NAB RESIDENTIAL PROPERTY SURVEY Q3-2017

HOUSING MARKET SENTIMENT LIFTS IN ALL STATES (BAR NSW) AND CONFIDENCE ALSO RISES. MORE FIRST HOME BUYERS ENTER THE MARKET AS FOREIGN BUYERS BECOME LESS INFLUENTIAL...

NAB Behavioural & Industry Economics

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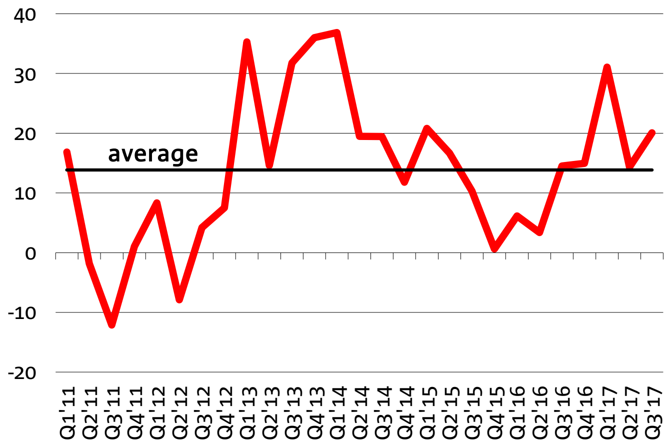
Housing market sentiment (measured by the **NAB Residential Property Index**) bounced in Q3, following a sharp fall in Q2. Sentiment improved in all states (except NSW), led by a very strong read in VIC. Confidence also lifted and was positive in all states, again led by VIC with WA the big improver. Property experts on average are pointing to stronger house price growth in all states in the next 1-2 years (except in SA/NT), with the biggest gains forecast for VIC and QLD. Expectations for rental growth have also risen to their highest level in nearly 4 years, with VIC leading the way. First home buyers continue emerging as key buyers in new and established housing markets, but tighter restrictions on foreign buyers appear to be biting with their market share of new property sales falling to a 5-year low (around 1 in 10). For the first time, tight credit was identified as the biggest constraint on new housing development in all states, while access to credit was the most significant constraint for buyers of established property. **NAB's** assessment of the market direction is largely unchanged with more moderate growth anticipated in 2018-19. House prices are forecast to rise 3.4% in 2018 (previously 4.3%), easing to 2.5% in 2019. Unit prices are forecast to rise 0.5% in 2018 (previously -0.3%), with a modest fall expected in 2019 (see p.8).

VIEW FROM PROPERTY EXPERTS

Market sentiment higher in all states except NSW. Confidence also lifts, with VIC leading the way, WA the big improver and SA/NT lagging.

NAB RESIDENTIAL PROPERTY INDEX



RESIDENTIAL PROPERTY INDEX BY STATE

	Q2'17	Q3'17	Next 1yr	Next 2yrs
VIC	36	63	74	66
NSW	36	31	51	50
QLD	12	16	48	56
SA/NT	-6	10	13	20
WA	-46	-31	18	47
AUST	**14**	**20**	**45**	**52**

VIEW FROM NAB ECONOMICS

Prices to slow but a number of positive elements should support the market enough to prevent a severe adjustment in prices in the next few years.

NAB HEDONIC HOUSE PRICE FORECASTS (%)*

	2015	2016	2017f	2018f	2019f
Sydney	15.5	10.7	5.1	3.7	3.0
Melbourne	15.8	9.5	8.6	5.5	3.4
Brisbane	6.9	2.7	3.1	1.9	1.2
Adelaide	3.8	3.8	3.4	1.7	1.7
Perth	-4.2	-2.9	-3.0	0.7	1.2
Hobart	7.0	9.6	10.0	4.9	1.7
Cap City Avg	**11.2**	**7.3**	**4.6**	**3.4**	**2.5**

NAB HEDONIC UNIT PRICE FORECASTS (%)*

	2015	2016	2017f	2018f	2019f
Sydney	13.1	5.8	5.9	0.5	0.6
Melbourne	7.5	4.7	6.4	1.2	-2.4
Brisbane	1.1	-3.0	-1.1	-1.8	-1.2
Adelaide	2.4	0.6	0.5	0.5	0.5
Perth	-2.8	-6.3	-1.9	0.4	0.7
Hobart	1.1	6.4	5.7	2.4	0.6
Cap City Avg	**8.2**	**3.5**	**4.7**	**0.5**	**-0.3**

SOURCE: CoreLogic, NAB Economics

Date **October 2017**| **Author: NAB Behavioural & Industry Economics**

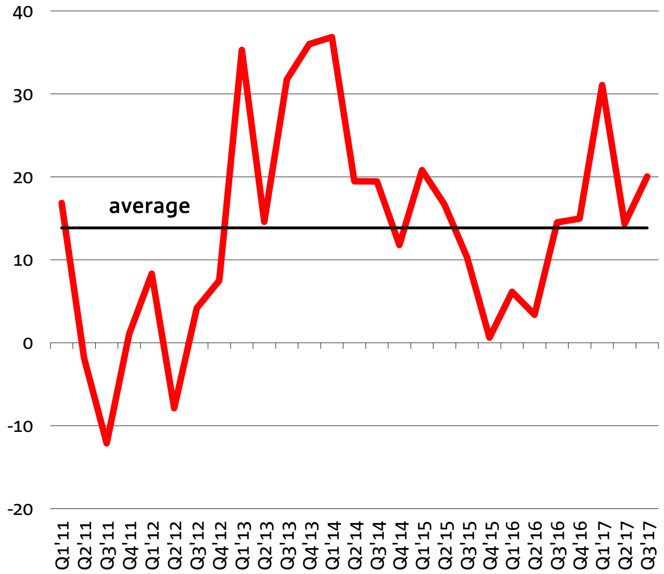
MARKET SENTIMENT EASES

The NAB Residential Property Index - based on survey expectations for capital growth and rents - bounced in Q3 2017 reversing a sharp fall in Q2. The Index rose 6 points to +20, mainly reflecting a sizeable increase in the number of property experts reporting positive rental growth during the quarter.

