



# MELBOURNE'S RESIDENTIAL MARKET

**Very positive, long term fundamentals offer unprecedented development and investment opportunities. For the whole community, developers, investors and financiers, the future prospects have never looked better.**

By Scott Keck | Executive Chairman Charter Keck Cramer

## FROM THE COMMUNITY PERSPECTIVE

Pre-existing conditions and new influences are coinciding to ensure that inner urban Melbourne, within 10 kilometres of the city, will continue evolving into a very high quality, inclusive community offering many lifestyle options. As the aging of the population and other demographic changes demand more affordable and convenient residential living solutions, Melbourne's medium density response through the provision of more apartments and townhouses is of a very high standard. From a community perspective, some reassuring influences may be summarised as follows:

- Planning controls and processes will ensure that Melbourne will not become an unsympathetic jungle of bad high rise structures, but rather will be a low-rise medium density landscape with a strong emphasis on open space as well as efficient, sustainable and aesthetic design.
- Under the building codes, construction standards are high, ensuring safety, reduced maintenance, durability and reliability of long term services and physical infrastructure.
- Emphasis on Owners' Corporations will ensure that multi-dwelling complexes are managed to a high standard to respect the rights of owner occupiers and tenants.

- In the inner urban precincts, the emphasis on mixed use will ensure that new residential apartments and townhouses are well serviced by complementary facilities, including education, medical, retail, entertainment, and recreational space.
- The proposal to congregate new development area in proximity to efficient and continually upgraded public transport is a primary objective that will have long term community benefits.
- Over the next 15 years, as Melbourne's population is projected to reach 5 million by 2026, the increasing preference for the inner urban lifestyle will underpin strengthening demand for inner urban housing, in turn supporting the developer and investment market.
- As Melbourne is a relatively young metropolis it does not have a legacy of poor earlier construction and planning which would otherwise restrain its capacity to meet the demands of a rapidly growing population. Instead it is able to expand by embracing the highest standards of planning, design and construction.
- High density residential development has already contributed to the renaissance of Melbourne's inner and middle suburban shopping strips over the past twenty years. Areas such as

St. Kilda and Fitzroy, which were once no-go zones for many people, are now able to be enjoyed by the entire community at any time of the day. Residents of new apartments have increased the level of pedestrian activity in centres and supported night time activities, making them considerably safer than before.

- While some may argue that apartment developments may only cater for particular segments of the market, the statistics show that the number of families living in Melbourne's inner city suburbs is now increasing. This is a result of these areas now being safer and more family friendly. One only has to see the number of families enjoying Melbourne's Docklands precinct, or the St. Kilda foreshore on the weekend, to realise that there are broad community benefits as a result of more intensive residential development.
- Twenty years ago, Melbourne's inner city areas were also blighted by redundant industrial buildings which were often vacant. The residential sector again played a role in returning these areas to the community through the redevelopment of these buildings into warehouse apartments, which again repopulated these areas, supporting the creation of safer, more vibrant precincts.

In summary, Melbourne offers high standards, despite contending with the issue of urban sprawl like many large cities. By contrast however, there is certainty in the fact that Melbourne's inner urban housing demand, construction and design dynamics are very well supported and led by an understanding and insightful statutory regime to maintain these high standards.

## FROM A DEVELOPER'S PERSPECTIVE

The Melbourne market is a relatively low risk environment, particularly because of a number of factors which may be summarised as follows:

- Local and state government planning policies and strategies provide strong support for higher density residential development as a means of containing urban sprawl, maintaining housing affordability and encouraging better utilisation of Melbourne's public transport system.
- There is acceptance of pre-commitment to sales prior to construction which allows projects to be de-risked through substantial underwriting prior to development commencing.
- Very substantial Stamp Duty savings through purchase "off the plan", together with various forms of First Home Buyers financial grants, provide strong incentives to the market.
- Although FIRB Guidelines do act in some manner to restrict direct investment in established housing by non-resident Australians, they otherwise encourage and facilitate non-residents who may be interested in investing in residential development.

"Melbourne offers high standards, despite contending with the issue of urban sprawl like many large cities. By contrast however, there is certainty in the fact that Melbourne's inner urban housing demand, construction and design dynamics are very well supported and led by an understanding and insightful statutory regime to maintain these high standards."

