Res Dev Real Talk

Property Development Market Update
Australia

AUSTRALIA
ISSUE ONE // SPRING 2021

In this issue:

Prepared by
Julian Brockhurst &
Daniel Norman

APRAO

aprao

Introduction

Julian Brockhurst // Aprao

With the majority of Australian capital cities in lockdown at the time of writing, COVID is dominating the news cycle evermore.

Although, when speaking broadly with the development industry participants, this is the last thing you want to talk about. The lending conditions, construction cost ballooning, tricky valuations, underwriting, labour shortages, Olympics announcements, buyer appetite and government stimulus are all much more interesting and concerning at the same time. We keep hearing about the hot market but how long can it be sustained? With government incentives set to end and construction pressure mounting, what do the next 6-12 months look like?

The trend of working from home is not only influencing the design of new resi stock but also commercial construction and its viability.

Will there be a pre-pandemic return to offices, a hub and spoke solution, or will it be truly decentralised and the home office crowned the winner?

Ultimately, it seems that new entrants into the development market are extremely bullish on projects they can turn around in 24 months or less. They are charging head-first into deals and continue to achieve good results. However, some more seasoned campaigners are wary of the price of sites, and eroding margins. They are happy to sit tight while bringing the existing stock to market.
Who's right? Why?

Read on to see what our experts have to say.

The drive for regional developments

**David Goldman, Co-Founder & Director //
Aspire Property Development**

The residential development market has broadly seen a return to strong demand across most of Australia, though particularly in the premium markets. We feel this is generally driven by pure domestic market sentiment, as opposed to foreign investors driving demand.

The push for regional properties, due to COVID-19 flexible working arrangements, has been great for regional communities, where they have seen substantial capital gains in a short period of time.

There's been demand regionally for premium apartments, particularly in Newcastle, though we should see consistent and strong demand for delivering house and land packages in idyllic coastal and regional centres for the next 5 years.

"The push for regional properties, due to COVID-19 flexible working arrangements, has been great for regional communities"

The double-digit growth in the Eastern Suburbs (Sydney) market in the past 18 months has been well accommodated, though the escalating costs of construction have generally brought the development market back into line.

Our view is that the Premium Eastern Suburbs Market will generally weather most macro-economic conditions well and its ability to return to strong demand will be quicker than other areas of Sydney and Australia.

When we decided to develop 'Yugen', our premium boutique development in Vaucluse Sydney, designed by award-winning architect Koichi Takada at the start of the pandemic in February 2020, there was a strong sentiment amongst developers to shelve projects.

However, we pushed forward based on our opinion of the resilience of the suburb of Vaucluse, though mostly on the fact that we feel that we understand what the key drivers are for purchasers in these premium suburbs.

We particularly focus on the discerning downsizer market, where there is a minimum internal and external area that will be tolerated by the purchaser. Our ethos, which we believe is also a key driver for purchasers within this market, is exceptional architecture.

Why are purchaser preferences changing?

"The progression of Work From Home [has led] many residential developers to rethink their product types to meet changes in purchaser preferences"

Luke Borg, Senior Project Manager // Savills, Australia & New Zealand

It's no secret that the COVID-19 pandemic has left a long-lasting impact on the residential development market in Australia, which will play out in the years to come.

We've witnessed the immediate effects of the pandemic, including controlled borders, changes in migration patterns and the progression of Work From Home (WFH), leading many residential developers to rethink their product types to meet changes in purchaser preferences and increasing construction costs.

Change in Purchaser Preferences

The reason for this change has been brought about by the inability to go into the office or travel interstate for work – the accelerated adoption of WFH. Major industry players are responding to this trend. For example, Harry Triguboff was quoted in May 2021 in the Australian Financial Review:

"People have rebelled, they don't want to travel two hours to work and two hours back anymore... I will build apartments a bit bigger for them, and I think the time is coming where I will have offices in my developments too."

We're experiencing this across the board in both apartment and land developments, with larger homes and more community facilities (including workspaces) being introduced.

We're also seeing the amendment of several existing development approvals to reflect new purchaser preferences.

Evidence of this is also apparent through the rise in house commencements, which increased by 5.9% from the March 2021 quarter, and a reduction in other residential commencements, which decreased by 11.3% respectively. This has highlighted a move to housing product over apartment product.

