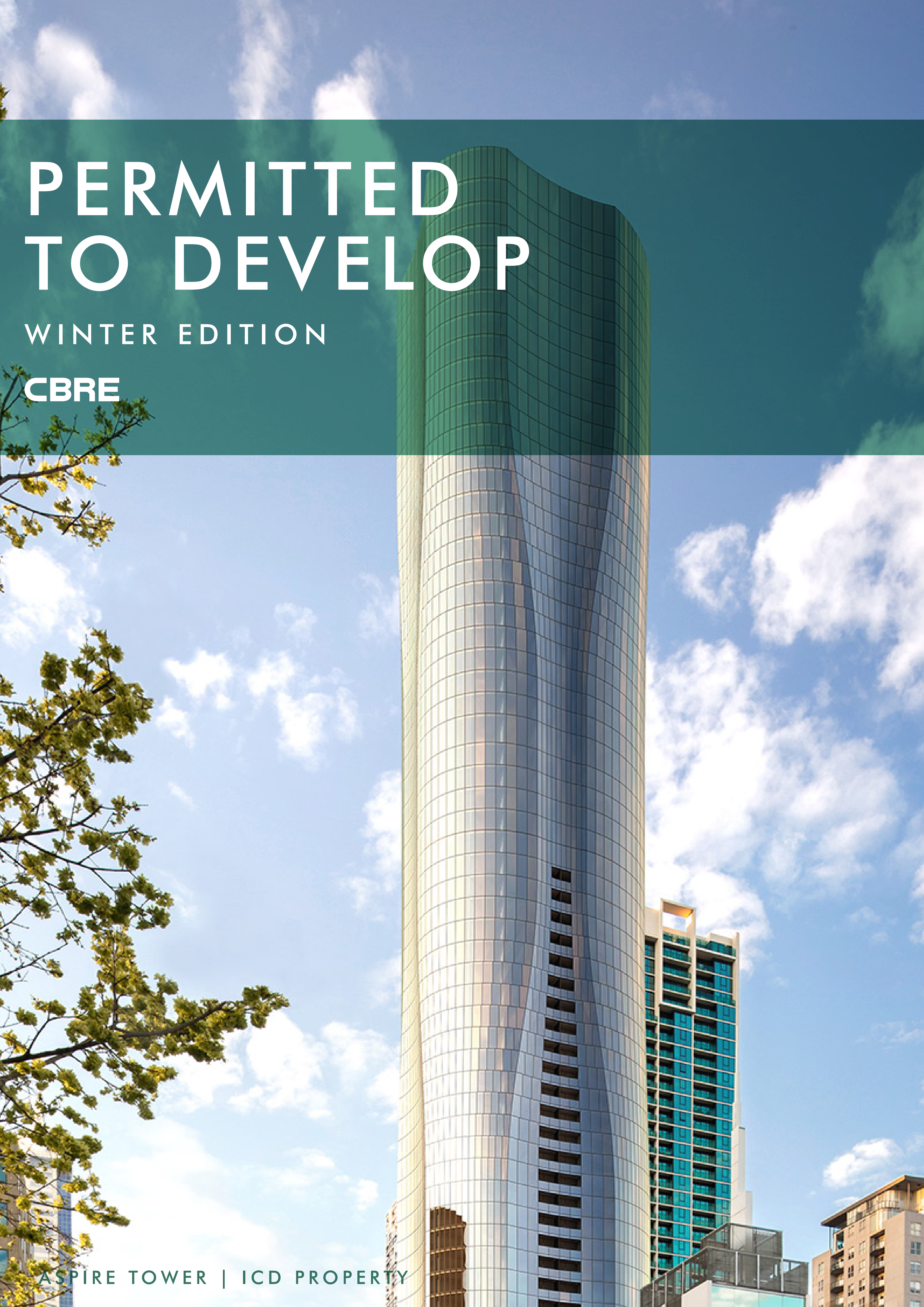
PERMITTED TO DEVELOP

WINTER EDITION

CBRE



ASPIRE TOWER | ICD PROPERTY

WHAT'S INSIDE

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FOREWORD

Welcome to our 2019 winter edition of Permitted to Develop.

