BLUE WEALTH
PROPERTY

AUSTRALIAN
PROPERTY MARKET

State Of Play

2023

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STATE OF PLAY

Introduction

Welcome to the 2023 State of Play.

As I write this intro, I've just returned from a family holiday in Fiji feeling refreshed to start the new year. I was four years old the last time I went to Fiji, and it was interesting to see the country through adult eyes. There were a few things that struck me about it.

The first was the number of Australian tourists there. Judging by the countries of residence for participants of the hermit crab races, about 90% of the resort patrons were Aussies. I guess this is more of a reflection on the proximity of Australia to Fiji than anything else.

The second was the tropical climate. Fiji is on the same latitude as Cairns and it's the wet season up there now. It was hot and humid as hell when it wasn't raining and combined with the sun and volcanic soil up there, anything and everything seemed to grow well.

Finally, there was the obscene contrast between the living conditions of the locals and the five-star resorts. The median income there is 15,692 FJD per annum, that works out to be around 10,350 AUD, which means most of the resort patrons would be dropping the equivalent of a local's annual wage on a one-week vacation. Getting out of our local suburbs and having a look at what is the norm globally gives us some perspective on where we are. It's a good reminder of how we won the lottery simply by living in Australia.

Similarly, a recurring theme throughout this publication will be to step back from the daily noise of the markets and remind us that property is an asset class that lends itself to investing and not trading. Perhaps the best way to get some clarity about our situation is to zoom out and move up a level to get some perspective about where we are and where we are likely headed.

Gavin Chau
Senior Research Analyst

Economic landscape and policy backdrop

The story of 2022 has really been one of two distinct halves. At the beginning of 2022, the global economy was starting to recover from the impacts of COVID, and material prices and shipping rates had all started to fall. This sense of optimism was reflected in global financial markets, and our national property market peaked around March. Even though inflation continued to rise as it had for much of 2021, the central banks were still slow to raise rates for fear of killing the recovery. However, as the year progressed, it became increasingly clear that inflation remained persistently high and, along with it, tensions between Russia and Ukraine. In response, asset markets began to wilt as central banks began to raise rates in mid-2022, marking the beginning of the federal reserve's most aggressive cycle of rate hikes in history and the RBA's fastest rate rises since 1994. By the end of the year, the RBA's cash rate was 3.1%, the highest it had been in a decade.

However, one of the most surprising things was the resilience of the Australian economy. Despite the higher interest rates consumer spending remained strong and unemployment rates remained at 3.5% the lowest they've been in half a century. The Australian economy ended the year 6.4% larger than when the pandemic struck, and wages grew at the fastest pace since 2007. Global GDP is still expected to come in above 3% and Australian GDP around 3.5% for the year – quite a remarkable result given everything that's happened.

However, we now live in a strange opposite world where bad economic news is good news for asset prices. It's important to make the distinction between Wall Street and Main Street. That is to say that asset markets aren't the economy, and the economy isn't asset markets. This is why we see terrible economic news followed by soaring asset prices as central banks drop the interest rates and fire up the money printer in order to stimulate the economy. The excess money created tends to flow into asset prices before the economy recovers due to the Cantillon effect. At present we have yet to see the last of the bad economic news flow through. Typically, the last domino to fall during an economic downturn is usually employment numbers. We have started to see the labour market begin to ease with the opening of borders and the return of overseas migrants. Once the unememployment rate rises further it will likely be the catalyst for the RBA to drop rates and begin to stimulate.

In 2023 those in asset allocation will be watching the official CPI rate and the reserve bank's policy response. We expect interest rates to remain high throughout the first half of the year, but as the effect of the successive interest rate rises works its way through the economy, as well as the mathematical effect of CPI being divided by a higher denominator, inflation will likely decline sharply by Q3 and along with it a turning of the interest rate cycle. The higher cash rate gives the RBA some breathing space to stimulate the economy if things get worse than anticipated.

CPI currently sits at a 32 year high of 7.8% below the 8% forecasted by the RBA for December and for GDP growth to slow to 1.5% over the course of 2023. The unemployment rate is also expected to remain at 3.5% until mid-2023. Our predictions on inflation easing haven't changed from May last year and things have been playing out as we expected. Global inflation is on a downtrend. At present inflation declines have been recorded in 25 out of 38 OECD countries with the US seeing six months of consecutive declines providing clear indication that we have likely seen peak inflation. The second half of the year is likely to see inflation fall off a cliff.

In September 2022 the DXY (USD) index also hit a long-term resistance level going back to 2009. We have been tracking this for some time and the USD has continued to weaken. This allows other countries to ease up with their rate rises because they don't need to defend the strength of their local currencies against the USD through interest rate rises. In addition a stronger AUD relative to the USD is inherently deflationary as it reduces the cost of trading in goods denominated in USD.

We expect the first half of the year to remain relatively bumpy. However, we're almost certainly through the worst of it, and

USD Index

Source: TradingView, Blue Wealth Property

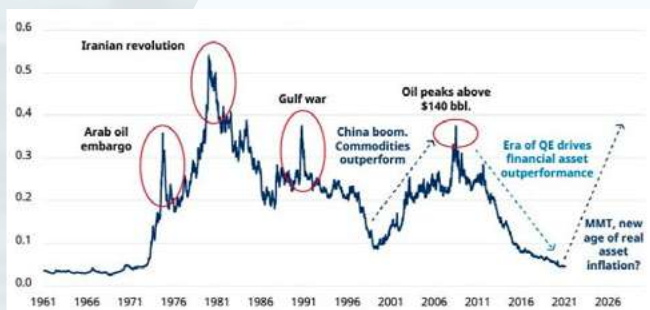
investors will have more reason to be optimistic moving ahead. In the short term, the only real variable is when and how aggressively the RBA ends its tightening cycle. In the long term, our base case remains that the real estate cycle on the east coast will peak between 2026 and 2029. Even in the industry, we must constantly remind ourselves to zoom out and look at the big picture to get clarity. With the declines in Sydney and Melbourne already easing, it's a good sign that a pause in the tightening of monetary policy will stabilise prices, giving investors in 2023 one of the best opportunities to enter the market in the next decade.

Potential for a second global commodities super-cycle

There are a growing number of analysts calling for a new global commodities super-cycle. The last super-cycle from 2000-2014 was primarily caused by an enormous infrastructure boom in China. At the time, the Chinese government was building a city the size of Brisbane every month and with it came an enormous demand for iron ore, coal, and energy. With Western Australia having the cheapest to extract and highest quality iron ore on earth, much of the value of this demand accrued to the Western Australian property market. Darwin was the other major beneficiary of this boom, and the sheer size of this demand was enough to kick both the market cycles out of their normal sequence.