- All levels of government are increasingly acknowledging that their support is needed to assist so that a housing shortage and accommodation crisis is avoided. Therefore the planning process should become progressively easier.
- The aging of the population and an historical emphasis on superannuation savings means there is now an increasing number of financially eligible purchasers seeking diversity of their investments, much of which flows into the residential market, ensuring an ever growing demand.
- The mechanism of pre-construction sales as condition of project finance implies that not all "planned" supply will be translated into actual supply and therefore limiting the potential for apartment oversupply.
- Projections of population growth and long term housing provide comfort and encouragement to developers. This allows future sites to be "landbanked" for continuity of stock supply to the market.
- Planning initiatives and infrastructure studies have clearly indicated the location of major growth centres and preferred precincts for apartment and townhouse development. This removes the risks associated with poor or uniformed choices in development location.

- Professionals in the Melbourne property market, including amongst others architects, planners, engineers, development managers, valuers, quantity surveyors are in good supply, have high professional standards, and business competition ensures cost effective professional fee rates. Consequently, developers are able to very quickly and cost effectively bring together a highly qualified team of professional project consultants to support their ventures.
- Within Melbourne, the various teams of estate agents and marketing consultants provide a highly professional, far reaching and effective marketing mechanism that facilitates quick and accurately targeted sales campaigns locally, nationally and internationally.
- Historically, given that Melbourne is a city of high home ownership, purchaser mortgage delinquency is extremely low and settlement risk has been historically negligible even at the most challenging times in the market.

In summary, for prospective developers, Melbourne is a mature market with strong underpinning fundamentals such as a fast growing population, inadequate supply, increasingly supportive planning regimes, strong marketing agencies and an acceptance of pre-construction sale commitments which underwrite virtually all projects. Comparatively, projects are able to be conceived, approved and underwritten prior to substantial capital investment.

## FROM AN INVESTOR'S PERSPECTIVE

Diversification of investment assets and annuities to include real estate has been a long held strategy of Australian investors—real estate or “bricks and mortar” being the biggest asset class of all Australians. Although property and equities may, over a long period, produce similar returns, investors appreciate that, they behave very differently over the years as investments for a variety of reasons. Consequently, direct investment in property, particularly residential real estate, can improve the diversification of a portfolio of assets, allowing for stronger performing assets to support those which experience weaker conditions from time to time.

Another reason for diversification into directly owned real estate is that it involves a long term commitment as a disciplined investment strategy, which is not easily changed and not vulnerable to fluctuating sentiment on a daily basis like equities. The fundamentals in favour of investment in contemporary real estate in Melbourne such as apartments and townhouses, include the following:

- For acquisitions “off the plan” prior to construction, Stamp Duty savings are substantial.
- For taxation, the interest on mortgages is deductible through the “negative gearing” provisions which are unlikely to change in the medium term.

- Apart from the deductability of mortgage interest cost, other expenses in excess of income can also be deducted, including depreciation and administrative costs.

- Given that the shortfall in inner urban housing which, is forecast to continue for many years, inevitably rental and capital growth will be assured, maximising Internal Rate of Return (IRR) dividends, especially when depreciation and other benefits are included.

- Under the Australian Superannuation Guidelines, it is acceptable for financially geared investments such as apartments to be incorporated as superannuation assets with the long term tax advantages that align within those structures.

- Increasingly innovation in building design and standards, avant-garde architecture, well considered locational choices and a variety of floor plan sizes and finishes are ensuring better quality products, which consequently means longer lasting, socially relevant and better performing assets.

- As a real estate class, residential real estate has the lowest risk, price entry and is the most liquid, making it the most in demand of all the property classes and therefore the deepest market of prospective buyers.

- The opportunity to pre-purchase “off the plan” prior to construction commitment allows purchasers to enjoy long periods of up to three years of potential capital gain through the provision of only a deposit, usually of no more than 10%. In favourable market conditions leveraged returns on that basis can be very high.

- In the longer cycle, apartments of good location will always maintain their value with the ability to be internally re-invigorated through bathroom and kitchen renovations.

- In contrast to commercial, industrial and retail real estate, residential holdings can quickly be adapted to broader personal use for family members, thus having a broader ownership application than investment alone.

