THE CASE FOR Melbourne

Negativity about Victorian property is dominating the media at the moment, but opportunities abound for selective investors. *Tim McIntyre* reports

"Doom," said the latest report. "Gloom," said another. 'Tis the season for economic releases, it would appear, and most recent report cards have boded badly for the prospects of the Melbourne property market and that of Victoria in general. Prices are down, just like at a certain supermarket, and appear to be staying that way, at least in the near future.

First, the BIS Shrapnel Residential Property Prospects 2012–2015 report, released at the end of June, found that after two years of nationwide price declines, the fundamentals are beginning to favour an improvement in residential market conditions. Of course, individual states and territories will perform differently in this period and the markets to benefit will be restricted to resource states and the under-supplied NSW.

This means that states on the right side of the two-tiered economy, such as Western Australia, Northern Territory and Queensland, can expect growth in real terms, while Victoria, Tasmania and the ACT will see any minor gains wiped out by inflation.

Next, the Deloitte Access Economics June Quarter Business Outlook said that while the dangers of poor housing figures in Victoria could be contained without wider damage to the state's ongoing outlook, its ties to manufacturing, negative exposure to a high performing Australian dollar and particularly weak retail sales figures will make it tough.

Finally, the CommSec State of the States paper, released on 20 July, listed Victoria in a more positive current light than the other reports, but warned it had slipped from third to fourth position overall and would drop further in the future, due to a soft job market, a downturn in the housing market and poor retail spending and investment figures.

Despite the negativity, investors claim the state has plenty of areas with good potential, which are being made to look bad by underperforming extremes.

A tale of two cities

Melbourne is currently a segmented market, according to Metropole Property Investment Strategist director Michael Yardney. “Melbourne has had a bad year with house prices falling by 6.56% according to RP Data, but it’s really a tale of two cities,” Yardney says. “While there is a huge oversupply of properties in the outer suburbs, with 35,000 unsold homes swamping the market and a looming oversupply of 14,000 new apartments coming on stream, some areas of Melbourne’s property market are still performing well.”

A shortage of well-located, established apartments and homes in the inner eastern and south-eastern suburbs is pushing values up significantly in these areas.

“According to Australian Property Monitors, East Melbourne’s median grew by 36% [over the past 12 months], while Carlton grew by 31%, Glen Huntly, 30% and Parkville, 23%, for example,” says Yardney.

“Further good news is that there is consensus among the two large data providers, with both Australian Property Monitors’ June quarter figures and RP Data-Rismark’s daily home value index showing house prices rebounding in a remarkable response to the RBA rate cuts of 0.75% over the last three months.”

Early signs of stability

Some positive signs have already begun to appear for Melbourne, according to the latest house price data from the Real Estate Institute of Victoria (REIV).

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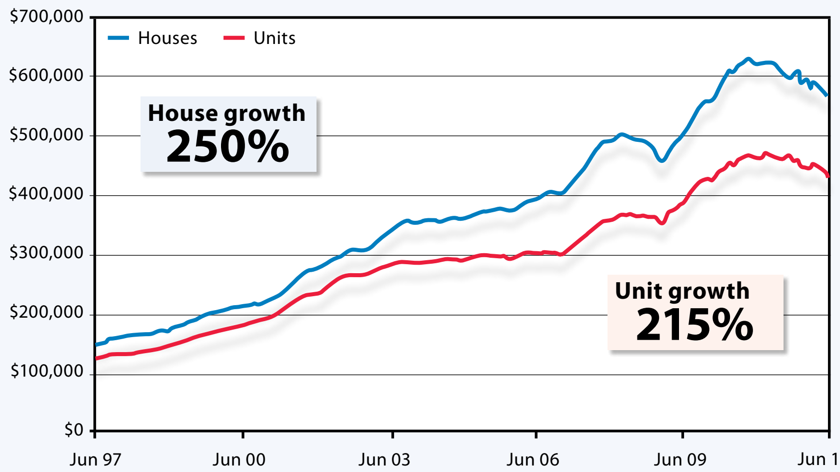
The report found that the median price of a house in Melbourne remained steady at $535,000 in the June quarter. This was the second consecutive quarter in which the median didn’t change, despite falling 5.3% over the past year.

The steady trend indicates the city’s overall market has reached its bottom, while the metro areas have already begun to pick up, with inner-ring house prices rising by 2.9% from the March quarter and unit prices increasing by 2.3%.

Areas where demand and property values have improved include eastern suburbs Balwyn and Malvern East, while demand is also on the rise in suburbs such as Langwarrin, Cheltenham and Pakenham in the south, Newport in the south-west and Reservoir in the north.