Commodities are cheap on a relative basis

Relative performance of the commodities[1] vs. S&P 500 shown as a ratio



Past performance is not an accurate predictor for future performance.
Source: Schroders, Bloomberg - 29 January 2021. [1]Represented by BCOM TR index. 600500.

While I don't know if this will play out or not, commodities have been a cheap asset class. Not only relative to other assets such as equities but also purely on a historical basis. They have been largely forgotten for the last nine years, but they seem to have turned the corner in 2022 returning 19.3% for the year. This was the best performing asset class by far with all other asset returns being negative (other than cash) which lends some credence to the claims. When commodities do boom, they tend to outperform by a large margin.

There are several points of comparison between now and the early 2000s. Both periods have seen significant underinvestment in commodity supply with capex in oil and gas mining falling around 52% globally between 2013 and 2020. Capital expenditure in the copper industry declined by 44% between 2012 and 2020. While China was the driving factor in the 2000s, it seems likely that we are about to embark on a coordinated global movement to facilitate the energy transition to EVs and clean energy. The energy transition will see an increase in the demand for copper and lithium used in EV batteries and the associated charging infrastructure.

The key differences are that the current focus on climate change is likely to limit investment in fossil fuels even as prices rise. This has the potential to create a supply shock and a resultant spike in prices. In addition, the current geo-political tensions have encouraged a move towards supply chain resilience and strategic stockpiling which could re-enforce demand across both soft and hard commodities.

As China re-opens while the West is on the brink of recession, demand for soft commodities such as soy, pork and corn are also likely to rise. Many countries are now rolling out long-term plans for strategic food reserves, in particular wheat, to lower their import dependency. While this remains speculative for the time being, if this plays out similarly to the previous super-cycle from 2000-2014 it will be beneficial to Australia as a whole, improving our terms of trade. However, Western Australia will also stand to benefit directly.

Asset class total returns since 2011

ETF	Asset Class	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2011-22 Cumulative	2011-22 Annualized
DBC	Commodities	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	11.8%	-7.8%	41.4%	19.3%	-7.4%	-0.6%
BIL	US Cash	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	2.2%	0.4%	-0.1%	1.4%	6.2%	0.5%
GLD	Gold	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	17.9%	24.8%	-4.2%	-0.8%	22.3%	1.7%
HYG	High Yield Bonds	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	14.1%	4.5%	3.8%	-11.0%	58.3%	3.9%
TIP	TIPS	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	8.3%	10.8%	5.7%	-12.2%	32.8%	2.4%
BND	US Total Bond Market	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	8.8%	7.7%	-1.9%	-13.1%	23.5%	1.8%
EFA	EAFE Stocks	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	22.0%	7.6%	11.5%	-14.4%	61.0%	4.0%
LQD	Investment Grade Bonds	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	17.4%	11.0%	-1.8%	-17.9%	45.8%	3.2%
SPY	US Large Caps	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	31.2%	18.4%	28.7%	-18.2%	282.2%	11.8%
PFF	Preferred Stocks	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	15.9%	7.9%	7.2%	-18.2%	55.6%	3.8%
EMB	EM Bonds (USD)	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	15.5%	5.4%	-2.2%	-18.6%	37.2%	2.7%
CWB	Convertible Bonds	-7.7%	15.9%	20.5%	7.7%	-0.8%	10.6%	15.7%	-2.0%	22.4%	53.4%	2.2%	-19.4%	167.0%	8.5%
IWM	US Small Caps	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	25.4%	20.0%	14.5%	-20.5%	163.5%	8.4%
EEM	EM Stocks	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	18.2%	17.0%	-3.6%	-20.6%	2.5%	0.2%
VNQ	US REITs	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	28.9%	-4.7%	40.5%	-26.2%	138.0%	7.5%
TLT	Long Duration Treasuries	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	14.1%	18.2%	-4.6%	-31.2%	43.1%	3.0%
QQQ	US Nasdaq 100	3.4%	18.1%	36.6%	19.2%	9.5%	7.1%	32.7%	-0.1%	39.0%	48.6%	27.4%	-32.6%	447.9%	15.2%
N/A	Bitcoin ($BTC)	1473%	186%	5507%	-58%	35%	125%	1331%	-73%	95%	301%	66%	-65.5%	5510266%	148.4%
Highest Return		BTC	BTC	BTC	VNQ	BTC	BTC	BTC	BIL	BTC	BTC	BTC	DBC	BTC	BTC
Lowest Return		EEM	BIL	GLD	BTC	DBC	BIL	BIL	BTC	BIL	DBC	TLT	BTC	DBC	DBC
% of Asset Classes Positive		61%	94%	44%	67%	39%	100%	100%	6%	100%	89%	61%	11%	94%	94%

Source: CPI Wealth

Where are we in the property cycle?

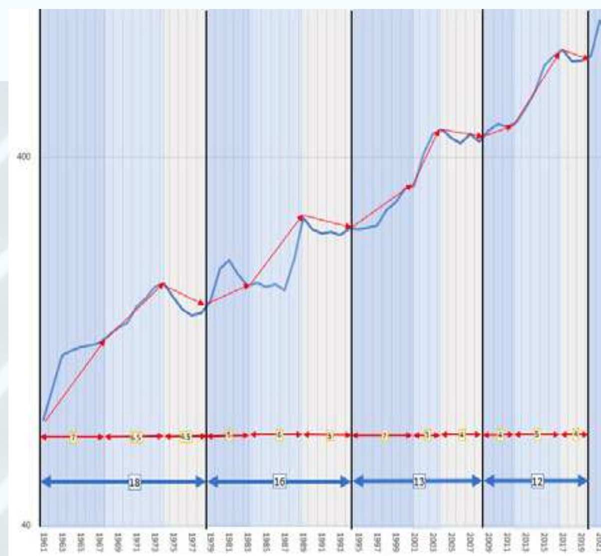
Before we start, we have to preface this with the statistical aphorism that "all models are wrong, but some models are useful, and most are dangerous". I would place this firmly in the useful model camp.

We have clearly entered a new start to the real estate cycle. Contrary to popular belief the real estate cycle runs in 15-to-18-year cycles. However, this only really seems to play out in the larger East Coast property markets in Australia. Specifically, Sydney, Melbourne, and Brisbane. Not surprisingly it also turns out that there is a high degree of correlation between these three markets. The other markets around the country are still small enough to be heavily affected by exogenous factors – primarily commodity cycles.