Sentiment improved in all states except NSW (down 5 to +31), where the slowing in house prices looks to be biting. In contrast, property experts in VIC were noticeably more buoyant, with sentiment rising sharply (up 27 to +63). Sentiment also improved among property experts in QLD (up 4 to +16), SA/NT (up 16 to +10) and WA - but is still languishing in negative territory (up 15 to -31).

NAB RESIDENTIAL PROPERTY INDEX

Overall housing market sentiment improved in Q3…



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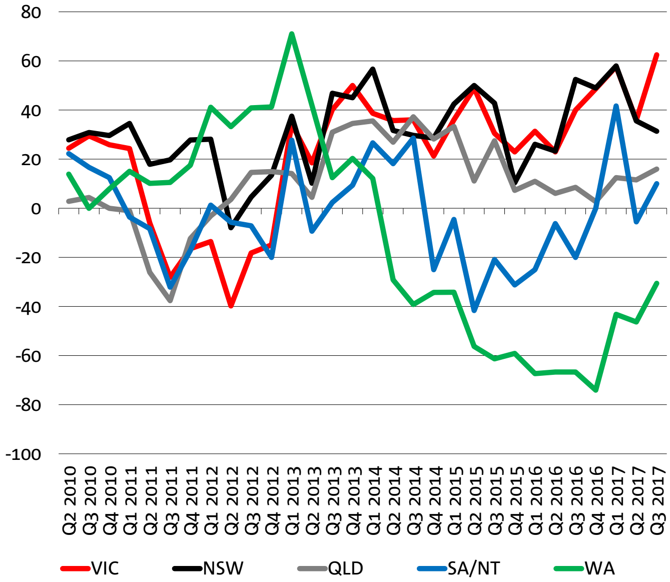
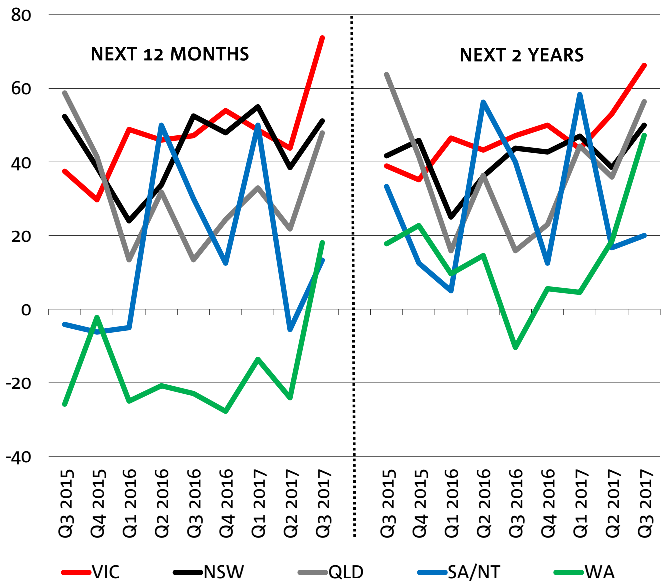
RESIDENTIAL PROPERTY INDEX: STATE

Sentiment turned down in NSW, but WA on the up (but still negative)…



Confidence lifts and positive in all states, led by VIC with WA the big improver…



Overall confidence levels among surveyed property experts also lifted. NAB's Residential Property Index is now predicted to increase to +45 in the next year (+23 in the last survey) and to +52 in 2 years' time (+35 previously).

The chart above shows confidence 12 months forward improved in all states, with property experts in VIC (up 30 to +74) and NSW (up 13 to +51) still the most optimistic. Confidence also rose sharply in WA (up 42 to +18) - its first positive read since Q1 2014. Large gains were also reported in QLD (up 26 to +48).

Longer-term confidence also lifted in all states. VIC still leads the way (up 13 to +66) in the next 2 years, and QLD (up 20 to +56) has overtaken NSW (up 12 to +50). Confidence improved most in WA (up 29 to +47), where the downturn in the local housing market looks to have bottomed.

SURVEY HOUSE PRICE EXPECTATIONS

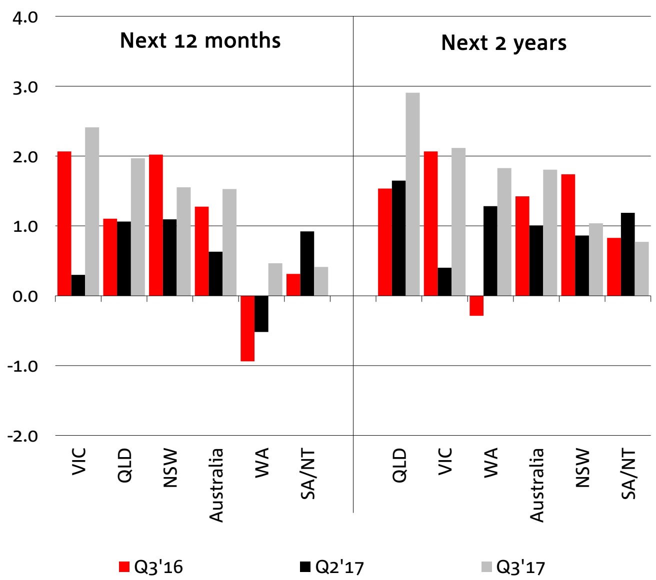
Average survey expectations for national house prices over the next 12 months have strengthened, with prices now expected to grow by 1.5% (0.6% in the previous survey).

Property experts on average are pointing to stronger house price growth in all states in the next 12 months, except in SA/NT where growth is predicted to slow to 0.4% (0.9%) in the last survey.

Property experts in are anticipating solid increases house price growth in the next 12 months in VIC (2.4% vs. 0.3% previously) and QLD (2.0% vs. 1.1%). Modest gains are also expected in NSW (1.6% vs. 1.1%). Property experts in WA also expect a return to growth (0.5% vs. -0.5%).

SURVEY HOUSE PRICE FORECASTS

Expectations lifted in all states in next 1-2 years (except SA/NT) with VIC & QLD leading the way…



Longer-term prospects also improved, with average survey expectations now pointing to house price growth of 1.8% in 2 years' time (1.0% in the previous survey).

Property professional in QLD remain most bullish, on average forecasting price growth of 2.9% in 2 years' time (1.6% in the last survey). Expectations were also revised up heavily in VIC (2.1% vs. 0.4%). Expectations in WA were lifted to 1.8% (1.3% previously, and were broadly unchanged in NSW (1.0% vs. 0.9%). Expectations in SA/NT however were revised down (0.8% vs. 1.2%).