Melbourne’s prices more than triple over 15 yrs



Source: RPData

Ripe for the picking?

- Melbourne has plenty of strong areas with potential, but the bad performers are dragging down overall medians
- Prices have been readjusting after a post-GFC boom and are close to bottoming out
- Properties with room to add value can be purchased at below market value
- Prestige market offers good value due to heavy vendor discounting
- While Melbourne house prices fell 2.6% over the year, they increased 1.6% in the June quarter (according to APM)

Suburbs set to benefit from infrastructure

Engineering projects	Investment	Completion	Suburbs to benefit
Wonthaggi desalination plant	$5.7bn	2012	Wonthaggi, Cape Paterson, Hicksborough, Kilcunda
Regional Rail Link West Werribee-Melbourne	$5.3bn	2016	Werribee, Hoppers Crossing, Seabrook, Altona
Peninsula Road Link EastLink - Mornington Peninsula	$1.3bn	2013	Seaford, Frankston, Mornington
Western Ring Rd Expansion	$980m	2014	Fawkner, Tullamarine, Laverton
South Morang Rail Extension	$560m	2013	Epping, Keon Park, South Morang, Thomastown
Melbourne Water Eastern Treatment Plant Upgrade	$417m	2012	Patterson Lakes, Chelsea Heights, Seaford
Western Highway Duplication Ballarat-Stawell	$404m	2012	Ballarat, Stawell, Ararat, Beaufort, Horsham
Wimmera Mallee Water Pipeline Conversion	$633m	2012	Horsham, Dimboola, Warracknabeal, Hopetoun
Melbourne Airport Expansion	$300m	2014	Westmeadows, Gladstone Park, Tullamarine
Port of Melbourne Redevelopment	$1.2bn	2016	Melbourne, Southbank

Commercial building projects	Investment	Completion	Suburbs to benefit
Victorian Comprehensive Cancer Centre - Parkville	$1.3bn	2016	Parkville, Carlton, North Melbourne
Melbourne Markets - Epping	$670m	2014	Epping, South Morang, Mill Park
Box Hill Hospital Redevelopment	$447m	2015	Box Hill, Mont Albert, Blackburn
Melbourne Olympic Park Redevelopment	$363m	2015	Cremorne, Richmond, Southbank
Highpoint Shopping Centre Upgrade	$300m	2013	Maribyrnong, Maidstone
Ravenhall Prison Complex	$500m	2017	Deer Park, Caroline Springs, Ravenhall

"We don't see any reason for buyers to be holding back this spring," says Robert Larocca, REIV's policy and public affairs manager. "Usually in Melbourne, you find the suburb that you like and then go one further out to find the one you can afford. The reverse is true at the moment; you can often look one suburb inwards and your dollar will actually go further."

Vendors are also likely to have decent results in the new selling season and are expected to make profits on sales, especially if they bought their properties before the market peaked in 2010/11.

"Savvy investors will buy a property below its intrinsic value, in an area that has always had about average capital growth and one with a twist," Yardney says. "Others who sit on the sidelines will look back in a few years and say 'I wish I'd bought in 2012'."

In the pipeline

While Victoria may not have the extent of infrastructure investments as the resource-rich states have, the state still boast billions of dollars of infrastructure projects, which will keep its economy ticking over for the immediate future. The biggest projects include the Wonthaggi desalination plant, a regional rail link connecting Werribee and Melbourne and two major road projects. These will need to be reinforced with further investment from public and private sectors going forwards, to sustain the Victorian recovery.

Plenty of suburbs in and around Melbourne are being boosted by current projects. Areas such as Horsham, Tullamarine, Epping and South Morang are benefiting from multiple endeavours, while a buzz of excitement is surrounding coastal southern suburbs like Frankston, Seaford and others en route to the Mornington Peninsula.

What the expert says

"It is clear that lower interest rates have resulted in a dose of renewed confidence in the Melbourne housing market over the past two months. It also appears that vendors are setting more appropriate list prices and properties are selling in a slightly shorter frame of time compared with a few months ago."

– Cameron Kusher, RP Data senior research analyst

"Particularly for investment houses, we're looking at approaching the bottom of the price cycle at the moment, so I think the opportunities are there, especially for medium-term capital growth. However, investors must be mindful of relatively higher vacancy rates and lower gross rental returns. I think we're still yet to bottom out in the unit investor market, given the wide choice of new apartments coming onto the market in Melbourne."

– Andrew Wilson, senior economist, APM

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Investor opportunities

An understanding of what is going on at street level in Victoria is valuable for investors keen to capitalise on wavering economic conditions. A closer look shows that some markets remain extremely strong, depending on the quality of the properties being listed.