How much predictive power does this model have for the East Coast? As it turns out, it is remarkably accurate. Other than some price and rent controls distorting the market pricing between 1946 and 1949, the market has averaged 14.8 years peak to peak or trough to trough. Following the peak of the boom there is an average period of correction or consolidation of around 4.4 years before a mid-cycle peak at 5.8 years.

If we look at the most reliable dataset from 1961 onwards, each market cycle features a run up period with an early-cycle top. Followed by a mid-cycle consolidation period where prices flatten off or even decline slightly. And finally, a big run up in the second half of the cycle which results in a standard blow off top and correction to reset everything before the new cycle can begin.

Sydney median house prices ($'000)



Source: Long Term Housing Prices in Australia and some Economic Perspectives, ABS, Blue Wealth Property

One thing that is interesting to note is that the government stimulus as a result of COVID has largely aligned each capital city in terms of timing. This will become clear as a theme throughout the remainder of this publication.

If we extrapolate the above model, it shows that we're almost certainly at a cyclical turning point and the start of an upswing. If history rhymes, then we can expect around 7-9 years of good growth followed by a blow off top and correction. In risk adjusted terms we're likely to be at the best point to enter the east coast property market.

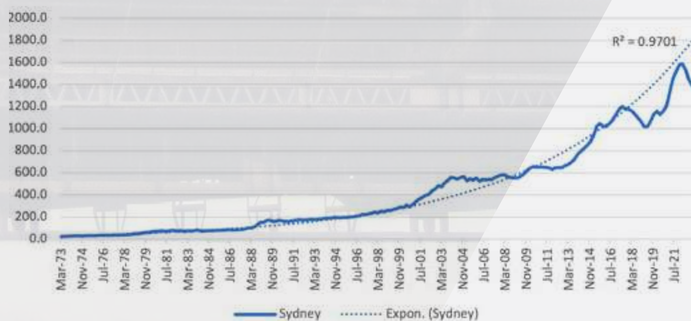
Sydney

At present Sydney houses are leading the property correction. With the median peaking above $1.5m in the beginning of 2022, the market got a little overextended. Over the course of 2022, Sydney houses fell by 8.3%. This was initially sparked by decreased affordability, but the pace of declines has increased as a result of successive interest rate rises. Sydney remains the most indebted housing market in the country and like the rest of the capital cities, continued softness and a general sideways movement is expected until Q3 in 2023.

While Sydney has seen the largest price decline of any capital city and the rental yields remain the lowest, yields have been on the rise since January 2022. This is the first time we have seen a trend reversal in rental yields since 2010. It's a healthy sign that at least one fundamental driver is being reset.

Prices in Sydney are currently under the exponential regression line. While technically undervalued based on this metric, it is likely to continue to chop sideways until the RBA changes its policy stance on interest rates. The newly introduced First Home Buyers Choice initiative now allows first home buyers to the option of choosing an ongoing property tax instead of a large upfront stamp duty payment. The trade-off for an initial lower cost of entry into the housing market will be an ongoing tax on the property. We expect this to help put a floor under the lower end of the housing market as the year moves forward.

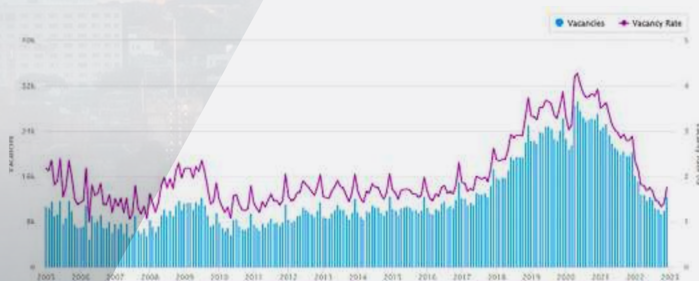
Sydney houses ($'000)



Source: PriceFinder, Blue Wealth Property

After peaking in May 2020, the vacancy rate has been on a rapid decline, bottoming in October 2022 at 1.3%. They have since began to creep up a little measuring 1.8% at December 2022. This indicates a market that remains undersupplied and an upwards pressure on gross rents remains.

Residental Vacancy Rates



Source: SQM Research

All sectors of the property market in Sydney have more than recouped the loss in gross rents because of the pandemic, with unit rents growing by 21.9% in 2022 and houses growing by 17.9% over the course of 2022. We expect rents to continue to rise by 9% for houses and 15% for units over the course of 2023 as skilled migrants return. 2024 is likely to see a tapering of growth with rents falling back to mid-single digits.

The rental yields in Sydney dipped during the pandemic due to the combination of lower gross rents and higher property prices but have since surpassed their pre-pandemic levels with rental growth overtaking price growth over much of 2022. As of December 2022, units are yielding 4.1% and houses yielding 2.7%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Sydney: 3 bedroom house & 3 bedroom unit rents ($per week)

Source: REIA, BIS Oxford Economics

Moving forward in 2023 the combination of real wage growth, improved affordability, higher rents, and lower interest rates will build a solid base from where a recovery will begin.

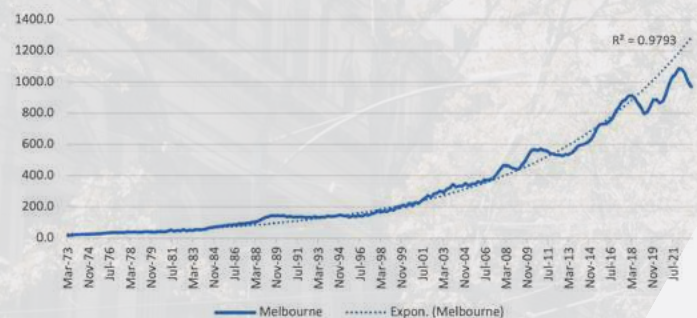
Melbourne

Like the rest of Australia easy money and government stimulus saw Melbourne's house prices increase by 22% in the two years to March 2022 despite rolling pandemic lockdowns. However, the rapid tightening of the credit conditions has seen the market soften considerably. At present the Melbourne housing market has seen top to bottom falls of 7.2% over the last 12 months. Most of the falls have been limited to the luxury housing market in the upper quartile as is the case historically. We expect the market to be soft for the first half of 2023 while prices generally move sideways. The pace of decline has slowed considerably.

Melbourne houses remain under the exponential regression line by a fair margin. It is perhaps the most heavily reliant on net overseas migration and the effect of the pandemic hit this capital city the hardest. While things have been comparatively tough for Melbourne over the past few years this technical indicator suggest that there remains a solid opportunity for buyers over the course of the coming cycle particularly when you consider the long-term growth of Melbourne remains among the top of the capital cities.

The number of listings in Melbourne have been in decline shrinking the size of the entire market. The implication is that it won't take much of a capital inflow to create a rapid move to the upside. The middle and bottom end of the market has likely already found a floor.

