13 January, 2023

Australian unit market update
January 2023

By Kaytlin Ezzy, Economist at CoreLogic

The Australian unit market's performance in 2022 can be split into two acts. The first four months of the year were characterised by an easing in the monthly growth rate, resulting in a modest 1.1% rise in values between December 2021 and April 2022.

Increasing interest rates, low consumer confidence and persistently high inflation dominated the second act, adding downward pressure on values and taking unit values -5.2% below their April peak. While the detached housing market followed a similar pattern, one difference between the two housing types has been the severity of these value movements.

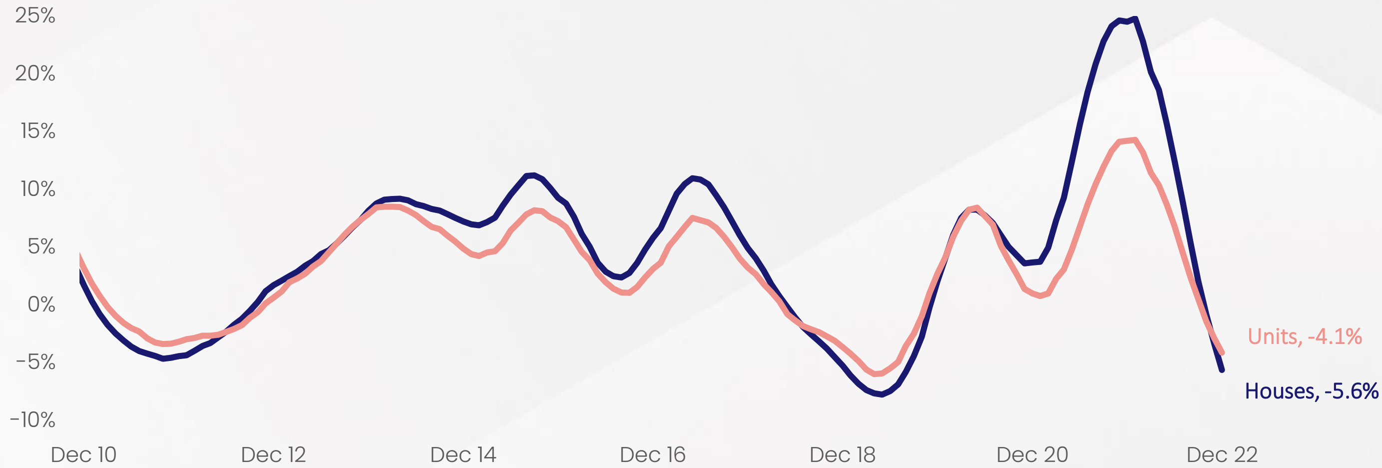
CoreLogic Economist Kaytlin Ezzy said the current downturn, May to December 2022, has shaved approximately -$73,000 off the average Australian house value, compared to a decline of -$32,400 in the average national unit value.

"Historically, house values have been more volatile than units, recording larger gains through the upswing and larger depreciation during a downswing. The current cycle has been no different," she said.

"As the downturn matures, the resilience of the unit market has now become evident in the annual growth trend, with the annual performance gap between house and unit values inverting for the first time since May 2020 in November (-50 basis points) and widening further in December(-150 basis points)."

"This is in stark contrast to September 2021, when the annual performance gap between houses and units peaked at 10.9 percentage points."

Figure 1 – Rolling annual growth rate, national houses and units



Affordability is a leading factor protecting unit values from steeper declines. At just under $600,000, the median value for national units is approximately $170,000 cheaper compared to the average house, while across the combined capitals, the gap is wider, at approximately $247,000.

"With eight consecutive rate rises reducing the average borrowing capacity by around 13.3%[1], it's likely a number of prospective buyers can no longer borrow the amount required to purchase a house and are instead looking towards the unit market as a more affordable option," Ms Ezzy said.

[1] Using the June 2022 median household income ($1701 p/w) sourced from ANU, the average borrowing capacity has decreased from $594,100 in April (P&I of 2.41%) to $515,300 in December (P&I of 5.08%- assuming the November and December rate rises are passed on in full).

