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Credit crisis good news for property buyers

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The global slowdown is wiping off overvaluations, bringing housing prices down, even in notoriously expensive Sydney

WITH Australian house prices coming under pressure from the global financial crisis, some market participants are rubbing their hands together: home buyers, or as Jack Thompson called them in the old Bank of Melbourne ads, "humbars".

Even first home buyers are in their best situation for many years, benefiting from a triple-pronged attack on barriers to ownership: aggressive interest rate cuts from the Reserve Bank; the doubling of the first home buyers grant to $14,000 (tripling to $21,000 if they buy a newly built home); and an improvement in the main real aid for housing affordability -- a decline in market prices, with all that means for sellers' expectations.

This will lift affordability from near-record lows for new buyers, with one important caveat: if they can get finance.

In that section of the housing market, things have changed dramatically in the past 18 months.

The latest Australian Bureau of Statistics figures show that loans for new home construction dropped by 4 per cent in August, while loans to buy newly built homes fell by 6 per cent.

The number of new home loans in August slumped for a seventh straight month, the longest slide in 14 years.

Paul Dowling, senior analyst at financial services researcher East & Partners, says the slump in home lending "adds another caveat" to confidence in the outlook for residential property.

"What's worrying the market is that the banks are cracking down on lending standards," Dowling says.

"It's not as pronounced as it is in the commercial property markets, but there is a general tightening of loan-to-value levels in retail mortgage lending, and the banks are also taking their time over approvals.

"They're exercising a lot more care in due diligence when they're presented with a retail mortgage proposition."

Dowling says most of the retail banks will lend at up to 80-85 per cent, but they are "much more focused" on the borrower's ability to service the loan.

"It's taking them, on average, about 10 days to approve a mortgage application, as opposed to the 24 or 48 hours it took them 18 months ago."

The fact is, the non-bank players that were so visible in the boom -- the loan aggregators and mortgage brokers -- are no longer in the market.

"They have no money to lend, because they can't fund themselves on the wholesale markets.

"It's good for the banks, but it has to hit activity in the housing market," Dowling says.

If home buyers think they're doing it tough, they should compare notes with commercial property buyers and developers. In that market, banks are tightening their credit requirements and cherry-picking the best of the propositions coming across their tables.

"At the moment, if you are a commercial property developer, you would need to have about 50 per cent equity for any lender to look at it.

"That's a huge difference to the LVRs that were being lent at 18 months ago," Dowling says.

Indeed, commercial property looks sicker than residential, in most classes.

While auction clearance rates in residential markets are down in all capital cities from a year ago -- only Adelaide is showing a clearance rate above 50 per cent, and the days of 100 per cent clearance rates a year ago are a distant memory for Sydney and Melbourne -- at least there are sales.

"I'd say commercial properties are coming off the boil just as much as residential, but we don't know the extent because of lack of transactions," Savills Australia capital transactions head Chris Freeman says.

"The valuers are in the predicament that there hasn't actually been any transactional evidence to go on, so they're asking how much has a property's value actually slipped.

"Whereas we in capital transactions are saying: here's where the offers are coming in at the moment.

"With interest rates coming down, it's only a matter of time before the gap is bridged, but the fact that we have hardly seen any major commercial transactions this year shows that the buyers and sellers are miles apart," Freeman says.

"Investors are pretty much parking their money in the bank at the moment."

Anyone who watches residential auction statistics could say the same thing -- and for mostly the same reasons.

"At the moment, if you can afford to wait to buy, it's probably not a bad idea.

"The economy is slowing down, unemployment is on the cusp of increasing, and interest rates are likely to go lower," ABN AMRO chief economist Kieran Davies says.

"If you look at the residential market and think you're probably not going to get the capital gains you were used to over recent years, and given all the uncertainty about the economy, I would have thought money was more likely at the moment to find its way into guaranteed bank deposits."

Investors, in particular, have "no pressing reason" to get into the market, Davies says.