Melbourne houses ($'000)



Source: PriceFinder, Blue Wealth Property

The vacancy rates in Melbourne spiked to 5.5% because of the pandemic. Again, this was due to Melbourne's heavy reliance on net overseas migration. As the borders opened, we predictably saw a sharp decline in vacancy rates which bottomed in November 2022 at 1.5% and as of December, they have seen a small tick upwards to 1.7%. At present the market remains in undersupply and as corollary gross rents have been rising very rapidly completely recovering from the losses sustained during the pandemic.

Residental Vacancy Rates

Source: SQM Research

Unit rents grew by 21.4% in 2022 and houses grew by 13.6% over the course of 2022. Melbourne's gross rents remain surprisingly cheap compared to the other capitals. We expect rents to continue to rise by 17% for houses and 15% for units over the course of 2023 particularly as semester one in universities drive an influx of population in Q1. In addition, the reopening of borders should see a solid return to population growth. In absolute terms, Melbourne is likely to see the highest influx of population of all capital cities in the medium term. The year 2024 is likely to continue to see rental growth tapering but remaining in the high single digits.

The rental yields in Melbourne dipped during the pandemic due to the combination of lower gross rents and higher property prices but have since returned to their pre-pandemic levels with rental growth rapidly catching up to prices. As of December 2022, units are yielding 4.1% and houses yielding 2.7%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

The improved yields as a result of flat house prices and rapidly rising rents is likely to see the fundamentals for Melbourne improving considerably over the course of the year. These are the necessary precursor conditions to see the last leg of the property bull market in Melbourne play out.

Melbourne: 3 bedroom house & 3 bedroom unit rents ($per week)

Source: REIA, BIS Oxford Economics

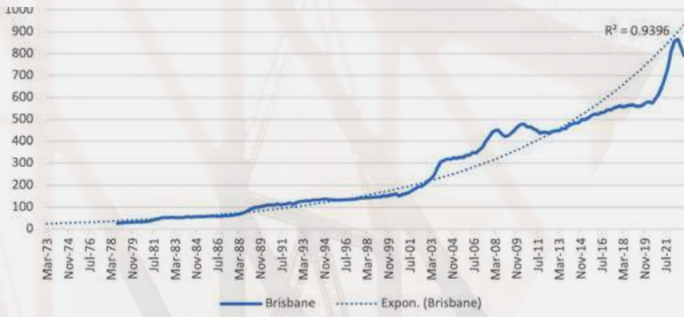
After nearly 10 years of flat growth the Brisbane housing market turned the corner in 2021 and was the best performer in FY2022 with the median house price increasing by 25%. The second half of the calendar year saw some of those gains given up as the successive interest rate rises from the RBA took hold. Ultimately this only pushes the recovery timeline back and we expect the Brisbane market to outperform by the end of the coming cycle but not before suffering from more declines over the first three quarters of 2023.

On a technical basis, the Brisbane housing market ran up very aggressively and got a little overextended. As such a pullback and consolidation is healthy for the market. Prices have been cheap both on a relative and absolute basis for a long time. The Brisbane housing market ran up to the regression line and bounced back a little giving a little breathing space to prospective investors.

The recent announcement of the land tax changes which would have seen some of the larger interstate investors land tax liability increase has been scrapped which is positive for the market.

One area to take note of is that much of Brisbane city is low lying and over the very long term it is likely that the tropical band of earth between the Tropic of Cancer and Tropic of Capricorn will broaden. This increases the likelihood of flood risks and care should be taken with respect to the specific part of Brisbane that is targeted.

Brisbane houses ($'000)



Source: PriceFinder, Blue Wealth Property

Overall, the population growth rate in Brisbane remains very high and the market remains extremely undersupplied. Brisbane has a relatively low reliance on net overseas migration with most of its population growth coming by way of interstate migration from the southern states. Net interstate migration hit a record high of over 50,000 in 2021. As such it was less affected by the pandemic than the other eastern states. Nevertheless, the vacancy rates peaked at 3% in April 2020 indicating a market in balance. This has now declined to 1.1% and there is upwards pressure on the rental market.

Residental Vacancy Rates

Source: SQM Research

The tight rental market caused house and unit rents to rise sharply. Gross rent for houses rose by 14% in 2022. The corresponding figure for units was 22.4%. Unsurprisingly, with the pressure on the rental market this was the fastest rate of increase of all capital cities. These conditions remain unresolved and are expected to continue through 2023. We expect house and unit rents to rise 10% and 12% respectively before tapering to mid-single digit growth over 2024.

The rental yields in Brisbane have remained relatively flat with rental growth roughly tracking price growth. As of December 2022, units are yielding 5% and houses yielding 3.6%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Brisbane: 3 bedroom house & 3 bedroom unit rents ($per week)

Source: REIA, BIS Oxford Economics

Gold Coast

Queensland is unique in that some of the regional satellites can at times outperform the capital. This can partially be explained by higher levels of affordability relative to Brisbane and particularly Sydney and Melbourne as well as internal migration flows – largely from the southern states.

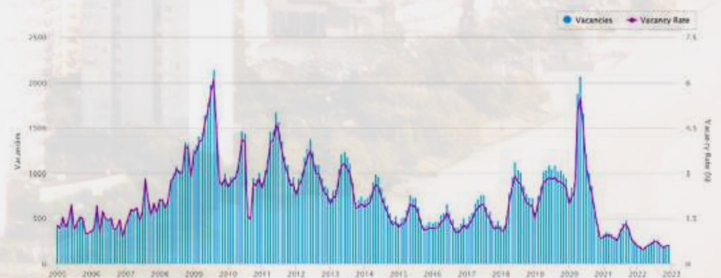
However, the Gold Coast economy is heavily reliant on tourism and the effect of the pandemic has suppressed the economy. However, the Gold Coast has not been immune to the effect of loose monetary policy and the RBA has still managed to pump house prices up by 50% over the two years to Q1 2022.

Gold Coast houses ($'000)

Source: PriceFinder, Blue Wealth Property

Like the other markets, rapidly rising interest rates have seen the top of the market roll over with prices declining 7%. We expect these markets to continue to soften over the course of 2023, as the full effect of the interest rate rises work their way through the economy.

Residental Vacancy Rates



Source: SQM Research

After vacancy rates spiked to 5% in May 2020, they have fallen off a cliff and are sitting at 0.6% as at December 2022 indicating a critical undersupply in rental accommodation. This has put a squeeze on the rental market with asking rents for houses jumping 25.4% in the 12 months to December 2022 and unit rents increasing by 23.5%.