SURVEY RENTAL EXPECTATIONS

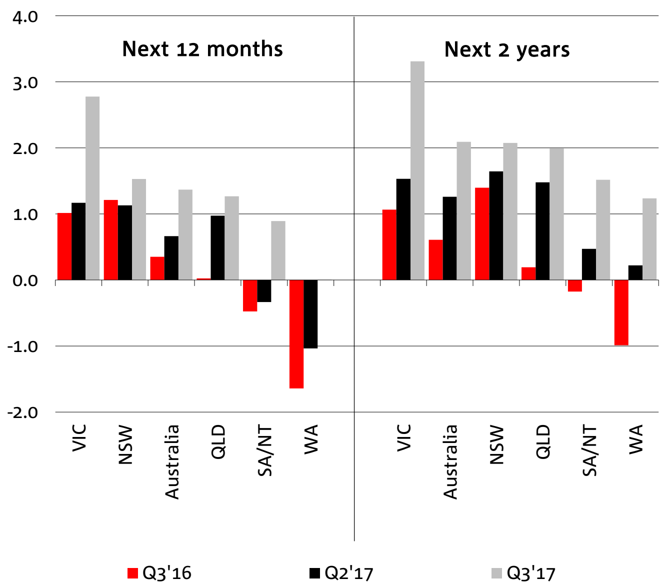
The average national survey outlook for rental growth in the next year was risen to a 3½ year high 1.4% (0.7% in Q2'17). Rents are however expected to rise broadly in line with house prices, suggesting that yields will remain unchanged.

Expectations for rental growth were higher in all states. Despite concerns about over-supply in apartment markets, property experts on average are expecting much faster rental growth in VIC (2.8% vs.1.2%). Rental growth is also expected to outpace capital growth, suggesting yields will rise.

With vacancy rates reportedly tight in most capital cities, property experts in QLD (1.3% vs. 1.0%), SA/NT (0.9% vs. -0.3%) and WA (0.0% vs. -1.0%) are also see rental growth accelerating in the next 12 months.

SURVEY RENTAL GROWTH FORECASTS

VIC to lead the country for income growth in the next 1-2 years; WA lowest but positive…



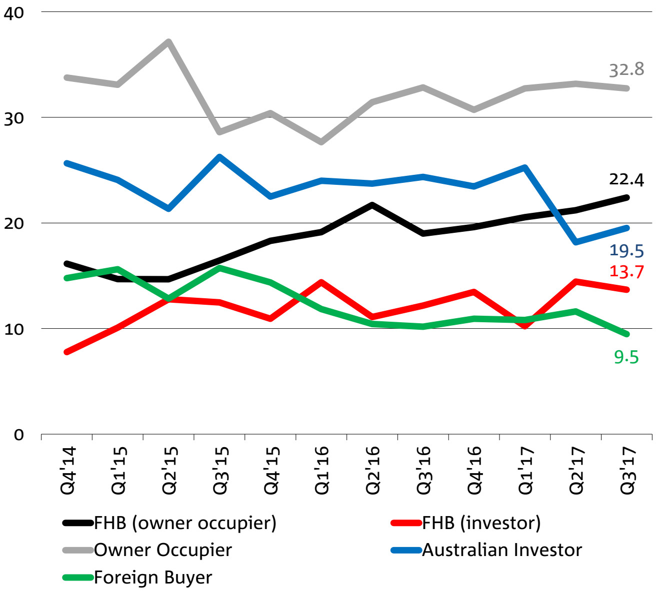
The average survey outlook is for rental growth to accelerate to 2.1% in 2 years' time (1.3% in Q2). Again, this mainly reflects a significant upward revision in expectations from property experts in VIC (3.3% vs. 1.5%). VIC is also expected to provide the best income returns of all states. Property experts also lifted their expectations in NSW (2.1% vs. 1.6%), QLD (2.0% vs. 1.5%), SA/NT (1.5% vs. 0.5%) and WA (1.2% vs. 0.2%).

NEW DEVELOPMENTS

First home buyers (FHB) continue to emerge as key buyers in new property markets. In Q3, FHB owner occupiers accounted for 22.4% of new property sales (21.2% in Q2'17), but the share of FHB investors fell slightly to 13.7% (14.4% in Q2). In total, however, FHBs made up 36.1% of all buyers of new property sales in Q3'17, up from 35.7% in the previous quarter - and the largest share since we began tracking this breakdown in Q4 2014.

The growth in FHB numbers in Q3 was likely to have been positively influenced by enhanced stamp duty concessions in some states to encourage FHBs into the market that took effect on July 1 2017.

SHARE OF NEW PROPERTY SALES (%)



Owner occupiers (net of FHBs) or "upgraders" pulled back a little in this market, accounting for 32.8% of total sales (33.2% in Q2).

But the share of local investors (net of FHBs) rose to 19.5%, from a survey low 18.2% in Q2 - but still well below survey average levels as recent measures imposed on banks to rein in investor lending continue to impact this segment of the market.

The share of foreign investors in new property markets however fell to 9.5%, from 11.6% in Q2 and their lowest share since mid-2012. Anecdotal evidence suggests tighter government regulations may be causing Chinese investors shift their focus.

Foreign buyers pulled back in most key states. In VIC, the share of foreign buyers in new property markets fell to 14.4% (20.8% in Q2). Foreign buyers were also less prominent in NSW, falling to just 7.8%, from 12.0% in Q2 and their lowest level since Q1 2012. In WA, their market share fell to 4.5% (6.9% in Q2). But in QLD, foreign buyers in this market accounted for 11.4% of all sales (up from a 3-year low 8.6% in Q2 (see section on Foreign Buyers below for more detail).