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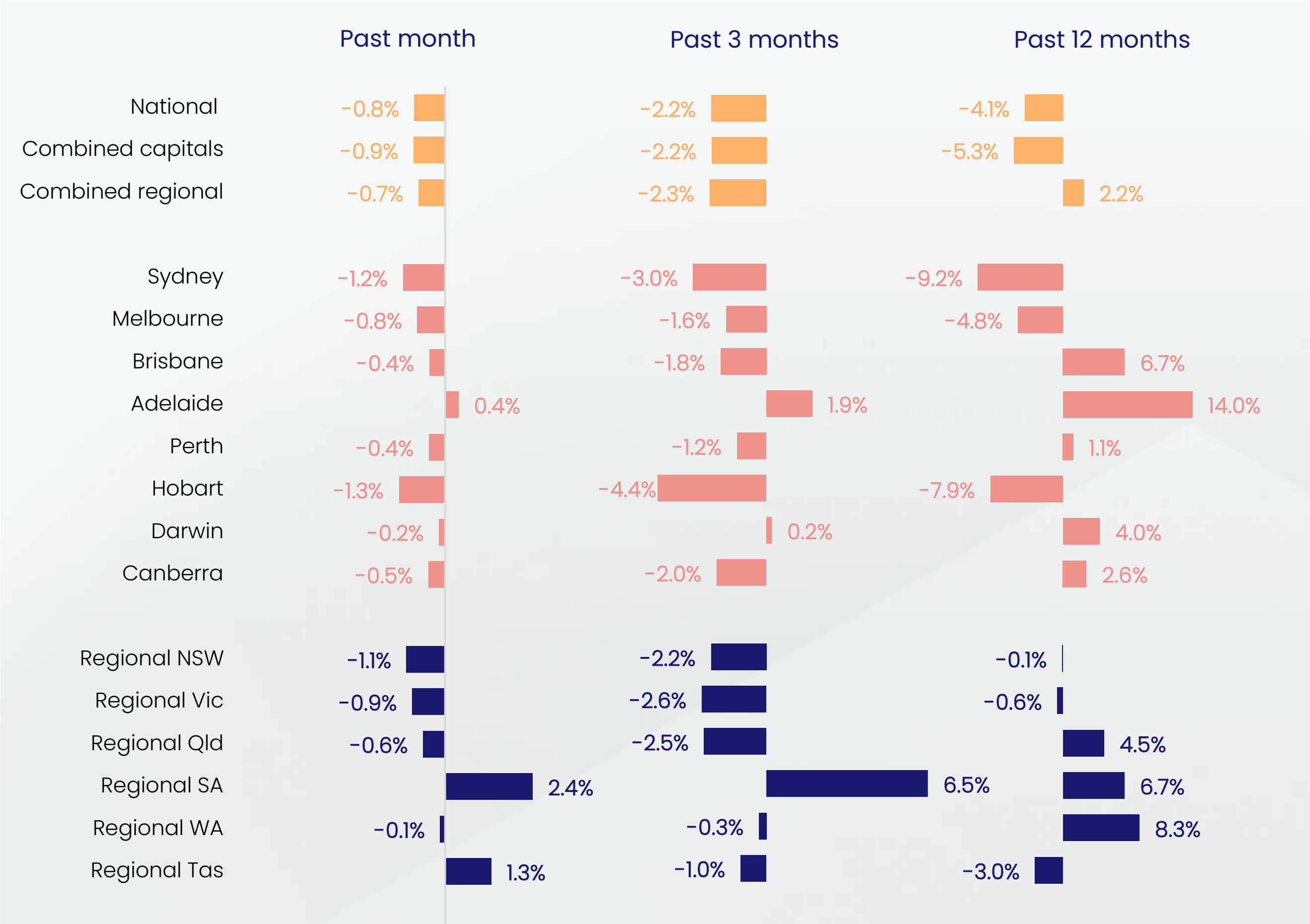
Figure 2– Change in unit values by region (as at end of December 2022)



Despite unit values being supported by their relative affordability, the rate-tightening cycle has seen the overall affordability of unit's decrease. Previous CoreLogic research shows the portion of the average household income required to service a unit mortgage increased from 30.0% in September 2021 to 35.8% in September 2022.