Even though the local economy is reliant on tourism, the capital inflows into the Gold Coast and Sunshine Coast property markets are largely a result of population movements from the southern states. As such the Gold Coast property market will remain relatively robust while the pandemic plays out. We can expect continued growth in gross asking rents even as rental yields continue to compress as house price growth outstrips rent growth over the medium term.

The rental yields in the Gold Coast have remained relatively flat with rental growth roughly tracking price growth. As of December 2022 units are yielding 5% and houses yielding 3.9%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Sunshine Coast

The Sunshine Coast market increased by a substantial 127% over the three years to 2003/4, eclipsing the price growth across metropolitan Brisbane and the Gold Coast over the same period. However, this level of price growth was unsustainable and property prices had a long period of consolidation in the 15 years to November 2020 recording growth near or below inflation.

There has been virtually no yield compression in either asset class with rents tracking growth quite closely. As a result, yields have remained quite strong with houses yielding 4.2%. The corresponding number for units is 4.7%.

Sunshine Coast houses ($'000)

Source: PriceFinder, Blue Wealth Property

However, the property market has well and truly turned the corner in 2021 with house prices increasing by 50% in the two years to Q1 2022.

Construction activity has also weakened as projects have been mothballed by developers during the uncertainty amid COVID. As a result, vacancy rates have not been affected at all, falling from a high of only 2.4% in April 2020 to 1% in December 2022 indicating a chronic undersupply in rental accommodation. As a result, asking rents have increased by 11.3% for houses and 6.4% for units over 2022.

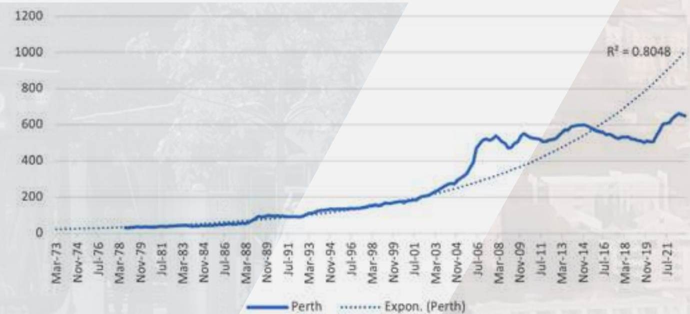
Residental Vacancy Rates

Source: SQM Research

We anticipate that construction activity will remain depressed in the short to medium term. As a result, this should continue to put upwards pressure on both rents and prices. The rental yields in the Sunshine Coast have remained relatively flat with rental growth roughly tracking price growth. As of December 2022 units are yielding 4.7% and houses yielding 4.2%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Perth

The Perth property market is an interesting one and has been heavily affected by commodity prices. As the markets around the country peaked in 2003/04 it continued to boom until 2014 in line with the global commodities super-cycle from 2000-2014. Unsurprisingly, when the commodity prices declined so did property prices, which fell continuously for the next six years.



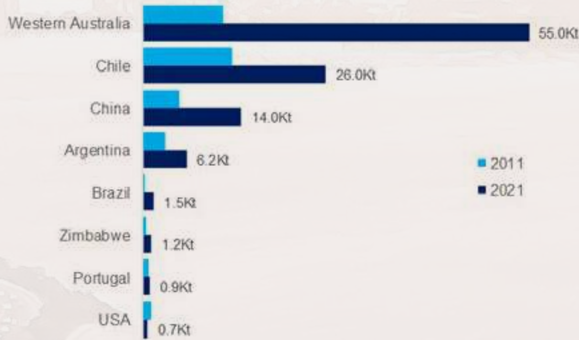
Source: PriceFinder, Blue Wealth Property

The market has since bottomed and is in recovery in line with the national markets. The modest growth of 3% in 2022 was a comparatively good result in what was otherwise a year marked by downturns.

Given the property market effectively experienced a super-cycle in line with commodity prices, it's unsurprising that house prices remain below trend. Housing remains relatively affordable and interstate migration flipped positive in 2022, for the first time in seven years so it's likely that prices will continue to trend upwards.

There are a few factors that could cause the Perth property market to surprise to the upside. One is the potential for another global commodities super-cycle driven by the EV revolution. While this is unlikely to have as much of an effect on Perth as the previous commodities boom, Western Australia is the worlds largest producer of lithium at 52% of global supply – an essential element in creating batteries. Smaller deposits of lithium also exist in South Australia, Queensland and the Northern Territory. Global lithium supply tripled in the 10 years to 2021 with Western Australia contributing 62% to the growth.

Lithium supply[1]: calendar years



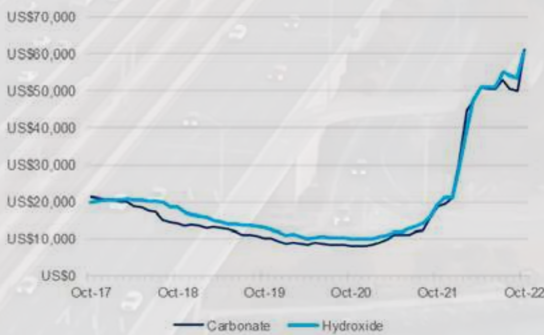
Kt= Thousand tonnes. [1] Mine production.
Source: US Geological Survey, Mineral Commodity Summaries (Annual).

Global lithium demand rose 91% in 2021 and is expected to rise a further 82% to 2024. China is the largest market for Western Australian produced lithium accounting for 96% of the sales in 2021-22. The move to EVs seems inevitable and it is likely that the Perth market will capture the lion's share of the benefit over the course of this property cycle.

Lithium demand[1]: calendar years

Kt= Thousand tonnes. [1] Demand is ahead of consumption by around 12 months due to time taken to manufacture batteries.
Source: Office of the Chief Economist, Resource and Energy Quarterly (Quarter).

Lithium prices[1]: months



[1] US dollars a tonne. Asia, Cost, insurance and freight (CIF). [2] Unit price of Western Australia's spodumene exports (free board) converted to US dollars using the monthly average exchange rate.
Source: S&P Global Market Intelligence/Benchmark Minerals (Month).

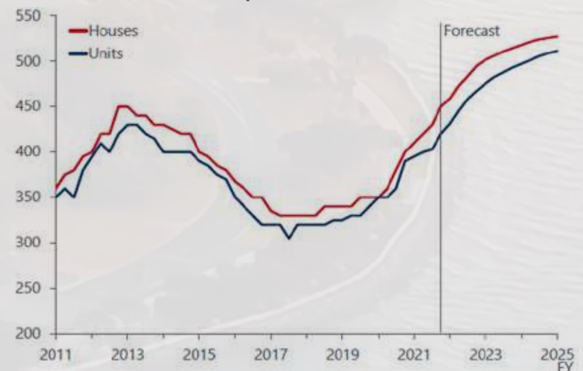
Residental Vacancy Rates

Source: SQM Research, Blue Wealth Property

The rental market in Perth remains solid with vacancies falling from a high of 7.3% in June 2017. This was because of a huge construction overhang, it has now fallen down to 0.5% indicating a critical undersupply in rental property.