"It still gets down to the fact that rental yields nationally are still very low: they're still on average about 3 per cent across the country.

"While mortgage interest rates have come down recently with the RBA cutting rates, rental yields are still much lower than the cost of funding an investment property would be.

"That can't help but hurt demand from investors," he says.

Rentals have slowly improved over the last three years, rising in all capital cities, says Cameron Kusher, an analyst at property researcher RP Data.

"Over the three years to July 2008, strong rental increases have directly resulted in gross rental yield improvements," he says.

Someone who bought the median-priced house in July 2005 had an average gross yield of 4 per cent, he says. If they still own that house and are achieving current median rents, that yield has increased to 5.3 per cent.

For units, the median-priced property yielded 4.7 per cent in 2005 and is now yielding 6 per cent.

"Even in the worst-performing market, projected rental yield is achieving 5 per cent (gross) for houses (Sydney) and 5.9 per cent for units (Sydney and Melbourne).

"In fact, if properties were purchased in many of these areas three years ago on an interest-only loan, many would be close to being positively geared at the moment," Kusher says. "Once value growth slows, rental rates will generally begin to improve, which in turn improves yields and increases potential property returns from investment property."

Louis Christopher, head of property research at investment researcher Adviser Edge, says the weakest housing market is Perth.

"Perth went the furthest beyond its long-term valuation.

"It's a very shallow market, in that the sales volumes are not significant, which means it doesn't take much of a change in demand for there to be short, sharp swings in the marketplace.

"The Perth market is off 10 per cent, even by Real Estate Institute of Western Australia numbers, and it's the city that we continue to be most bearish on. We would anticipate that a total decline of 20 per cent would not be out of the question, which is getting on for US-style falls."

None of the other capital cities is in such dire straits as Perth, he says.

"We think the next weakest spot is southeast Queensland, particularly including the Gold Coast and Sunshine Coast.

"Quite often you hear the discussion that Australia is not going to be as bad as the US, because the US had a building boom, which we did not have.

"That's largely true, but if that situation applies anywhere in Australia, it's southeast Queensland."

Christopher says the Adelaide market has "run along very well" in the past three years, on the back of the resources boom. "That has been great for South Australia.

"It has meant exceptional job creation and a nice pick-up in the housing market.

"The key question for Adelaide is: will jobs be maintained?

"Obviously, any sustained weakness in the commodities market will not help the state, and any nationwide increase in unemployment probably won't help it either."

The cities poised to do the best, he says, are Sydney and Melbourne.

"We think Sydney is likely to hold its relative value quite well, barring a sharp recession.

"You have to remember that Sydney has been a weak market since the end of 2003. It has been a while since we've been in this mode for Sydney.

"There was a brief period in the second half of 2006 and early 2007 when it was starting to pick up, but given the additional interest rate rises of 2007 and early 2008, it has really pushed Sydney back underwater again.

"That said, when you look at the relative affordability between Sydney and the other states, given the weakness of Sydney for some time now, the affordability gap has really narrowed in Sydney's favour.

"Sydney, of course, is still the most expensive city, but when you look at it on a 'price to relative income' basis, Sydney is actually starting to look like one of the cheaper cities. Not many people realise that."

Melbourne is in a similar situation, Christopher says.

"Melbourne house prices had quite a rise in 2007 -- house prices on average went up by 16-18 per cent -- and there is justifiable concern that after that sort of rise it might quickly come back again.

"The relative affordability is similar to Sydney: on a price-to-income basis it's looking pretty good.

"Certainly, if you look at unit prices, they're quite cheap and the thing about Melbourne and Sydney is that they're very deep markets."

Christopher also likes the prospects of Hobart.

"The thing you can say about Hobart is that it is still one of the most affordable cities in the country, and that alone has made investors take a closer look.

"In the long term, investors will continue to take a closer look, because of Tasmania's attributes -- things like eco-tourism, which I don't think has been totally tapped," he says.