"I went to an auction for a two-bedroom art deco at Armadale (in Melbourne's south-east) a couple of months back, which I thought might have sold for the mid $600,000s," says Cate Bakos, Empower Wealth buyer's agent. "It ended up going for $737,000, which was a stellar result for the whole block. You wouldn't have known it was a buyer's market. When an asset is perfect and has great capital growth attributes, it will do really well. As soon as you've got imperfections… you're near a main road, or the floor plan isn't great, whatever it might be, then you're languishing on the market. There are many more imperfect assets than perfect and that's why we've currently got a buyer's market."

These imperfect properties present savvy investors with a chance to buy, improve and make money.

Great current opportunities

It is currently a great time for investors looking to get a well-priced foothold in the market, especially when there is scope to add value or upgrade.

"I always take the micro-market view," Bakos says. "If you only take the macro view, it doesn't make Victoria look like an attractive prospect, but put your micro-market hat on and there are some stellar bargains out there. The buying conditions are fantastic."

Bakos outlines the following opportunities:

Top quartile properties

In any area, top quartile properties are lagging. In this kind of market, the high end struggles first because people aren't prepared to dig deep. If you're looking for prestige, the opportunities to buy discounted are particularly high.

Areas to recover quickly

Properties with scarcity factor, in suburbs where houses have their own character and are close to rail transport, are doing well. Lifestyle defined suburbs with a village of their own, within 15km from the CBD will recover first. Some examples are Armadale, Glen Iris, Ashburton, Malvern, Bentleigh, Yarraville, Seddon and Thornbury.

A look at RP Data figures for the above suburbs shows substantial price slips in the past 12 months, but stubbornly positive average annual growth over 10 years. Healthy average discounts from vendors are presenting some real opportunities.

Areas immune to volatility

Metro areas, where yields are strong and vacancy rates are tight are still getting good uptake, because they have the hallmarks of a good suburb, where tenants want to live. Areas like Brunswick and St Kilda are good examples. Regional centres such as Geelong and Ballarat are also attracting investors for high yields and vacancy rates.

Case study

Subdivide and conquer

Megan Williams, 28, and partner Victoria Vercoe, 24, have seized the opportunities offered in the current buyer's market, to pick up a property with the potential to add value through subdivision.

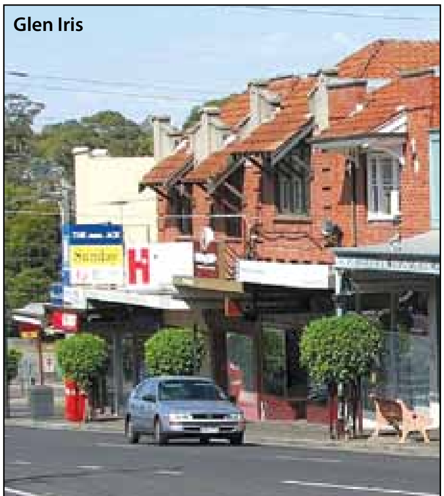
Located at Deer Park, west of the Melbourne CBD, the three-bedroom weatherboard house came on a 630m^2 block of land and was an absolute steal at $276,140.

"It is walking distance to schools, public transport, local shops and Brimbank Central Shopping Centre," says Megan, who currently lives in West Footscray. "We also chose the location because Deer Park is only 15km from the city. We expect that as the population of Melbourne increases, the need for housing will increase. As the suburbs in greater Melbourne are further developed, what is deemed inner-city living will also expand."

The couple plans to rent the property out for around 10 years and then knock it down and build a couple of units.

Megan says negative market sentiment did not affect their decision to buy. If anything, it presented a great opportunity.

"The current climate enabled us to purchase a house on land suitable for subdivision, within 15km from the city and for less than $300,000. That's almost unheard of," she says. "We would certainly look at other investments in Victoria and hope to make our second purchase soon."



Glen Iris

Suburbs poised for fast recovery

Suburb	Median price	12-month growth	Average annual growth	Vendor discount
ARMADALE	$1,400,000	-21%	9.6%	-9%
GLEN IRIS	$1,200,000	-4%	8.9%	-9%
ASHBURTON	$870,000	-12%	9.4%	-7%
MALVERN	$1,470,000	-18%	9.8%	-9%
BENTLEIGH	$825,000	-6%	8.6%	-8%
YARRAVILLE	$606,500	-6%	8.6%	-9%
SEDDON	$636,900	1%	9.7%	-6%
THORNBURY	$666,250	-7%	8.4%	-6%

Source: RP Data June 2012