The undersupply has been reflected in asking rents with houses jumping 18.9% in the 12 months to December 2022 and unit rents increasing by 14.1%. We expect rents to continue to grow by 16.5% over the three years to June 2025 for houses and 19.7% for units. The rental yields in Perth have climbed upwards owing to the long period of flat growth it experienced with units yielding 6% and houses yielding 4.1%. We expect these yields to increase over the course of the year as gross rents continue to increase and property values remain flat over the first half of the year.

Perth: 3 bedroom house & 3 bedroom unit rents ($per week)



Source: REIA, BIS Oxford Economics

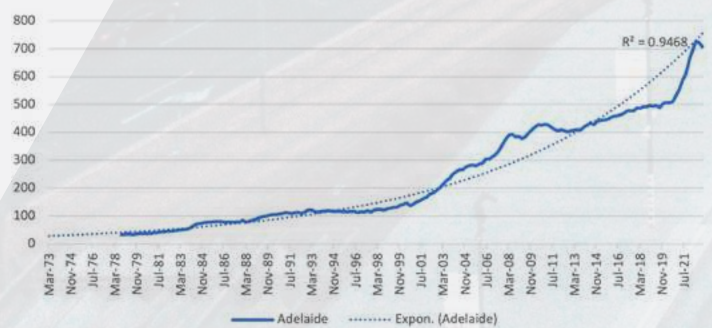
Adelaide

Despite being a capital city, Adelaide has long suffered from both demographic and macroeconomic headwinds of the lowest GSP per capita in the country, slowing population increases and an inability to transition from the declining manufacturing sector to the faster growing knowledge-based service sector economy. As a result, the long-term property market characteristics have closely resembled a small regional centre with flat to negative price growth and high yields.

Despite this, the South Australian economy has remained relatively insulated from the effects of the pandemic due to its lower reliance on international tourism and students. In addition, the public sector makes up a relatively large proportion of its economy. In perhaps the best example of the effect of low interest rates and accommodative fiscal policies on the property market, Adelaide property prices have been a standout performer increasing 8.9% in the 12 months to Q3 2022.

This was aided by the fact that the city had underperformed in the 10 years to 2020 and had relatively high levels of affordability. This said it hasn't been able to escape the effect of the challenging credit conditions and momentum has slowed in the market. The peak to trough price declines is expected to be limited though and Adelaide will likely hold onto a better proportion of the capital growth accumulated over the low interest rate period of the pandemic due to the relative affordability.

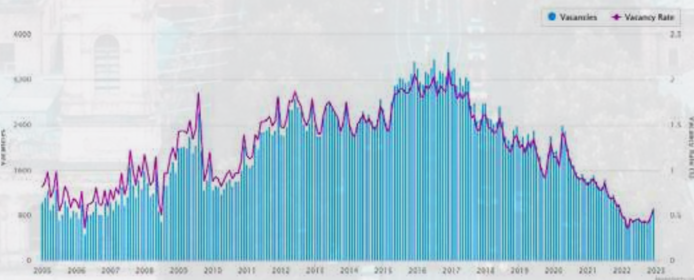
Adelaide houses ($'000)



Source: PriceFinder, Blue Wealth Property

Adelaide's rental market has remained in an undersupply even throughout the pandemic because the overseas migration has comparatively little effect on population growth rates. It has continued to tighten, dropping from 2.1% in 2016 down to 0.6% in December 2022 indicating a market in critical undersupply.

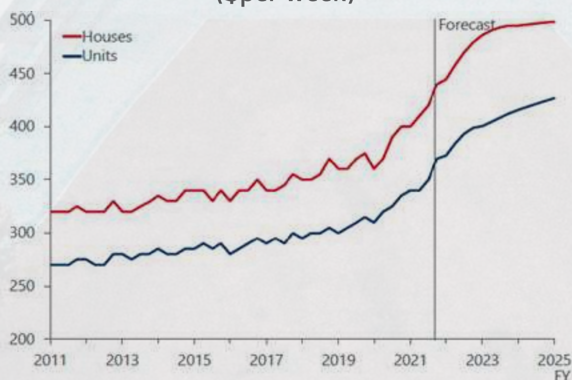
Residental Vacancy Rates



Source: SQM Research

Unsurprisingly the rents have spiked in Adelaide which grew by 14.7% for houses and 15.7% for units over the course of 2022. We expect gross rents to increase by 8.6% for houses and 10% for units before falling back to low single digit growth in 2024. The rental yields in Adelaide have climbed upwards owing to the long period of flat growth it experienced with units yielding 5.7% and houses yielding 3.8%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Adelaide: 3 bedroom house & 3 bedroom unit rents ($per week)



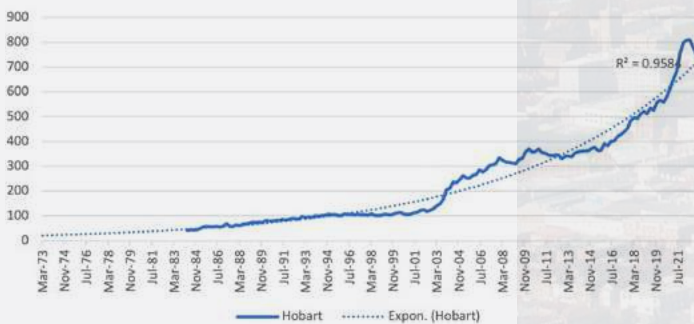
Source: REIA, BIS Oxford Economics

Hobart

Hobart continued to surprise to the upside in FY2022 with house prices rising by 18.4% year on year. The small size of the market along with the large undersupply in property combined with the interest rate environment have squeezed the market in a volatile move to the upside. However, by Q3 it ended up declining by 2.4%. It is now the third least affordable city and continues to face long term demographic headwinds.

It should be noted that the entire property market is really only priced on the sale results of the 5% or so that are actively traded at any given time. Due to the small size of the market in Tasmania it doesn't take much of an increase in buying or selling volume to move the entire market.

Hobart houses ($'000)



Source: PriceFinder, Blue Wealth Property

Like many of the smaller capital cities, Hobart's rental market has remained in an undersupply even throughout the pandemic due to the low exposure to overseas migration. Despite the flat population growth, the rental market has remained in a technical undersupply since 2014 owing to the low amount of construction activity. The vacancy rates have continued to tighten dropping from 3% in 2012 down to 0.6% in December 2022 indicating a market incritical undersupply.