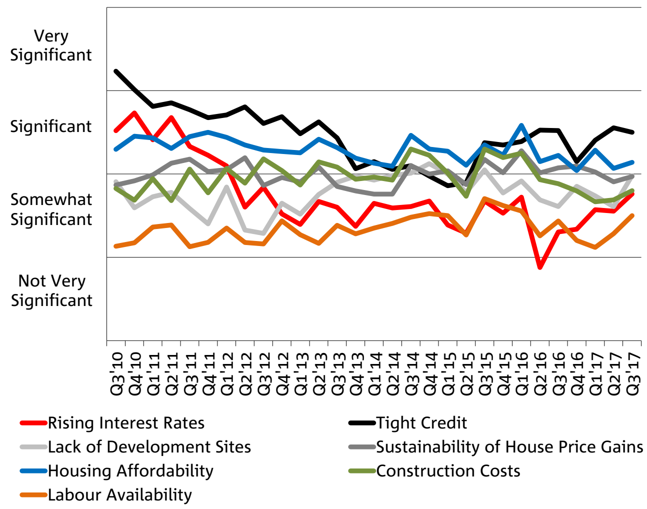
NEW HOUSING MARKET CONSTRAINTS

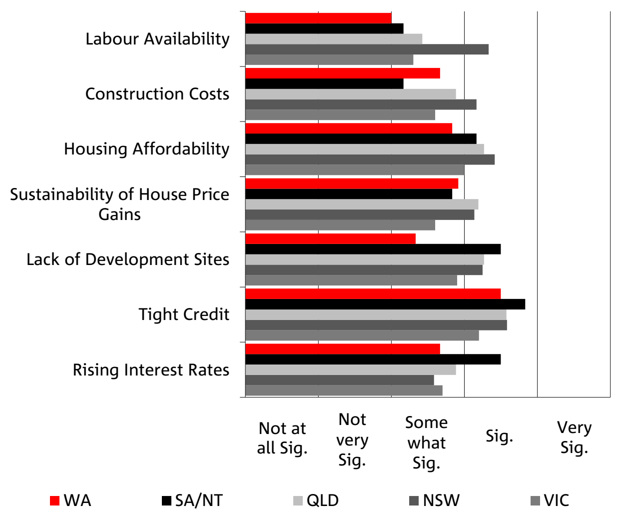
Overall, tight credit continued to be identified as the biggest constraint on new housing development in Q3, according to surveyed property experts. For the first time, tight credit was also highlighted as the main barrier in all states.

Housing affordability concerns also remain a "significant" constraint (particularly in NSW), while the concern increased the most in relation to a lack of development sites (led by QLD and VIC).

It is also becoming apparent that property professionals are becoming increasingly worried about the impact of rising interest rates.

KEY CONSTRAINTS - OVERALL & STATES

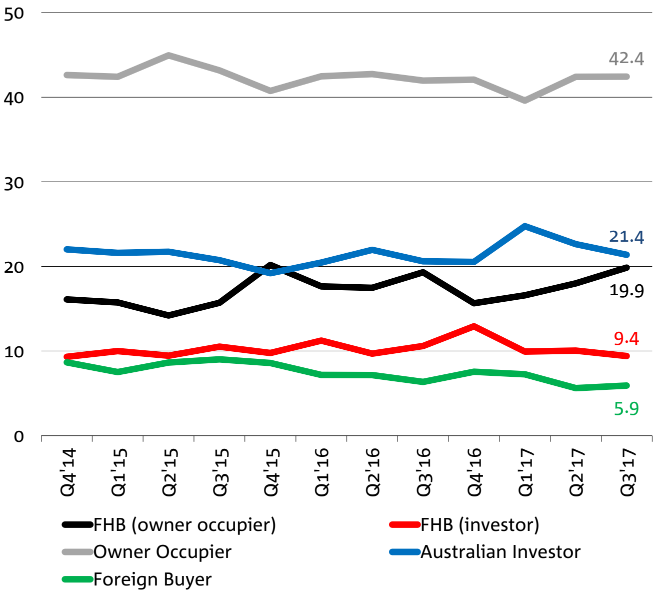




ESTABLISHED PROPERTY

FHB (owner occupiers) are also playing a bigger role in established housing markets, accounting for 19.9% of established property sales in Q3'17 (18.0% in Q2). FHB (investors) accounted for 9.4% of all sales (10.1% in Q2). Overall, FHBs accounted for 29.3% established property sales in Q3'17 (28.1% in Q2).

SHARE OF EST. PROPERTY SALES (%)



Owner occupiers (net of FHBs) continued to play the dominant role in established property markets in Australia, with their share of total sales unchanged at 42.4% in Q3.

Local investors (net of FHBs) however continued retreating, with their overall market share falling for the second consecutive quarter to 21.4% (22.6% in Q2).

Foreign buyers of established property were a little more prevalent in this market, with their overall share of sales rising to 5.9% in Q3 (5.6% % in Q2).

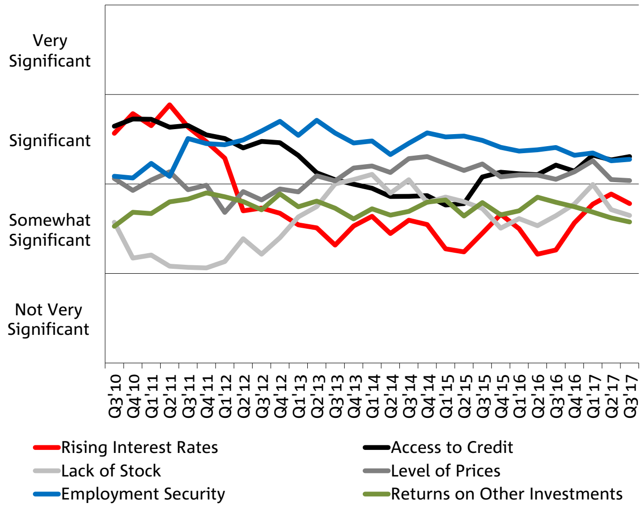
Foreign buyers of established Australian residential property played a smaller role in VIC (8.0% vs. 9.0%), NSW (5.6% vs. 5.9%), and WA (4.2% vs. 4.5%), but increased their market share in QLD (6.7% vs. 3.8%). For more detail see section on Foreign Buyers below.

