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Mood lifts on mild recovery

Property observed
Robert Harley

Over the weekend one property developer told me that January was the "first month of the next boom". It was a bit tongue in cheek. But it does fit the change of mood.

The stock market rally, the improvement in global confidence, and some encouraging housing results have given property, both residential and non-residential, a good start to the year.

As always, there are cautions.

Housing activity, curbed by the new attitude to debt, remains at long-term lows. Key sectors are oversupplied, including inner-city apartments in Melbourne, and new housing in the city's growth corridors.

In non-residential property the big challenge is the weakness of underlying demand. No one expects rents in the office towers or shopping centres to rise much. What they are hoping for is higher values, driven by lower yields on the same income.

At the same time, the banks and receivers are readying for another clearance of distressed assets at the cheaper end of the market.

And the federal election, now set for September, means an eight-month negative for property. Activity slows ahead of elections as big decisions are postponed.

The upside will come after the vote, particularly if the new government has a clear majority.

Today, one month into the year, the signs are encouraging.

The latest house price numbers from Fairfax Media subsidiary APM paint a stronger picture of 2012 than did earlier numbers from rival RP Data-Rismark.

But the RP Data-Rismark figures for January, due on Friday, are expected to show a strong first month for the year – at least in Sydney, Brisbane and Perth.

Last weekend on the hard-hit Gold Coast, the Ray White Surfers Paradise January auction, known as "the event" delivered 72 home and apartment sales. Prices are a fraction of what they were but at a clearance rate of 70 per cent the result is the best in six years.

Ray White Real Estate chairman Brian White said the buoyant buyer support at "the event" had the appearance of being a game-changer.

"It was the depth of competitive bidding, something not seen for five years, that signalled something of significance was happening," he says.

"Sure, prices have been adjusted but buyers are now disregarding those levels. No longer did this event prove a continuing decline in property values.

"Markets only positively change through the competition of buyers. That happened this week on the Gold Coast. Better-than-anticipated prices were achieved again and again."

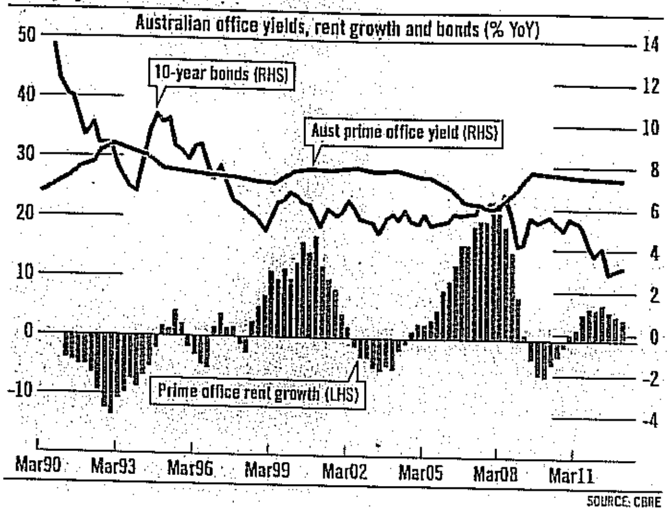
The repricing of property on the Gold Coast is only part of the story.

Around the country, the focus is shifting from what appears to be no-risk assets such as cash and fixed interest to higher risk-higher return assets such as shares and property.

AMP Capital head of investment strategy Shane Oliver noted that shares, and to a lesser degree property, were likely to be "better options for investors (depending of course on their individual risk tolerance) as global recovery supports growth assets and low yields hampers the returns from bonds and cash".

In very simple terms, Dr Oliver expects five-year returns of about 4.5 per cent a year for cash and term deposits, and 3 per cent or less from bonds, compared with 5 per cent a year from residential property and 10 per cent from shares.

Why yields fall



SOURCE: CBRE

"Residential property and shares already offer higher yields and will benefit as economic growth improves," Dr Oliver said.

"With mortgage rates well off their highs and likely to fall further, the residential property market appears to have bottomed out ... with a mild cyclical recovery likely over the next 12 months."

But he expects limited growth because buyers remain cautious about debt, worried about jobs, and wary of what are still "very high property prices relative to incomes and rents" and long-term trends.

> **Property markets around the world are, overall, more active than for a long time.**
> Brian White, Ray White Real Estate

Most analysts expect single-digit house price growth, at best, in 2013.

RP Data national research director Tim Lawless expects the January house price growth to moderate.

"I would be very surprised to see month-to-month movements in excess of 1 per cent on a regular basis during 2013," he said.

"In fact, over the past week the daily index across the five capital city aggregate has levelled, perhaps foreshadowing less exuberant conditions over February,"

In commercial property, the re
estate investment trusts had an exce
lent year in 2012 and continued to ri
in January.

Analysts are predicting improv
returns, not from better performan
in the assets themselves but from low
debt costs, merger and acquisition pr
miums, the shift of smaller investo
back to the sector, and rising values

Merrill Lynch analyst Simon Ga
ing estimates that the REITs alon
not counting unlisted buyers or p
vates, have $14 billion of firepower
they borrow up to their conservati
gearing levels.

But so far, as I have written sever
times, we have not seen a general ri
in values.

CBRE's head of research in Au
tralia, Stephen McNabb, says the la
of income growth in the shopping ce
tres and office towers is holding ba
any reduction in yield or rise in valu

"As the chart shows, if anythi
there has been a negative relationsh
between yields and rental growth, pa
ticularly at major turning points li
the early '90s and pre-GFC," M
McNabb said.

In other words, property yields
not follow bonds down and boo
prices as most expect. The reverse
the case.

As bond yields fall because of ec
nomic weakness, property yields ri
for the same reason.

"The bond yield has proven to be
good leading indicator of econom
and ultimately rental growth hen
explaining the divergence in bo
yields and property yields over tim
Mr McNabb said.

"In many cases there is an inver
relationship between bond yields a
property yields."

"The most recent level and tren
for 10-year bonds is consistent wit
subdued growth outlook, with low
risk appetite ... this suggests a su
dued environment for commerc
property markets in 2013, with re
tively stable yields."

Nevertheless, the low interest ra
are clearly having an impact.

"Property markets around t
world are, overall, more active than
a long time," Mr White said.

"In my view, this week's auction d
play of buyer intentions and bu
aggression on the Gold Coast is t
best indicator imaginable for Au
tralia in 2013."

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