"Mortgage serviceability has likely continued to erode with further rate rises in October, November and December, taking the cash rate 300 basis points above the emergency lows in April," Ms Ezzy said.

"Assuming the November and December rises are passed on in full, the monthly mortgage repayment on a typical unit will have increased by $614, despite the mortgage principle decreasing by approximately $26,000[2]."

Sydney remains the country's most expensive capital city unit market, with a median value of $772,807, despite recording an annual decline in value of -9.2%, the largest of the capital cities. Suburbs in Sydney's Eastern Suburbs and Northern Beaches recorded the largest unit value declines, falling more than 20% in some instances. Units in Centennial Park, Belrose and Vaucluse recorded declines of 23.8%, 23.4% and 23.1%, respectively.

On the flip side, Adelaide had some of the best-performing unit values in 2022, with suburbs such as Seacliff Park, Paradise, Campbelltown, Newton and Mitchell Park all recording annual increases in excess of 30%. Across the broader Adelaide region, unit values rose 0.4% in December, taking values 14.0% higher over the 12 months to December 31.

Across the other capital cities and 'rest of state' regions, unit values across Regional Western Australia rose by 8.3% annually, followed by Brisbane (6.7%), Regional SA (6.7%), Regional Queensland (4.5%) and Darwin (4.0%). Canberra and Perth recorded milder annual increases of 2.6% and 1.1% respectively, while Regional New South Wales (-0.1%), Regional Victoria (-0.6%), Regional Tasmania (-3.0%), Melbourne (-4.8%) and Hobart (-7.9%) all saw values fall below the levels recorded this time last year.

[2]Monthly mortgage repayments were calculated assuming a 20% deposit and a 30-year loan. The current mortgage repayment is calculated using the current national median unit value and an average variable mortgage rate of 5.08%. The April mortgage repayments was calculated using April's index-adjusted median value and the average variable rate of 2.41%.

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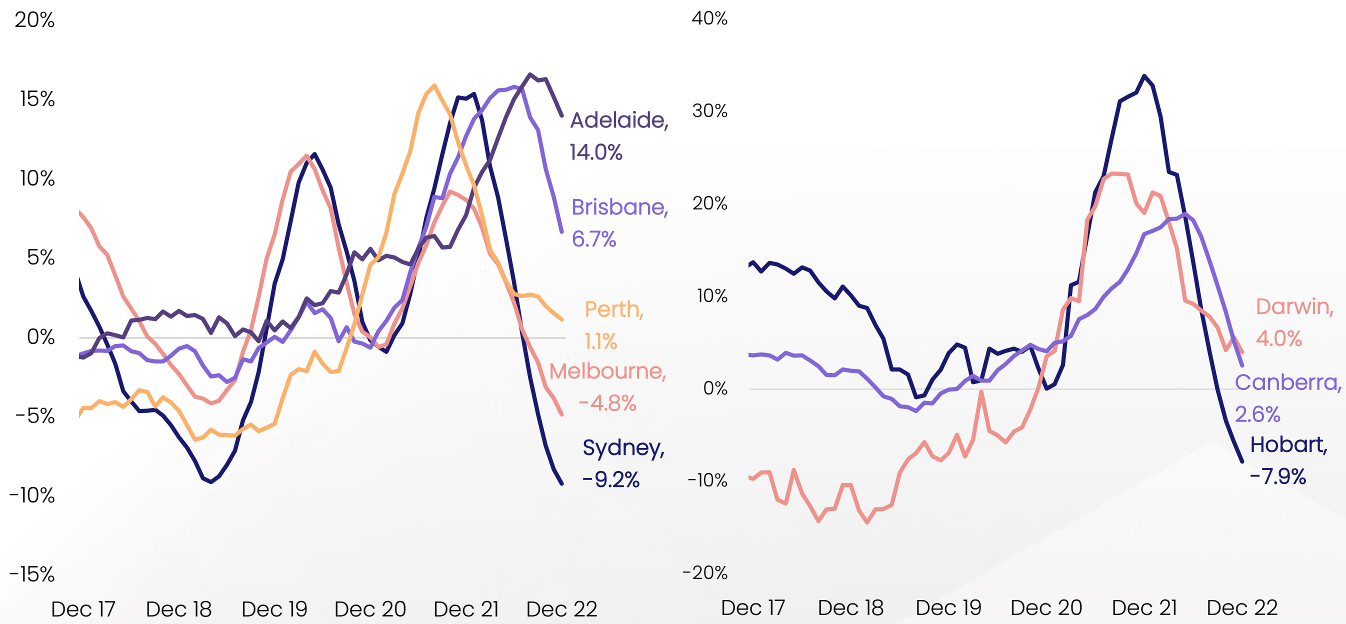
Figure 3– Rolling annual growth rate - capital city units