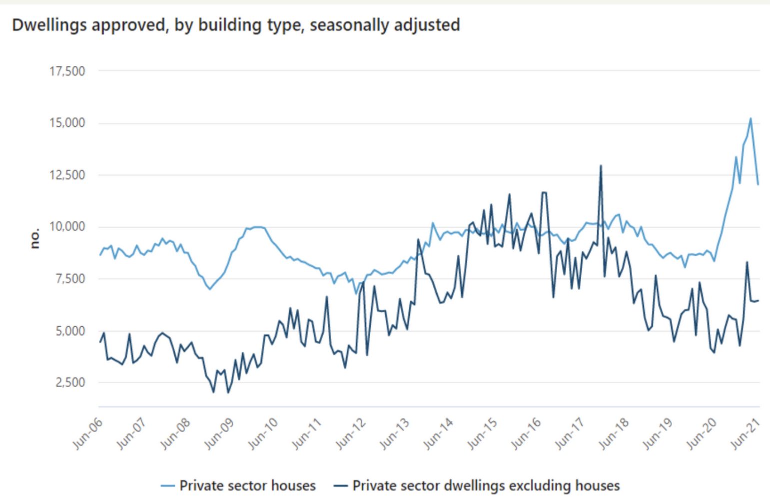
Pressure on Construction Prices

Within the last 12 months we have observed an increase in construction prices of upwards of 5%.

From our discussions with contractors and suppliers, we have identified the contributing factors to this challenge being limited building material supplies and skilled workers, due to controlled borders and changes in migration patterns, combined with an increase in building approvals over the previous 12 months.

We've seen this increase in construction prices impact residential developments considerably. Developers are reassessing current projects and making adjustments to ensure the impact on project margins are kept to a minimum. We're also seeing some developers hold off on projects in anticipation of cooling construction prices.

The main learning for us from the recent changes in the residential development market is the need for developers to take time to rethink their typical product types and make adjustments to meet changing purchaser preferences and ever-increasing construction prices.



ABS Dwellings approved, by building type data

What are valuers saying?

Bart Mead, Global Head of VAST // JLL – Valuation & Advisory

Valuing in the current market is still very challenging, even in our second year of Covid.

Material Uncertainty clauses are disappearing from Valuation reports across all asset classes and Covid clauses are becoming more market-specific, rather than generic. This is generally driven by sufficient market transactions occurring, to ensure valuers are in a position to analyse an active market with sufficient depth.

However, most markets have passed beyond established market fundamentals and property value drivers, which will often indicate that prices have exceeded a sustainable market level and therefore will be subject to future corrections.

Having said that, this is very market-specific, as the market is made of multiple markets and sub-markets, which all have their own fundamentals and drivers.

Government financial stimulus appears to be drying up, which will add a further level of uncertainty on how the economy – and therefore the property market – will perform over the coming twelve months. This is on the back of record prices being paid across multiple markets and asset classes.

The concern is that the high levels of demand we're currently experiencing could disappear as quickly as it had appeared. This level of demand and continued growth in demand was contrary to the predictions and the market expectations.

"This level of demand and continued growth in demand was contrary to the predictions and the market expectations"

The Valuation profession, like many others, is experiencing an unprecedented demand for their services, resulting in extensions of turnaround times and some sectors saying they are booked up for the remainder of 2021, unable to take on any further instructions. This is due to the high level of current market activity, high levels of refinancing and compliance work hanging over from 2020.

While the profession is enjoying strong market conditions, it is facing industry-changing pressure from the professional indemnity insurance market.

The number of options available to Valuers has decreased further in 2020 and 2021, not due to any issues from within the profession, rather from the broader insurance market.

This has seen firms either not being able to secure cover, or securing cover at substantial premium increases. This will contribute to the further consolidation of the industry.

Lending sector update

Alan Oster // NAB, Group Chief Economist

Funding conditions continue to improve.

In Q2 the overall number of survey respondents who said it was harder to obtain borrowing or loans (debt) continued to outweigh those who said it was easier.

However, the net overall number improved sharply since Q1 by 12% to -4%, signalling that debt funding conditions were at their easiest since Q2 2015.

Perceptions around equity funding also continued to improve with the net number who said it was harder to obtain equity also falling, meaning that equity funding was seen as being easier to obtain than at any time since mid-2015.

The commercial property market sentiment is still negative but continuing the slow recovery from the COVID-induced downturn in mid-2020.

On average, the NAB survey sees national industrial values rising. The highest are NSW (3.3% & 3.9%) and QLD (3.5% & 3.3%).

However, office values are to fall -0.3% in 12 months, and grow 0.8% in 2 years time, but negative in VIC (-2.0% & -0.1%).

