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A softening sharemarket and continued interest rate uncertainty is set to change the face of Melbourne's property market in 2008, write Mark Armstrong and David Johnston

In decades past, Melbourne's property market was a relatively easy place for first-time investors and homebuyers to gain a foothold. With a large population and broad-based economy, the city's property prices didn't suffer the meteoric rises and sharp corrections of Sydney (and more recently, Perth).

But in recent years, things have begun to change. Many investors left the Melbourne market in 2003-2004 when prices grew strongly and rental returns diminished. They stayed out until early 2007, but even then, the return was a trickle, not a flood.

By contrast, homebuyers stayed out of the market for only a couple of years. They began coming back around 2005 and have dominated the scene ever since. This means the homebuyer sector has been largely responsible for driving the Melbourne median house price up from \$393,000 in December 2006 to \$485,000 in December 2007— an increase of 23.4 per cent.

This growth has been particularly pronounced at the top end of the homebuyer market in areas like Camberwell, Kew and Malvern East, where, according to the Real Estate Institute of Victoria, owner occupiers own around 75 to 80 per cent of property. Many of these homebuyers have large share portfolios or hold senior positions in listed companies, so their incomes are tied to sharemarket performance.

Over the last couple of years, a strong economy and buoyant sharemarket have increased their confidence. Armed with a higher tolerance for risk, they have geared heavily to purchase expensive homes.

However, the cumulative effect of multiple interest rate rises over the last five years will start to bite in these locations in 2008. Homebuyers don't have the ability to counteract the effect of rate rises by increasing asking rents, so it's likely that demand will soften and prices will moderate.

At the same time, increasing sharemarket instability will see more investors turning to residential property in the belief that it offers a comparatively stable place to park their funds. Others who bought property during the late 1990s and have held onto their assets will be attracted back for another round by rising asking rents and strong capital growth. As we head further into 2008, last year's investor trickle will gradually build to a flood.

Both groups of repeat investors have a huge advantage over first-time investors and homebuyers. Those who have benefitted from the sharemarket's rapid rise over the last few years will have plenty of cash to put towards an investment property.

Those who stayed in the property market will have achieved substantial capital growth, making it easier for them to re-enter the fray. These investors can also purchase more confidently than first-timers because they can put up their existing investment property as security rather than having to put up their family home.

In short, the Melburnians best placed to buy property in 2008 and beyond are those who are already investing. This has major ramifications for the Melbourne market.

As demand in homebuyer-dominated areas slows down, the blue ribbon sector, which includes locations such as Richmond, South Yarra and Elwood, will gather momentum. Investors have long had a stronghold in this sector, owning 55 to 60 per cent of property. As more investors return to the market, competition in these locations will increase and capital growth will escalate.

If the only people who are genuinely competitive in the market are those who are already there, Melbourne will begin to follow the longstanding trend of major northern hemisphere cities, where a small proportion of the population owns the bulk of property.

In this case, the force of compound growth will be enough to propel their wealth further away from that of those who are not in the market. As each year goes by, those knocking on the door will find it harder to get in. Some may be locked out for good.

If they're going to have any chance of getting into the market, first time investors and homebuyers must turn their focus to emerging suburbs like Preston, Pascoe Vale and Oakleigh. When they do, prices in these areas will climb steeply and the face of Melbourne property will undergo yet another transformation.

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