"While there have been some early signs of a slowdown in the pace of declines, the outlook for units, just as it is for the property market as a whole, remains uncertain," Ms Ezzy said.

The upwards revision of a number of banks peak cash rate forecasts in December, as well as renewed concerns about the looming fixed-rate cliff, saw the monthly rate of decline re-accelerated from -0.6% in November to -0.8% in December, Ms Ezzy said. The increased rate of monthly declines across Sydney (20 basis points) and Melbourne (50 basis points), makes up 56.0% of Australia's unit market and weighed heavily on both the combined capital and national trends.

Some of the variances in unit value growth across the different regions can partially be explained by total listing supply. Over the four weeks to Christmas, total advertised unit listings across Melbourne and Hobart were 3.3% and 19.9% above the previous five-year average, respectively, while total listings across Sydney normalised somewhat over the year. At the other end of the scale, advertised unit listings across Adelaide, Brisbane and the combined regionals were -54.6%, -39.7% and -37,4% below the five-year average.

Figure 4 - Total unit listings, change from previous year and previous five-year average - 4 weeks ending 25/12/2022

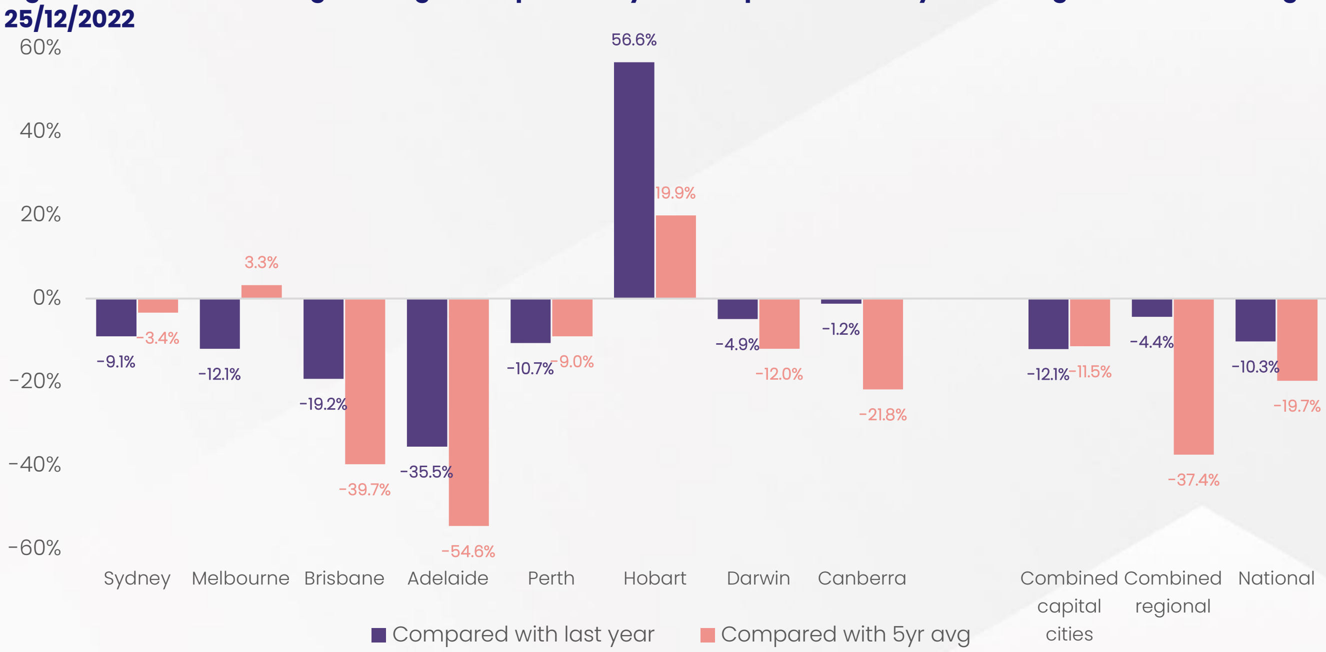


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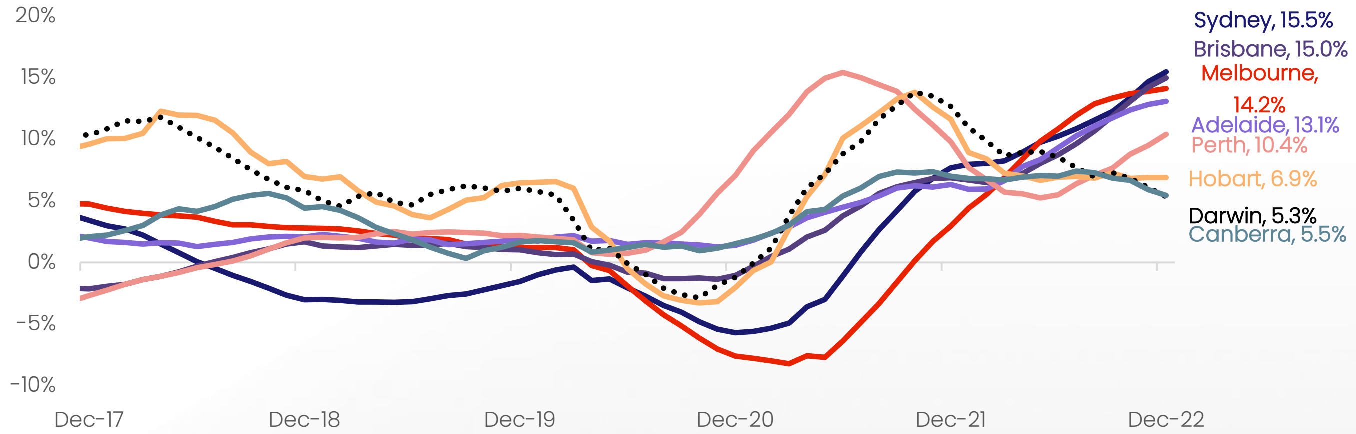
Figure 5 – Rolling annual rental growth rate –capital city units



A record annual rental growth rate of 13.4% nationally was also a standout trend of the 2022 Australian unit market. While house rents also recorded solid rental growth of 9.0%, the relative affordability of unit rents - $519 compared to $570 for houses - coupled with the return of overseas migration saw rental demand shift towards the medium to high-density segment. This preference for unit rentals was seen across all capitals, except for Perth, where house and unit rents increased 11.3% and 10.4%, respectively, in 2022.