"The number of developers expecting to start new works in the next 6 months is up sharply to 57%"

In Retail, values are set to fall -0.2% in the next year and grow 0.4% in 2 years, with CBD Hotels at -0.6% & 0.5%.

The number of developers expecting to start new works in the next 6 months is up sharply to 57%, which is the highest since the third quarter of 2015. This suggests that the construction sector should stay robust in the near term.

A large pipeline of work already put in place means dwelling investment should continue to grow over much of 2021, with the Q2 survey also indicating 51% of developers – a 10% increase from the previous quarter – are planning to start new projects that are targeting residential developments.

Moreover, property professionals see debt conditions improving further in the next 3-6 months.

For equity funding, the number who expected access to be easier outweighed those who think it will be harder. This is the first time expectations have been positive since late-2015.

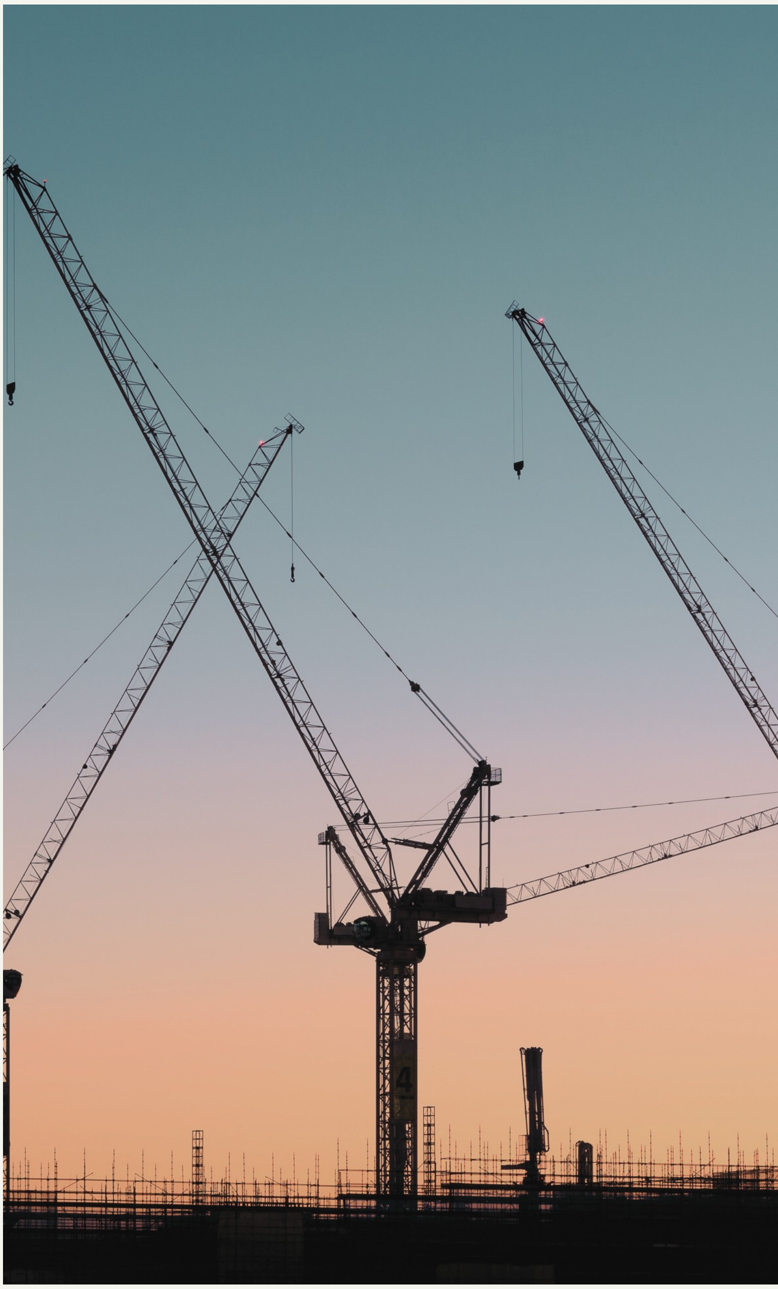
The average pre-commitment to meet external debt funding requirements for new developments in Australia fell again for residential (58.7%) and commercial (56.6%) in Q2.

"Property professionals see debt conditions improving further in the next 3-6 months"

Contact – Gary Louis, State Manager WA/SA, Commercial Real Estate // NAB
gary.louis@nab.com.au

A boom for construction?

