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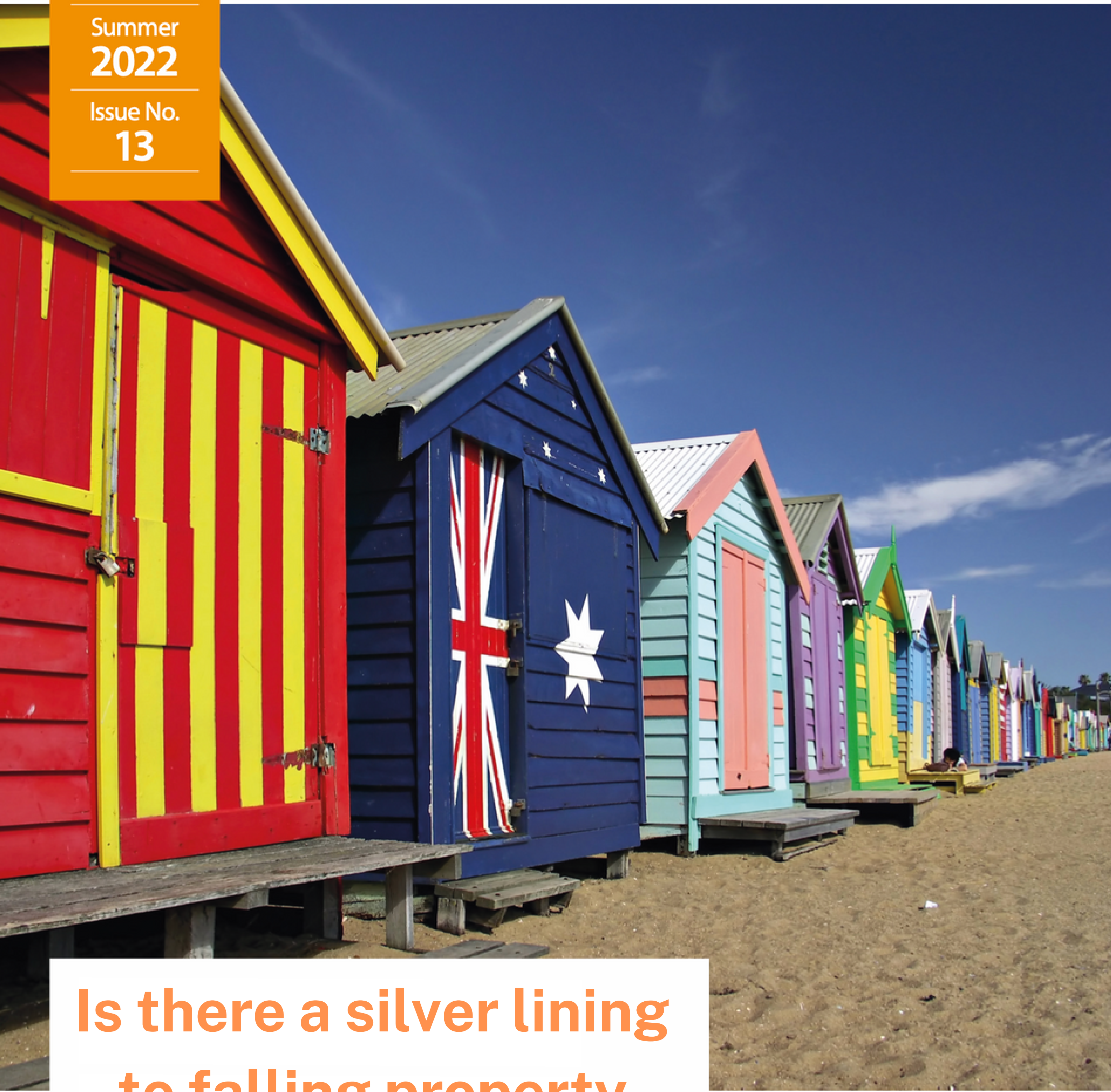

Is there a silver lining to falling property prices?

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Is there a silver lining to falling property prices?

With economists predicting that residential property prices could fall as much as 20%[2], Australia's long-running property bubble may have finally burst. But with adversity comes opportunity.

How much has the market fallen so far?

CoreLogic data shows that capital city house prices are down more than 7% as at October 2022 from the April 2022 peak. Sydney is leading the way with a drop in value of more than 10% since peaking in January, with Melbourne down 6% since February's high.[3]

Home units in capital cities are holding their value better than houses, with prices down 4%.[4] The regions are also showing resilience, with prices down less than 5%.[5]

For property owners who've become accustomed to price growth, these price falls are a stark reversal.