Residental Vacancy Rates

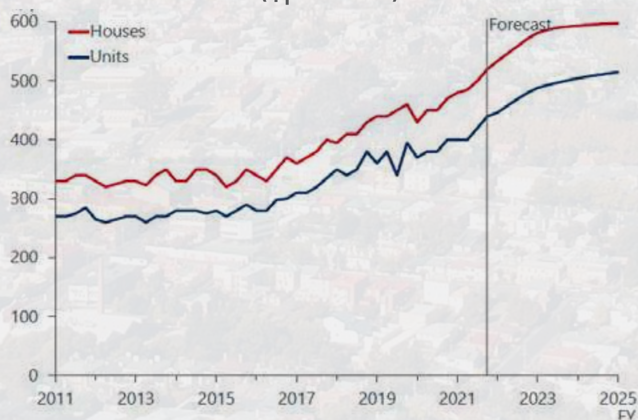
Source: SQM Research

As a result, the rents have spiked in Hobart which grew by 7.6% for houses and 9.7% for units over the course of 2022. We expect gross rents to increase by 8.7% for houses and 8.8% for units before falling back to zero or low single digit growth in 2024. The rental yields in Hobart have not

materially changed over the course of the pandemic with units yielding 5.3% and houses yielding 3.7%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Overall Hobart continues to be one of the riskier markets to invest in despite seeing some good growth in recent years. Housing demand grows slowly with most of the price increases coming from low construction activity which has the effect of holding the supply curve in place.

Hobart: 3 bedroom house & 3 bedroom unit rents ($per week)



Source: REIA, BIS Oxford Economics

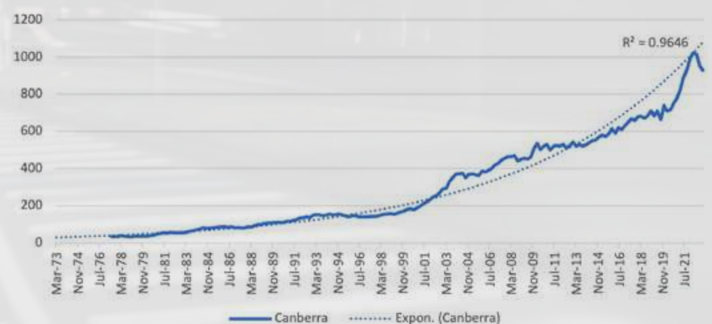
Canberra

Canberra has long been a low volatility market somewhat mirroring the profile of a defensive stock with lower capital growth and higher rental yields than east coast capital cities. A large part of this is due to the high proportion of public sector employment which tends to be more stable than the private sector and the availability of land for new housing developments.

On face value the Canberra market appears to have all the characteristics to show good potential for capital growth. Average incomes have been the highest in the country for at least a decade, rental yields are also strong with units yielding 5% being the second highest in the country behind the Northern Territory. The corresponding number for houses is 3.8%. Population growth is also significantly higher than the national average. Additionally, there is a slight deficiency in housing stock. Given these factors its perhaps surprising that the ACT property market has consistently underperformed. In the 10 years to December 2020, both yields and growth have tended to track inflation at about 2-3% growth per annum. House prices grew at around 3.5% per annum over that timeframe.

However, like the rest of the country the capital inflows from the RBA's quantitative easing program have had a profound effect on prices in Canberra with house prices increasing by 19% in 2021. Prices have declined 3.5% in 2022 in line with the rest of the country and will remain soft until Q3 in 2023.

Canberra houses ($'000)



Source: PriceFinder, Blue Wealth Property

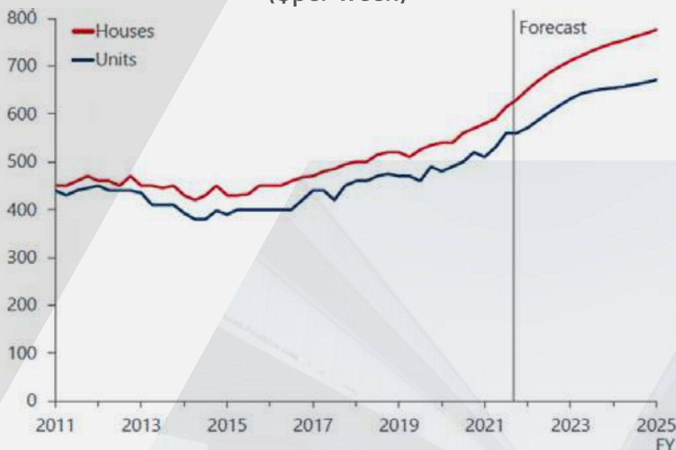
Vacancy rates in Canberra have remained in a technical undersupply for nearly two decades and they are currently sitting at 1.9% indicating an undersupply in rental accommodation.

