve Bank has announced a plan for a series of incremental rises that would see the official interest rate go from 3 per cent to somewhere between 5 and 6 per cent by late 2011.

Interest-rate rises played a big role in the cooling of the property market even before the global financial crisis, so they are likely to have a dampening effect on activity and price growth again, depending on how far and fast they come.

“There’s a kind of false economy out there at the moment,” **says Robert Papaleo, research director at property consultancy Charter Keck Cramer.**

“We’re not through this recession yet, despite what some of the numbers are saying. What we’re seeing is just as much as over reaction on the upside as it was on the downside last year.”