The Aftermath of the Election & Royal Banking Commission: The Residential Development Market

The residential market has seen a correction over the past 20 months, however we may be near to the bottom of the cycle. Multiple factors have played a part in the correction, however access to funding and government intervention have been the major constraints. These have particularly targeted the development market. Off the plan sales rates significantly slowed in 2018 and this trend has continued into H1 2019. Therefore, developer's hurdle rates (required to commence construction) have become harder to achieve. Let's put this into context over a greater time period: over the last 2 to 3 years the market has moved to an owner occupier product in comparison to the investor product that we saw being sold during the peak years of 2014-2017. Due to restrictions by APRA and government intervention, we have seen investors (including FIRB purchasers) almost exit the market entirely over the past 12 to 18 months. There has been a complete turn around over the period whereby Investors made up 70% of the off the plan purchaser market and now only represent 30% of the purchaser market.

Due to this, developers and sales agents have encountered difficulties as purchasers have become more sophisticated (typical of an owner occupier). Many of our customers are experiencing challenges with their margins which is due to the fact that they are having to improve the quality of the development. Plus, there are challenges around the delivery timelines given that access to sales (and therefore funding) has also been constrained.

This is a significant change, when you consider that during the peak period of the cycle, investors were the deepest purchaser pool within the market and the average reservation to unconditional contract was as short as 2 to 3 hours up to 2 days.

TATE | Supplied by ANGLE

Currently, the average time of reservation to an executed unconditional contract is 6 to 8 weeks.

In addition to the market product needing to have an increased quality, our customers are also finding that construction costs are increasing due to the amount of infrastructure work ongoing in the State.

Is there light at the end of the tunnel?

Although these challenges remain, at the 2 previous RBA meetings the RBA has consecutively dropped the interest rate by 25 bp, to a record low of 1.00%. The RBA have suggested that this is to curb the risk of growth in the unemployment rate and increase growth in the economy.

All major banks have passed on rate cuts to the consumer, albeit none providing the full 50 bp.

Coupled with the recent Federal Election result, APRA reducing the interest rate stress test assessment of 7% is anticipated to provide more stimulus to the residential market and will further slow the decline of growth.

Notwithstanding, one of the ultimate issues in 2019 has been access to finance, for both developers and purchasers.

Overall the market has a significant way to come before growth is returned. We provide an extract of the recent report on the effects of the "2 unknowns" to the Residential market, being the Federal Election and the "Banking Royal Commission" from our Residential research team.

Given the current variables, we believe that we will not see growth in the residential market until credit is more readily accessible to both owner occupier and investor purchasers. Hopefully we start to see this around the turn of the new year.

Anyway, you've probably read enough about the current state of the market, and it can be a bit tiring. Fortunately, we have been provided with a great insight from Dom Cerantonio, the Managing Principal at Cera Stribley Architects. Dom's article will provide us insight into current design trends they are implementing to benefit their clients. The article also touches on the effect of the Better Apartment Design Guidelines (BADs) to the market.

Additionally, Kerren McNamara from KIN Property is going to provide us with the settlement numbers and facts! KIN Property specialise in settlement coordination services ensuring successful completion of off the plan residential projects. They provide us with the real settlement numbers over the past year and give us the key steps to ensure 100% successful settlement of a project.

Hopefully you find the articles beneficial. If you have any feedback, please do reach out and I will buy you a coffee as I love discussing the market, and all things property!

Thank you!

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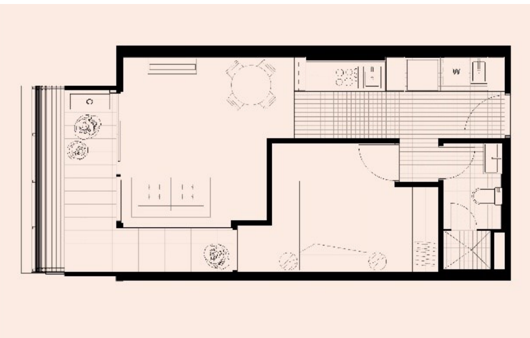
OPINION PIECE

Our Lucky Opportunity

A lot can change in a few months.

When I first sat down to write this article there was a lot of bad sentiment surrounding the property market. Property prices were falling, access to finance and lending was tight, government regulation had prohibited market driven design and there was an upcoming election that predicted an incoming government that threatened to send shockwaves through the entire property industry with its proposed changes to negative gearing and capital gains taxes. However, in just two months, the market is said to have bottomed out which has generated positive sentiment, APRA (Australian Prudential Regulation Authority) has loosened lending criteria that was put on the banking sector 12 months earlier and we saw an incumbent government win the unwinnable election which has brought hope and perceived stability.