Residental Vacancy Rates

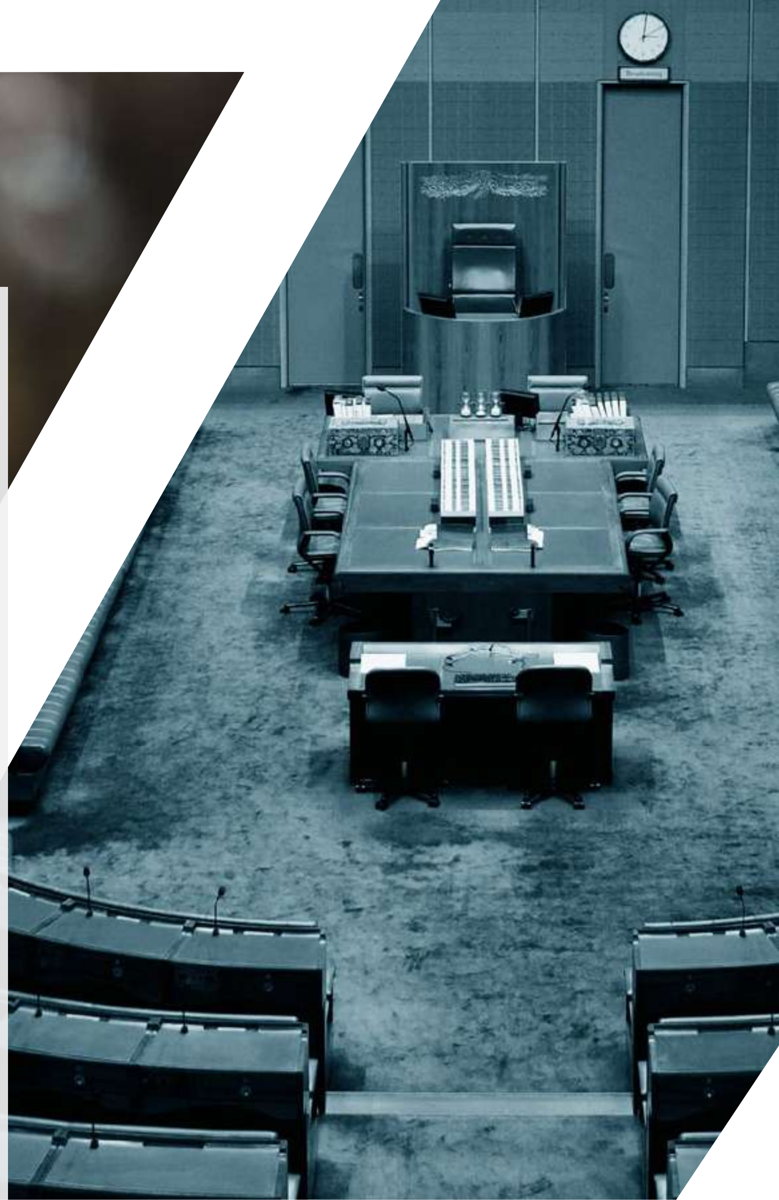
Source: SQM Research

The resultant upwards pressure on rents caused gross rents for houses to increase by 4.8% and 5.3% for units over the course of 2022. We expect gross rents to increase by 11% for houses and 8.5% for units before falling back to zero or low single digit growth in 2024 due to rental affordability acting as a dampener. The rental yields have declined slightly over the course of the pandemic with units yielding 5% and houses yielding 3.8%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Canberra: 3 bedroom house & 3 bedroom unit rents ($per week)



Source: REIA, BIS Oxford Economics

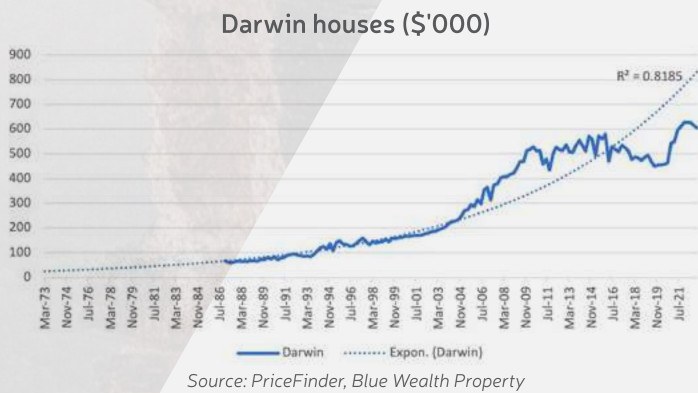


Darwin

Darwin remains the most affordable city in Australia and its performance has mirrored that of Perth's in many ways being heavily affected by the resource boom from 2000 to 2014. Consequently, it suffered from falling property prices from 2014 to June 2020 where the accommodative monetary policy settings caused prices to rise by 14.7% over the course of 2021. Affordability alone wasn't enough to offset the effect of tightened credit conditions and 2022 saw the end of the gains with the market falling by 1.9%.

The Northern Territory has seen weak and at times negative population growth since 2015 at the conclusion of the commodities boom. There continues to be a dwelling stock deficiency which along with the comparatively modest growth over the course of the pandemic should put a floor under prices over the course of 2023. There is the potential for increased population growth due to major investments in the resources and defence sectors.

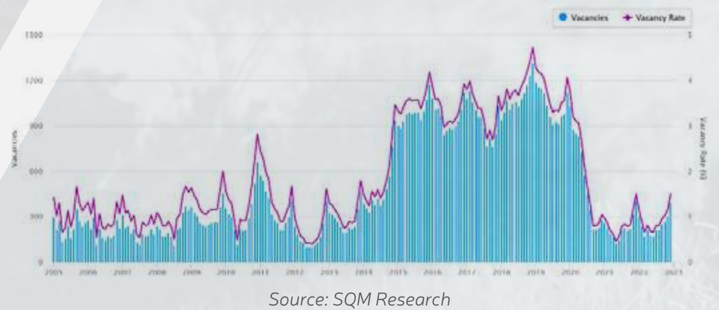
Darwin houses ($'000)



Source: PriceFinder, Blue Wealth Property

Darwin's vacancy rates have fallen off a cliff following the spike caused by population outflows at the conclusion of the last commodities boom and they are currently at 1.5% indicating an undersupply in rental accommodation. The market has not been affected by the pandemic due to the low reliance on overseas migration to boost its population growth.

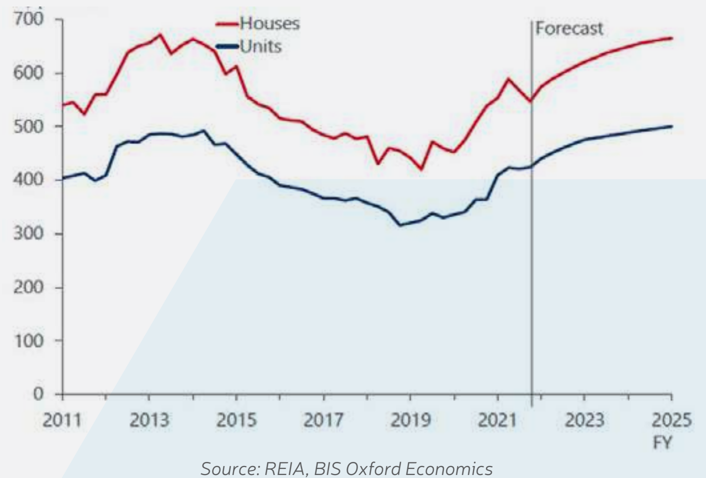
Residental Vacancy Rates



Source: SQM Research

Interestingly, despite the low vacancy rates, gross rents in houses remained flat while units had a modest increase of 5.4% over the course of 2022. We expect gross dwelling rents to increase by 5.4% per annum to June 2025. The rental yields in Darwin increased over the course of the pandemic with units yielding 6.4% and houses yielding 5.4%. We expect these yields to increase over the course of the year as gross rents continue to increase and property prices stagnate over the first half of the year.

Darwin: 3 bedroom house & 3 bedroom unit rents ($per week)



Source: REIA, BIS Oxford Economics

Level 2, 8 Australia Avenue, Sydney Olympic Park, NSW 2127
+61 (0)2 9743 0077 | enquiries@bluewealth.com.au | www.bluewealth.com.au