The strong return of overseas migrants, who typically choose to rent in inner-city Sydney and Melbourne upon arrival, was likely a contributing factor to Sydney's record annual unit rental increase, up 15.5% or $83 per week over the year. Brisbane saw rents rise 15.0% over the year, followed by Melbourne at 14.2%, equating to a rent hike of $66 per week and $60 per week, respectively.

Across Sydney and Melbourne, the strong annual results were driven by inner-city unit suburbs, while Brisbane's unit rental growth was evenly distributed between the inner-city and outer-suburban markets. Units in Melbourne's CBD recorded the strongest annual rental appreciation, up 37.8% over the 2022 year.

"It's not surprising that Melbourne city recorded the highest unit rental growth for the year. The COVID period, consecutive lockdowns, suspension of overseas migration and a preference for lower-density regional markets caused rental values to fall -23.8% between March 2020 and May 2021. It wasn't until June 2022 that unit rents in the city rose above pre-COVID levels," Ms Ezzy said.

While the pace of rental growth has started to ease as rental affordability has become increasingly constrained, the strong return of overseas migration coupled with consistently tight rental supply should help support unit rental appreciation for some time yet.

National gross rental yields for units expanded further in December, increasing ten basis points to 4.39%. It's likely gross yields will continue to recover in 2023 as values find their floor and rents reach a peak.