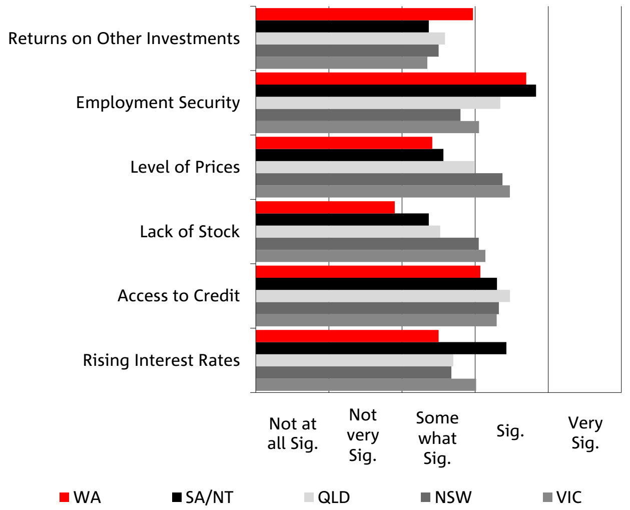
ESTABLISHED HOUSING MARKET CONSTRAINTS

Access to credit was the most "significant" impediment for buyers of existing property in Australia in Q3, according to surveyed property experts, marginally ahead of employment security.

House price levels were also a "significant" barrier. Rising interest rates was the next biggest worry, but less so relative to the last quarter. Concerns around lack of stock and relative returns on other investments as an impediment to buying established property also moderated.

KEY CONSTRAINTS – OVERALL & STATE





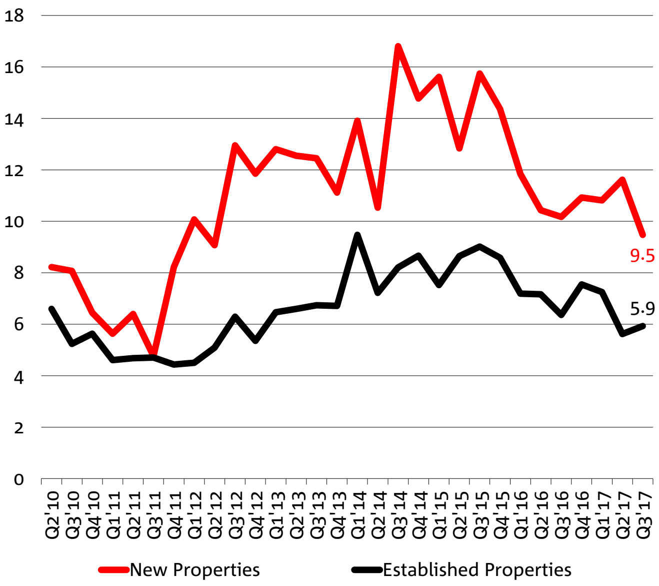
By state, access to credit was identified as the main impediment to buying existing property in QLD. Price levels were the biggest concern in both VIC and NSW. In WA and SA/NT, however, property experts said employment security was biggest barrier.

FOREIGN BUYERS

Tighter restrictions on foreign buyers of Australian properties appear to be biting, with the share of foreign buyers falling to a 5-year low 9.5% in new property markets, but up a little to 5.9% in established markets (albeit still near 4-year lows).

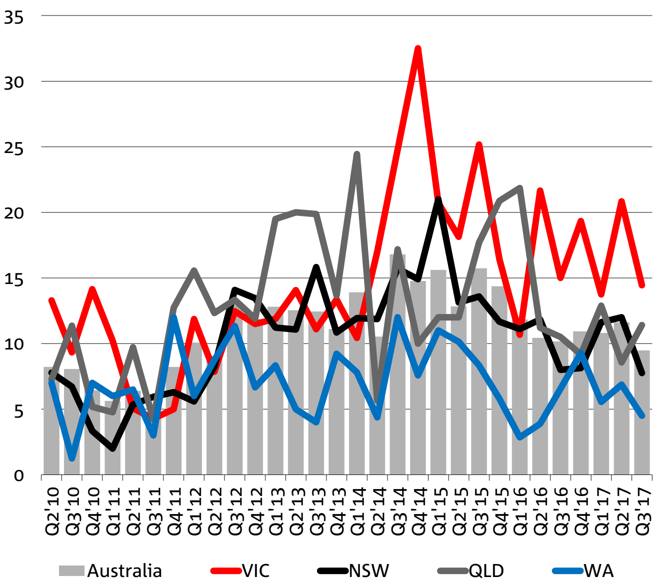
DEMAND FOR PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)

Less foreign buyers in new housing markets…



Lower foreign buying activity in new property markets was led by VIC, where the share of sales to foreign buyers fell to 14.4% (20.8% in Q2). Foreign buyers were also noticeably less prevalent in NSW, where their market share fell to 7.8% - its lowest level since Q1 2012 and down from 12.0% in Q2. The proportion of foreign buyers in new property markets also fell in WA to 4.5% (6.9% in Q2). In contrast, foreign buyers increased their market share in QLD to 11.4% (8.6% in Q2) despite the introduction of a foreign investor land tax surcharge in July 2017.

DEMAND FOR NEW PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)

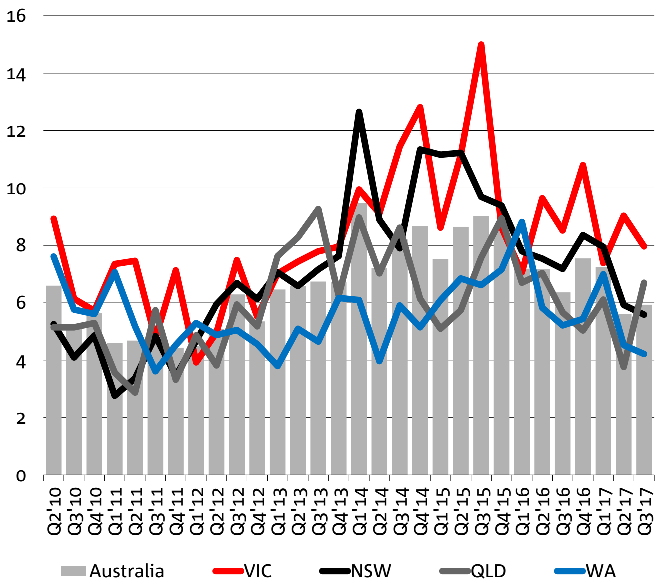


In established housing markets, the overall share of foreign buyers rose a little from 5.6% to 5.9% in Q3, but remained anchored at near 5-year lows.