Robert Sobyra // Director Research & Digital, Construction Skills Queensland



The 12 months to June 2021 saw Australians borrow more than $43 billion to build new houses. That figure is 75% higher than pre-COVID forecasts. Suffice to say, we're in a boom.

Yet like all others before it, this boom is not uniform and it won't be permanent. The driver of this activity is record low-interest rates and generous government assistance, which suddenly and unexpectedly put thousands of Australians in a position to buy or build a house.

These borrowers wasted no time converting their new mortgages into projects. At least $48 billion worth of new housing has already been approved across Australia – a record.

These approvals have created an enormous headwater that is now exerting downstream pressure on the national building pipeline. On top of this, the commercial sector is humming along.

Builders and tradies everywhere are flat out. By our estimates, the industry is currently operating around 20% over capacity and grappling with endemic materials and labour shortages.

There is a long way to go before we see this pipeline of work normalise. But normalise it will.

The thing about this boom is that it's not new demand – it's demand that has been brought forward. By that, I mean these buyers are people who couldn't qualify for a mortgage 12 months ago.

The government stimulus brought those buyers off the bench and put them in the front row.
But here's the rub: if it weren't for those incentives, these buyers probably would have bought in 2023 or 2024.

So, what happens when we get to 2023-24?

Well, those buyers simply aren't going to be there anymore, which means there will be much fewer contracts being signed.

Come 2023, we may well find that endemic supply shortages have been replaced with a chronic demand deficit. You'll want to make sure you're well-positioned for this transition.

Brisbane Olympic outlook

Bruce Baker & Tom Broderick // CBRE

A spike in office leasing, a significant tourism boost, outperformance in the residential market and an estimated $5.1 billion in sports-related capital investment. These are just some of the forecast spinoffs from the 2032 Brisbane Olympics.

The successful bid makes Brisbane the smallest city by population to host the summer games since Montreal in 1976. But we expect it to be a super-sized outcome for South-East Queensland, with direct benefits from the event and infrastructure investment as well as secondary benefits from the global recognition that the region will receive.

With much of the sporting infrastructure already in place, and only six new venues needing to be constructed, we estimate that circa $5.1 billion of capital investment will be required to deliver key sporting projects, such as the Brisbane Live Arena above Roma Street Station and the Gabba upgrade.

This compares to the total benefit to Queensland, which is expected to be $8.1 billion.

Much of the capital investment will occur in the second half of this decade, averaging $800 million to $1.1 billion of investment per year from 2027-2030.

Global Recognition

Our Brisbane Olympics research report notes that one of the less measurable benefits of Brisbane being chosen to host the 2032 Olympics is global recognition.

This was evident the day after the announcement when "Brisbane" was in the top 20 Google searches across the US and there was a clear upward trend in Brisbane searches globally.

We expect the recognition benefits to be larger for Brisbane than major global cities such as London and Tokyo.

This is largely because tourists and the corporate sector are very familiar with those destinations, but far less aware of Brisbane.

"So virtually every sector of the property market is set for a boost – meaning it won't just be the athletes racking up medal-winning performances"

Residential

South-East Queensland has been one of the strongest performing residential markets in Australia over the past 18 months, underpinned by the relative affordability and lifestyle benefits of Brisbane, the Sunshine Coast and the Gold Coast.

If Sydney is any guide, the announcement of the Olympics could possibly continue this outperformance.

From the time of the September 1993 Sydney announcement up until the event, Sydney was the best performing capital city residential market in Australia, averaging 8.4% house price growth per year.

So, virtually every sector of the property market is set for a boost – meaning it won't just be the athletes racking up medal-winning performances.

apra

About Us

Thank you for reading this Aprao report. We hope you enjoyed it!

Aprao is a cloud-based development feasibility tool, which is used by property developers, land teams, valuers, agents, development finance lenders and property professionals.

Get started free, no credit card required.

Contributors

Daniel Norman, Aprao

DANIEL@APRAO.COM

David Goldman // Aspire Property Development

DAVID.GOLDMAN@ASPIREPDM.COM

Luke Borg // Savills

LBORG@SAVILLS.COM.AU

Bart Mead // JLL

BART.MEAD@AP.JLL.COM

Alan Oster & Gary Louis // NAB

GARY.LOUIS@NAB.COM.AU

Robert Sobyra // Construction Skills Queensland

ROBERT.SOBYRA@CSQ.ORG.AU

Bruce Baker & Tom Broderick // CBRE

TOM.BRODERICK1@CBRE.COM