Figure 6 - Gross rental yields (units) – current vs one year prior

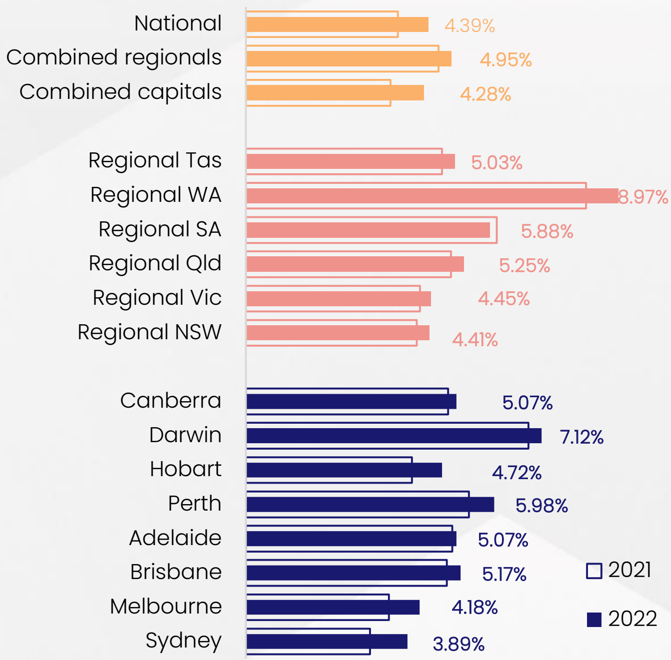
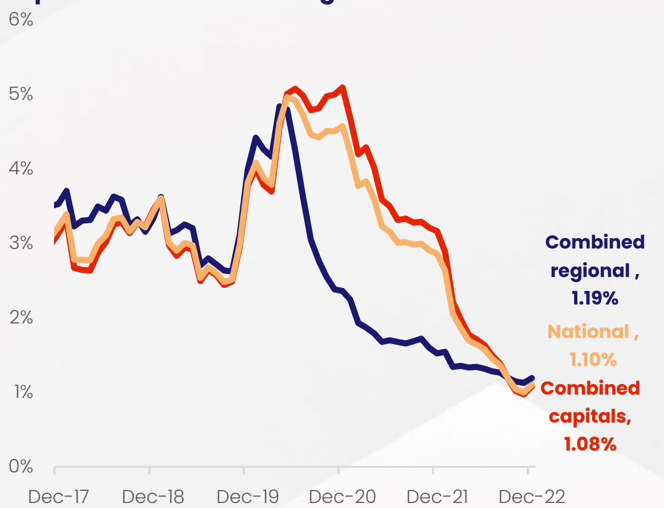


Figure 7 – Unit vacancy rates – National, combined capitals and combined regional



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The outlook for 2023 remains skewed to the negative, with the cumulative rate rises now above the 300-basis point serviceability buffer that recent borrowers were assessed under. Additionally, a large portion of fixed-term loans are expected to expire throughout 2023, with many borrowers who entered the market in the past two or three years transitioning from a fixed-term rate around the 2% mark to rates in excess of 5.0%. With interest rates expected to rise throughout the first quarter of 2023, it's likely a growing number of households will be feeling the pinch from higher interest rates along side such high inflation, stretching household balance sheets.

However, Ms Ezzy suggested a number of tailwinds should help shield unit values from the worst of the current downturn, including relative affordability, low supply levels, and the return of investors, who typically prefer the medium to high-density sector.

"As units approach the floor in values, the prospect of medium to long term capital gains, coupled with strong rental returns, could entice more investors," she said.

Another potential tailwind for NSW units is the introduction of a land tax option for first-home buyers.

"It's not uncommon for many first home buyers to postpone looking for a property until they can afford a home that will meet their medium to long-term needs, rather than purchase a more affordable unit that would meet their short-term needs. As one of the largest transaction costs, stamp duty is a significant factor contributing to the cost of entering the housing market."

"The introduction of the land tax as a stamp duty alternative for NSW first home buyers could see more demand shift towards the medium to high-density segment as younger buyers look to satisfy their short-term needs."