Foreign buyers accounted for a smaller share of sales in VIC (8.0% in Q3 vs. 9.0% in Q2), NSW (5.6% vs. 5.9%) and WA (4.2% vs. 4.5%).

In QLD, however, they accounted for 6.7% of established property sales, up from 3.8% in Q2.

DEMAND FOR ESTABLISHED PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)



TYPE, SHARE & PRICE OF PROPERTIES BOUGHT BY FOREIGNERS

The mix of properties purchased by foreign investors in Australia in Q3 continued to swing towards houses at the expense of apartments - although the latter was still the most common type of residential property bought.

Around 49% of all residential properties purchased in Australia by foreign investors in Q3’17 were for apartments - although this share fell for the second consecutive quarter and was down from almost 54% in the March quarter.

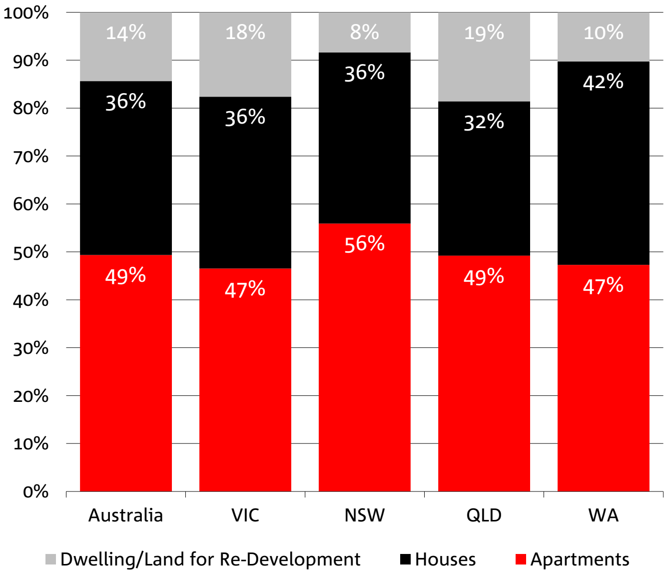
At the same time, the share of houses being purchased climbed to a survey high 36.3%, from 35.2% in the previous quarter and just under 30% in the March quarter.

A little over 14% of all properties purchased by foreign investors in Q3 were classified as land or dwellings for re-development.

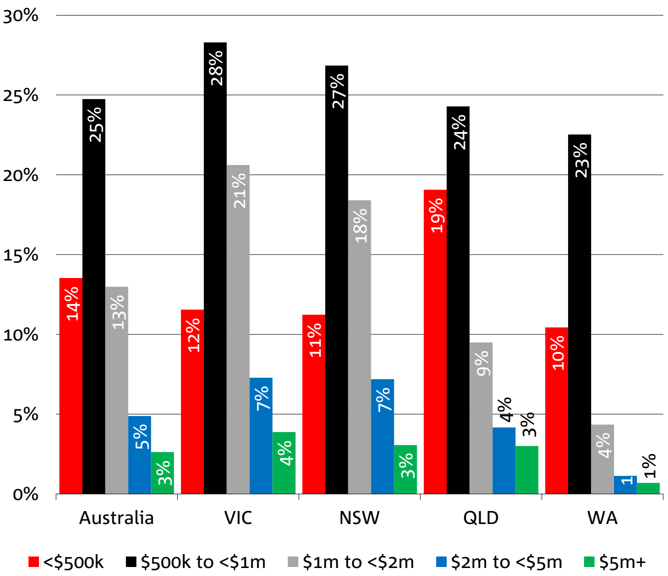
However, these ratios varied quite a lot by state. Apartments accounted for a much bigger share of sales in NSW in Q3 (56%), whereas houses accounted for the largest share in WA (42%).

One in 5 sales in QLD (19%) and VIC (18%) consisted of land or dwellings for re-development, compared to around 1 in 10 in NSW (8%) and WA (10%).

FOREIGN PURCHASES – STATE (%)



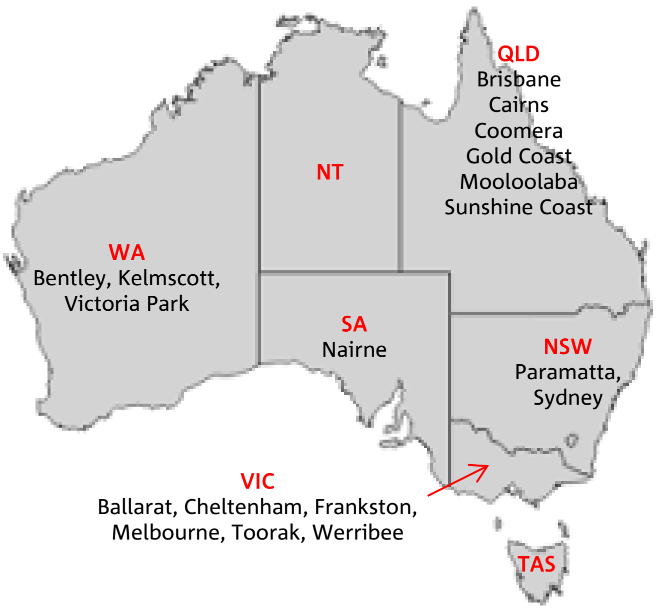
AMOUNT SPENT BY FOREIGNERS BY INVESTMENT LEVEL (%)



Overall, 14% of all properties purchased by foreign investors were for properties valued below $500,000 and 25% between $500,000-$1 million. Around 13% invested $1-2 million, 5% between $2-5 million and 3% over $5 million.

Property purchases in the $500,000-$1 million range accounted for approximately 1 in 4 sales in all states. QLD had the most sales in the sub-$500,000 range (around 1 in 5), while VIC (7%) and NSW (7%) had the largest share of sales between $2-5 million.