Residential development (both single and multi-residential) is the lifeblood of many architectural practices and there has been a grey cloud over these sectors for the last 12 months with a lot of projects not selling, on hold or put off for good. But with optimism around credit lending, a lot of developers are seeing light at the end of the tunnel and the inception for new projects are a plenty, however it is a different playing field. Architects are now being faced with new challenges, particularly around design, policy and regulation. There is also the balancing act of affordability and construction labour cost that significantly effect development profitability.

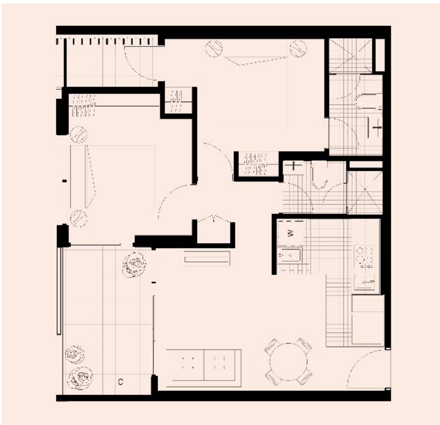


1.01 Pre BADS One Bedroom Apartment
Internal Area 44SQM

Government intervention

In March 2017, the Victorian government introduced Amendment VC136, the Better Apartment Design Standards (BADS) and Amendment VC143, the reformed residential zones which have both had a profound impact on how architects approach design in Melbourne. VC136 focuses on apartment design related to areas, bedroom and living room sizes, access to light and ventilation and storage amenity. Amendment VC143 concentrates on providing suitable garden area to general residential development.

There is little doubt that both these amendments were designed to create better living standards however they present a range of concerns surrounding design and affordability. Before BADS, two-bedroom apartments would typically range from approximately 65sqm to 75sqm in size. However, it was conceivable to achieve a two-bedroom apartment in under 60sqm through substandard room sizes and internal bedrooms – this was the reason for the implementation of BADS. With minimum room dimensions now regulated, achieving a two-bedroom, two-bathroom apartment under 70sqm is quite difficult from a design perspective resulting in most two bedrooms being larger than 75sqm. Similarly, with one-bedroom apartments, sizes of under 50sqm were regularly seen. BADS saw a minimum apartment size of 50sqm introduced driving sizes up by 10-20% across the board instantly.



1.02 Pre BADS Two Bedroom Apartment
Internal Area 59 SQM

The flow-on effect of BADs.

If you were selling a standard two-bedroom apartment in a blue-chip suburb (pre-BADS) a developer would be hoping to achieve potentially $12,000p/sqm for the sales resulting in an end value of around $780,000.00 AUD for an apartment of 65sqm. This would seem a reasonable price for a standard apartment. With the introduction of BADS, and assuming the same sales rate, we would expect to pay $960,000.00 AUD for an 80sqm apartment, a 23% increase for very much the same apartment albeit larger which would seem high for a standard apartment. In lieu of this, developers and agents are being forced to sell for lower rates, yet construction prices are rising due to large local infrastructure projects. The development model needed to change.

With several projects unable to sell, developers are looking at alternative models and diversification into other sectors such as commercial offices and hotel to make their projects viable. For residential projects, we have seen numerous developers target the downsizer market and more owner occupier buyers which has led to larger, more premium stock versus the investor targeted apartments. These more premium markets are a lot smaller meaning that there is a greater emphasis on architectural design, marketing, storytelling, sustainability and cost.

1.01 Post BADS Two Bedroom Apartment
Internal Area 120 SQM

Pine Ave | Supplied by ANGLE

Edition | Supplied by Samuel Property | Rendered by Stab

Due to more of a premium offering presented, we are now designing better buildings. As explained earlier, previously an 80sqm apartment would have been considered as luxurious however now, the market is expecting 90-120sqm for a two-bedroom apartment as standard. Previously, a client would request the smallest balcony size allowed to maximise the internal net saleable floor areas. Now, large open terraces suitable for entertaining that can be up to 20-30sqm are encouraged, even at the loss of NSA. There has been a slight shift in preferred materials from curtain wall facades and glass balustrades in favour for more solid materials such as high-quality brick work, natural concrete and stone. There has also been a hesitance to use composite metal cladding with several products now considered a major fire risk as seen at Lacrosse in Docklands and the Nero 2000 building in the CBD.