2 The Age, The eye of the storm: House prices still have a long way to fall, 1 November 2022, accessed 15 November 2022.

3 CoreLogic, CoreLogic Home Value Index: Six months of falls for Australia's residential property market, 1 November 2022, accessed 16 November 2022.

4 Ibid.

5 CoreLogic, Monthly Housing Chart Pack, November 2022, accessed 16 November 2022.

Increasing gross rental yields. Falling property prices combined with rent hikes means the average income earned from residential property, as a percentage of property values, has risen.

Rising interest rates – the driving factor

In response to soaring inflation, the Reserve Bank of Australia (RBA) raised interest rates in May 2022. Since then, interest rates have continued to rise, reaching 2.85% as at November 2022.[6]

Now that debt costs a lot more to service, homebuyers aren't borrowing as much as they did before. Compounding the challenge, homebuyers are also absorbing an inflated cost of living.

And although borrowers are factoring in rising interest rates, there's still more downside pressure on property prices to play out, particularly since the RBA is planning further interest rate rises.[7]

So, when will housing prices finally reach the bottom? Likely not until after interest rates stabilise and buyers know how much it will cost them to service their loans.

The upside of the residential property downturn

Increasing gross rental yields. Falling property prices combined with rent hikes means the average income earned from residential property, as a percentage of property values, has risen. According to CoreLogic, across Australia's capital cities, average gross rental yields have risen 0.47% since February 2022 to 3.43%. Breaking this down, the average gross rental yield for units increased by 0.57% versus houses at 0.43%.[8] Gross rental yields in regional areas are on average higher than in capital cities at 4.4% for houses and 3.4% for units.[9]

And increasing international migration will further boost the demand for rental properties.

Lower auction clearance rates. When more properties get passed in at auction, this dials up the pressure on sellers to negotiate on price and terms. Clearance rates dropped to an average of 59.5% over the four weeks to 6 November 2022, from 78.5% for the same period a year ago.[10]

Longer time on the market. Properties now take longer to sell which means investors have more time to negotiate on price, terms and to complete due diligence. In the three months to October 2022, the time the average property was on the market stretched out to 36 days, up from 20 days in the three months to November 2021[11].

Regional markets are holding up better than capital cities. Regional markets are benefiting from lower price points versus capital cities and increased demand driven by the exodus of people from capital cities. Areas within commuting distance are benefiting the most. This interest in the regions is a trend that appears to be here to stay as workers take advantage of formalised work-from-home employment arrangements.[12]

The threat to residential property investors

Loan servicing costs are high and rising. Some economists are predicting that the RBA will continue to raise interest rates over the next year, possibly another full percentage point to 3.85%.[13] And there's no limit to how high interest rates could go.

Harsh penalties for those unable to stay invested for the long term. The weakening residential property market is putting some investors into a negative equity position. So, if the unexpected happens and you need to cash out your investment in a hurry, selling a property can take months and carries the risk of significant capital loss.

Economic uncertainty. Rising inflation and rocky consumer confidence, among other adverse economic pressures, could make it hard for some tenants to pay their rent.

Complex legal obligations. Becoming a landlord comes with shifting legal exposure together with tax and reporting obligations.

Unexpected maintenance costs. While there's always a cost to maintain property, significant, unexpected damage, such as from excessive rainfall or mould, can mean financial pressure.

Other ways to invest in property

Because of the large up-front costs, interest rate risks and longer time horizon, residential property investing isn't for everyone. The good news is that investing through your super or a managed fund can provide growth and yield opportunities from investments in commercial, industrial or retail property.

Getting advice

After decades of steady growth, we may be returning to a cycle of property market volatility. This makes scenario planning, cash flow modelling and risk-buffering an essential part of residential property investment. We can help you look at your options and determine if residential property investing is a suitable option for you.

6 Mozo, How high will interest rates go? 11 November 2022, accessed 16 November 2022.
7 Ibid.
8 CoreLogic, CoreLogic Home Value Index: Six months of falls for Australia's residential property market, 1 November 2022, accessed 16 November 2022.
9 Ibid.
10 CoreLogic, Monthly Housing Chart Pack, November 2022, accessed 16 November 2022.
11 Ibid.
12 Ibid.
13 Mozo, How high will interest rates go? 11 November 2022, accessed 16 November 2022.