SUBURBS TIPPED TO ENJOY ABOVE AVERAGE GROWTH IN NEXT 12 MONTHS



AVG SURVEY EXPECTATIONS: HOUSE PRICES (%)

	Q2'17	Q3'17	Next 1 year	Next 2 years
VIC	0.5	2.0	2.4	2.1
NSW	1.4	1.2	1.6	1.0
QLD	0.6	0.6	2.0	2.9
SA/NT	0.1	0.3	0.4	0.8
WA	-1.4	-0.9	0.5	1.8
AUST	**0.5**	**0.7**	**1.5**	**1.8**

RENTS (%)

	Q2'17	Q3'17	Next 1 year	Next 2 years
VIC	0.7	1.6	2.8	3.3
NSW	0.5	0.7	1.5	2.1
QLD	-0.2	0.1	1.3	2.0
SA/NT	-0.5	0.0	0.9	1.5
WA	-1.7	-1.4	0.0	1.2
AUST	**-0.1**	**0.2**	**1.4**	**2.1**

NAB'S VIEW OF RESIDENTIAL HOUSES PRICES

An improvement in market sentiment across most states last quarter (according to the NAB Residential Property Survey) suggests there may still be some legs left in the housing market. However, we continue to see market conditions that vary considerably across locations, with each city seemingly at very different stages of their housing cycles. Looking through the variation though, annual property price growth across 8 capital cities has moderated only marginally to 8.5% y/y in September, down from this year's high of 11.4% in May. Sydney, Melbourne and Hobart have each continued to see double digit yearly rates of growth, although the momentum is clearly with Melbourne and Hobart, as Sydney is seeing a much more pronounced slowing in recent months - a trend that is reflected in other measure of the market pulse, including auction volumes, clearance rates, and market sentiment. On the other side of the coin, prices in Perth remain lower than they were at the same time last year, although the magnitude of the falls has gradually subsided since mid-2016, consistent with expectations that the worst of the economy's post mining boom woes may soon be behind us. But despite prices remaining a little more resilient than expected this quarter (outside Sydney), we have maintained our view for more muted market performance going forward, particularly following our revised expectations for RBA rate hikes which have been brought forward to mid-2018 (from H2 2019).

In terms of annualised growth, Hobart has been the best performer of late, with prices rising more than 14% over the year to September. However, of the bigger east coast markets, Melbourne has seen the strongest growth, rising around 12% over the year. Meanwhile, prices in Sydney have risen almost as much - up 11% - however, that marks a notable slowing from growth of nearly 20% earlier this year. For the other capital cities, the Brisbane and Adelaide markets are seeing more modest gains, which are more in keeping with subdued increases in household income, while Darwin is the only other major city besides Perth to see declines over the past year.

By property type, detached house prices have generally performed better across most markets. In many cases that simply reflects the land component of the property price, however, the apartment segment in some markets have also come under pressure from supply-side concerns. That has been particularly evident in Brisbane, where reports of settlement issues have become common, with unit prices seeing a 2.6% decline over the past year despite detached houses seeing a solid gain of 4%.

Melbourne has often been cited as a market with apartment oversupply risk as well, however, solid population growth and an overall buoyant housing market has helped to underpin near double digit growth in unit prices - similar observations can also be made for Sydney.

We have long anticipated a definitive shift to more moderate market conditions, brought about by a combination of factors (which vary across markets) including deteriorating affordability, rising supply (primarily apartments) and tighter credit conditions following the macro prudential response to financial stability concerns (mainly targeted at investors). While we are yet to see clear evidence of that, we continue to hold this view - although recent price trends suggest the timing of the shift may vary somewhat across markets. Additionally, we anticipate an even higher degree of uncertainty around the price outlook than usual given the relatively unchartered waters of macro prudential intervention. Such measures are often thought to have their greatest (dampening) impact on the market early on, before losing their potency over time - making the seemingly divergent trends between the Sydney and Melbourne markets at present all the more perplexing. This could suggest some upside risk to our outlook should prudential policy lose potency, helping Sydney regain some of its previous price momentum. Foreign demand is another consideration that is difficult to ascertain. Policy makers both domestic and overseas have sought to stem the tide of foreign capital entering the Australian property market, and the NAB Survey indicated that these measures have had a noticeable impact.

Our analysis of underlying property values suggests that prices have deviated substantially from income based fundamentals in recent years. However, there are still a number of positive elements that should support the market enough to prevent a severe adjustment in prices (assuming important factors such as the economic outlook play out largely as expected). Mortgage rates remain near record lows (despite a tightening in credit conditions earlier this year), and some lenders appear to be taking their foot off the brake again more recently - according to RBA data the discounted variable mortgage rate has returned to its previous low. That is helping to keep mortgage interest payments well down on previous peaks (as a share of disposable income), despite disappointing growth in incomes. Meanwhile, the housing supply-demand balance remains quite favourable, with most cities (excluding Perth and Darwin) seeing rental vacancy rates in undersupplied territory (below 3%), consistent with NAB estimates that show a high degree of pent-up demand for housing in many states (especially NSW and Victoria) - population growth in Victoria has been particularly strong, and is expected to remain elevated.

With only a few months remaining in 2017, changes to the price forecasts largely reflect more up to date information on prices, including recent revisions to the hedonic price history by CoreLogic (reflecting methodological changes). Overall, the forecast for 2017 is now slightly lower for detached houses than reported in the Q2 NAB Residential Property Survey, mainly due to softer price growth in Sydney. That more than offsets upward revisions to most other capital cities. For medium density dwellings, supply side risks are yet to materialise as expected, prompting upward revisions in most capital cities for 2017 (especially Melbourne). House prices are forecast to rise 4.6% (previously 5%) in 2017, while unit prices are forecast to increase 4.7% (was 3%).

Further out, our assessment of the market direction is largely unchanged, with the factors raised above, along with RBA interest rate hikes in H2, likely to drive more moderate price growth on balance in the major property markets next year. That said, recent price momentum and much stronger market sentiment in the NAB Survey have prompted us to revise up some of our forecasts for 2018, especially for Melbourne apartments. However, that is more than offset by softer growth in Sydney. House prices are forecast to increase by 3.4% in 2018 (previously 4.3%), with growth easing further to 2.5% in 2019. The underperformance seen in the apartment market is set to continue, reflecting the heightened supply concerns in some cities and uncertainty around the future of foreign demand. The timing of when new supply will come online and the willingness of potential buyers to shift their preferences towards smaller dwellings (influenced by affordability, cultural shifts, infrastructure and so on) remains a source of uncertainty for the outlook, although the recent resilience in prices has been encouraging. Unit prices are forecast to rise 0.5% in 2018 (previously -0.3%), with a modest decline expected in 2019.