Figure 8 -Unit performance summary table (as at end of December 2022)

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Regional NSW	Regional Vic	Regional Qld	Regional SA	Regional WA	Regional Tas	Combined capitals	Combined regional	National
Values																	
Median value	**$772,807**	**$589,752**	**$492,059**	**$437,027**	**$406,621**	**$528,256**	**$382,695**	**$599,937**	**$570,867**	**$409,666**	**$540,503**	**$262,069**	**$266,017**	**$385,545**	**$612,308**	**$504,437**	**$591,480**
Monthly	-1.2%	-0.8%	-0.4%	0.4%	-0.4%	-1.3%	-0.2%	-0.5%	-1.1%	-0.9%	-0.6%	2.4%	-0.1%	1.3%	-0.9%	-0.7%	-0.8%
Quarterly	-3.0%	-1.6%	-1.8%	1.9%	-1.2%	-4.4%	0.2%	-2.0%	-2.2%	-2.6%	-2.5%	6.5%	-0.3%	-1.0%	-2.2%	-2.3%	-2.2%
Annual	-9.2%	-4.8%	6.7%	14.0%	1.1%	-7.9%	4.0%	2.6%	-0.1%	-0.6%	4.5%	6.7%	8.3%	-3.0%	-5.3%	2.2%	-4.1%
Total return	-6.3%	-1.4%	11.9%	19.6%	6.8%	-3.9%	11.1%	7.6%	3.9%	4.3%	10.1%	17.6%	17.0%	1.9%	-1.8%	7.4%	-0.3%
Rents																	
Median rents	**$616**	**$482**	**$504**	**$433**	**$479**	**$484**	**$509**	**$582**	**$478**	**$352**	**$564**	**$279**	**$468**	**$372**	**$527**	**$480**	**$519**
Monthly	0.9%	0.7%	1.1%	0.8%	1.1%	0.6%	0.1%	-0.1%	0.4%	0.5%	0.9%	-0.2%	1.1%	0.9%	0.8%	0.7%	0.8%
Quarterly	3.9%	2.3%	3.6%	2.0%	3.1%	0.1%	1.0%	-0.2%	0.8%	0.8%	2.2%	-1.5%	5.7%	1.3%	3.1%	1.7%	2.8%
Annual	15.5%	14.2%	15.0%	13.1%	10.4%	6.9%	5.8%	5.5%	7.2%	5.6%	13.3%	4.9%	14.2%	6.2%	14.1%	10.5%	13.4%
Gross yield	3.89%	4.18%	5.17%	5.07%	5.98%	4.72%	7.12%	5.07%	4.41%	4.45%	5.25%	5.88%	8.97%	5.03%	4.28%	4.95%	4.39%
Vacancy rates	1.38%	0.98%	0.79%	0.26%	0.64%	0.88%	1.90%	1.61%	1.32%	0.80%	1.14%	1.29%	1.90%	1.17%	1.08%	1.19%	1.10%

CoreLogic is the largest independent provider of property information, analytics and property-related risk management services in Australia and New Zealand.

Methodology

The CoreLogic Hedonic Home Value Index is calculated using a hedonic regression methodology that addresses the issue of compositional bias associated with median price and other measures. In simple terms, the index is calculated using recent sales data combined with information about the attributes of individual properties such as the number of bedrooms and bathrooms, land area and geographical context of the dwelling. By separating each property into its various formational and locational attributes, observed sales values for each property can be distinguished between those attributed to the property's attributes and those resulting from changes in the underlying residential property market. Additionally, by understanding the value associated with each attribute of a given property, this methodology can be used to estimate the value of dwellings with known characteristics for which there is no recent sales price by observing the characteristics and sales prices of other dwellings which have recently transacted. It then follows that changes in the market value of the entire residential property stock can be accurately tracked through time. The detailed methodological information can be found at:

https://www.corelogic.com.au/research/rp-data-corelogic-home-value-index-methodology/

CoreLogic is able to produce a consistently accurate and robust Hedonic Index due to its extensive property related database, which includes transaction data for every home sale within every state and territory. CoreLogic augments this data with recent sales advice from real estate industry professionals, listings information and attribute data collected from a variety of sources.
* The median value is the middle estimated value of all residential properties derived through the hedonic regression methodology that underlies the CoreLogic Hedonic Home Value Index.

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