"Financiers in Australia demonstrated throughout the Global Financial Crisis their strong governance, analysis skills and acumen and are understandably selective about exposure."

"Diversification of investment assets and annuities to include real estate has been a long held strategy of Australian investors – real estate or “bricks and mortar” being the biggest asset class of all Australians."

Investors looking to real estate have always preferred residential holdings. There is now a general public awareness that the issues of inner urban need, demographic gentrification and a desire for greater reliance upon public transport will continue to drive this market and it can therefore be expected to be underpinned by long term demand.

### FROM A FINANCIER'S PERSPECTIVE

The shortage of supply, guardianship of statutory planning and building controls, the pre-construction sale regimes which allow project de-risking, and the quality and reliability of the construction industry in Melbourne all combine to make financing of worthy projects and quality clients, rewarding, risk-adjusted strategy. Appropriately structured, financiers are also able to be involved in the initial development construction phase, and have the opportunity to enjoy the post-development longer term financing of individual purchasers. Favourable circumstances for financiers include the following:

- The process in Australia does not require commitment from financiers until projects have been significantly de-risked through a sales pre-commitment, and the contracting of an appropriately qualified, reliable builder. The sales and delivery phases are therefore less of an issue than in many other more “speculative” markets.
- The reassurance of professional advisors greatly assists financiers to conclude a very reliable credit analysis, particularly relying on the high standard of valuation and appraisal practice within Australia.
- As market circumstances and competition allow the institutions to adopt their own prudential guidelines, the requirement that developer equity be substantial avoids the risk associated with high loan to value ratio exposure. In this regard, there are many domestic developers with very strong balance sheets and, in more recent years, an enormous interest from overseas capital seeking to participate in the local environment, which is supported by the FIRB Guidelines.
- Historic, negligible purchaser settlement delinquency is a characteristic of the Australian domestic market and there are no real concerns that this will change.

- The negative gearing taxation and other concessions which financially favour residential real estate as an investment lead to a track record of extremely low mortgage delinquency, allowing financial institutions to build a very stable and profitable mortgage portfolio on the basis of this asset class.

- In the remote event of mortgagee failure, residential holdings in the apartment and townhouse category, all being of relatively low price entry point, are easily liquidated, resolving a mortgagee's exposure.

In summary, financiers in Australia demonstrated throughout the Global Financial Crisis their strong governance, analysis skills and acumen and are understandably selective about exposure. Although requiring major projects to be pre-committed, they do, on appropriate terms, provide finance and have remained willing to support the sector through liberal retail finance to individual purchasers. No doubt institutions appreciate profitability through engagement with developers but they are understandably seeking higher levels of equity given the change in the financial landscape. This opens up a tremendous opportunity for the bigger, private developer organisations that have a strong balance sheet.

### IN CONCLUSION

large inner urban regentrification residential and mixed use projects have a strong track record of being successful in Melbourne. In recent time, within the last decade, the evolution of Docklands is the city's most outstanding and successful example, but in addition to which there has been the redevelopment of Waverley Park by the Mirvac Group, the redevelopment of the Tooronga Shopping Centre site by Stockland, the “Forrest Hill” Precinct in South Yarra by a variety of developers, Main Drive Kew by the Walker Corporation. Currently, planned immediately, projects include “Harcrest” by Mirvac, in Wantirna South, “Ascot Chase”, in Ascot Vale by Urbex, the former Vision Australia Headquarters in Burwood Road, Burwood, purchased by Australand, Channel 9 Site in Richmond acquired by Lend Lease, Orrong Road Prahran a joint venture by Lend Lease, the previous Pentridge Jail redevelopment under the control of VaLad, and the recent purchase by the Satterley Group of the Kodak Site in Coburg. In addition, development opportunities remain in Docklands at the control various developers.

Looking forward, particularly in terms of known or forthcoming availability, there is little available, particularly very large land holdings of strong socio-economic inner urban location. An announcement has been made about the forthcoming offer of the strategically very important site held by AMCOR in Alphington, a holding of 16.5 hectares (ha.), which at its potential for full development would represent probably the largest redevelopment inner urban opportunity in Melbourne in the last 20 years other than for Docklands itself. Given the rarity of such an opportunity, particularly strong interest is anticipated in respect of that opportunity.