By capital city, house price growth is forecast to be solid outside of Perth, consistent with outcomes in the NAB Residential Property Survey, good local labour markets and relatively tight supply. Sydney, Melbourne and Hobart will all see solid, albeit slower, growth in prices. Brisbane and Adelaide will cool also, while Perth will remain very weak - although 2018 is expected to mark the beginning of a gradual turnaround for Perth. These trends will broadly continue into 2019. Units price in most cities are expected to be fairly flat in 2018, while Brisbane will likely see additional declines. Naturally, any additional changes to government or prudential policy to address affordability or financial stability concerns, are likely to have an impact on these forecasts.

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NAB HEDONIC HOUSE PRICE FORECASTS (%)*

	2015	2016	2017f	2018f	2019f
Sydney	15.5	10.7	5.1	3.7	3.0
Melbourne	15.8	9.5	8.6	5.5	3.4
Brisbane	6.9	2.7	3.1	1.9	1.2
Adelaide	3.8	3.8	3.4	1.7	1.7
Perth	-4.2	-2.9	-3.0	0.7	1.2
Hobart	7.0	9.6	10.0	4.9	1.7
Cap City Avg	**11.2**	**7.3**	**4.6**	**3.4**	**2.5**

*Percentage changes represent through the year growth to Q4

NAB HEDONIC UNIT PRICE FORECASTS (%)*

	2015	2016	2017f	2018f	2019f
Sydney	13.1	5.8	5.9	0.5	0.6
Melbourne	7.5	4.7	6.4	1.2	-2.4
Brisbane	1.1	-3.0	-1.1	-1.8	-1.2
Adelaide	2.4	0.6	0.5	0.5	0.5
Perth	-2.8	-6.3	-1.9	0.4	0.7
Hobart	1.1	6.4	5.7	2.4	0.6
Cap City Avg	**8.2**	**3.5**	**4.7**	**0.5**	**-0.3**

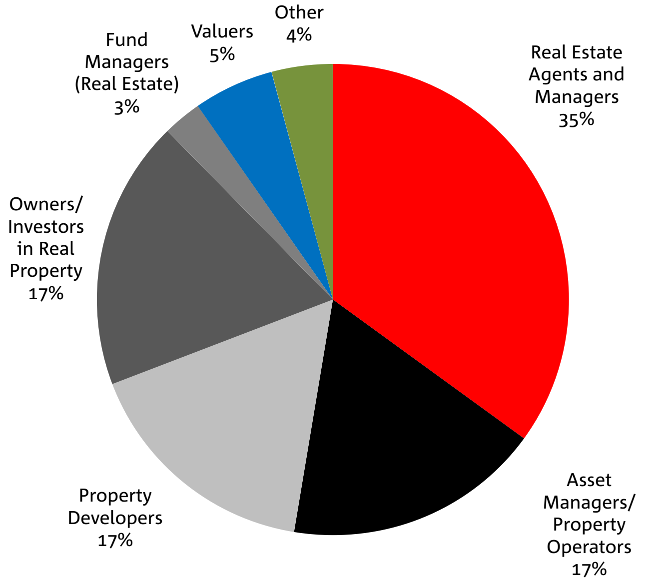
*Percentage changes represent through the year growth to Q4

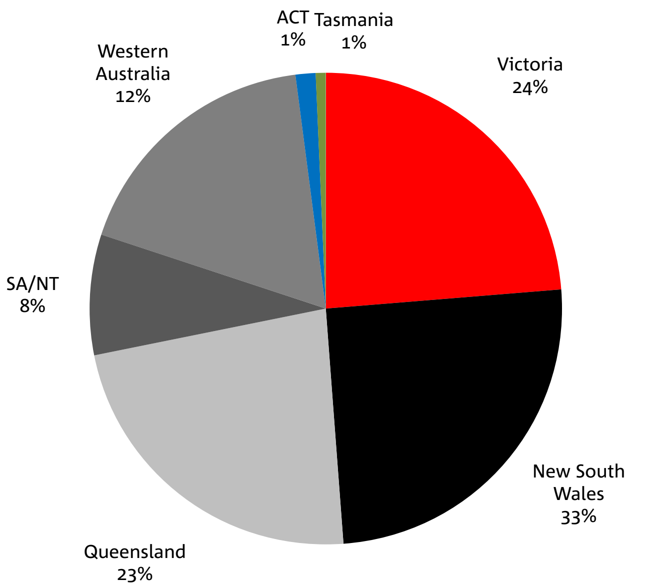
SOURCE: CoreLogic, NAB Economics

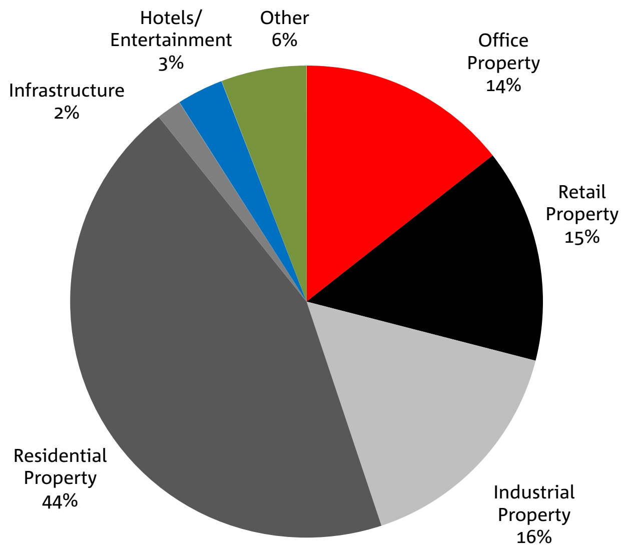
ABOUT THE SURVEY

The NAB Quarterly Australian Residential Property Survey was first launched in Q1 2011. The survey was expanded from NAB's Quarterly Australian Commercial Property Survey, which was launched in April 2010. Given the large number of respondents who are also directly exposed to the residential market, NAB expanded the survey questionnaire to focus more extensively on the Australian residential market.

The large external panel of respondents consists of Real Estate Agents/Managers, Property Developers, Asset/Fund Managers and Owners/Investors. Around 300 panellists participated in the Q3 2017 Survey and the breakdown of our Survey respondents - by location, property sector and business type - are shown below.







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