Carparking is another element to a project whereby we have seen a major shift. From a statutory perspective, for every one-bedroom apartment you are required to provide 1 car space (but less is often supported), for every two bedroom apartment you are required to provide 1 car space and for three bedrooms or more, you are required to provide 2 car spaces per apartment. However, market expectations are more strenuous. There is an expectation that each apartment should have at least 1 car-space and every two-bedroom apartment should have 2 car spaces, at the very least. Contrastingly, we are seeing a push from local council for less cars. In February this year, Moreland City Council released its proposed strategic plan for parking – Parking Implementation Plan 2019. One of the major proposed policies was around statutory parking provisions and a shift from a minimum quantum approach to a maximum quantum approach, meaning, if approved, there would a maximum limit to how many cars a developer could provide.Given the already testing market, this government intervention could make developments even more difficult to sell presenting another range of challenges for developers and architects alike.

Edition | Supplied by Samuel Property | Rendered by Stab

It is quite clear that at all levels of government, there has been an attempt to slow down multi-residential development in Melbourne. Federally, APRA implement stricter lending criteria which has made buying off the plan more difficult for aspiring purchasers. The Victorian State Government continues to introduce changes to the planning scheme that result less affordable dwellings and local councils continue to develop local policies changes that result in fewer desirable outcomes. And yet, in four successive years, Melbourne has added more than 100,000 residents each year and based on current growth rates, will become Australia's most populated city in 2026.

How can we ever expect to house our population if we cannot build good quality, affordable and desirable dwellings due to government intervention? In 1964, Donald Horne wrote a book named The Lucky Country. The book portrayed Australia's growth as lucky rather than any of our actual strengths specifically lamenting the lack of innovation and ambition. Ironically, right now, Australia is in a fortunate position. We have an opportunity to shape our cities whilst many other countries suffer from aging cities and overpopulation.With property prices having just recorded the smallest month decline in 12 months, it would seem the worst is behind us and a positive outlook ahead.

However, even with the optimistic sentiment, architects are still faced with regulation that is not conducive to creative design. The government should be removing the red tape and letting the market dictate what is acceptable rather than introducing policies that prohibit innovation.
Minimum apartment sizes and minimum room dimensions only provide a platform for prosaic outcomes. If we want the best design results for our city and if we want to create desirable housing for all people, then we need to allow our designers the freedom to design innovatively and not be restricted by short sighted policies. Maybe then, we will become the Lucky Country.

CS
–A

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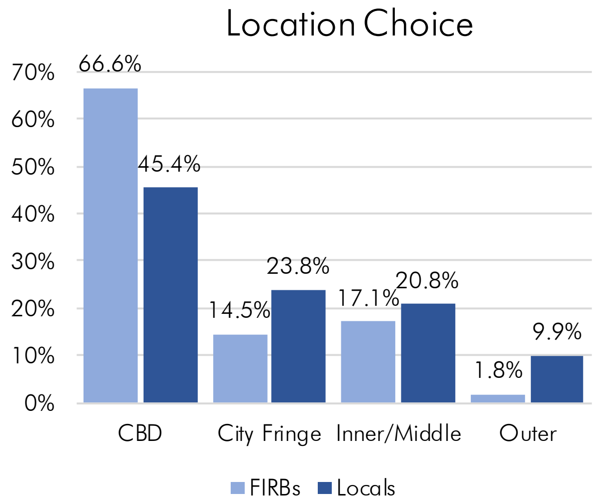
HOT ISSUE

The Australian Property Market - What do the numbers say?

The mainstream media present a clear image of "doom and gloom" around the Australian property market with falling prices, softening demand and depressed future growth, but what do the numbers say? KIN Property has settled over 7,000 residential properties for developers over the past 12 months and is in a unique position to assess key trends in the property market. Through analysis of our projects we have identified a number of clear trends – some predicted, some not – that go beyond the general commentary on the property market seen across various media platforms. While the following analysis is limited to 30 residential projects[1] completed over the last 12 months the emerging trends are indicative of a market that still has much to offer well-planned and considered developments. Key trends in settlement projects are as follows:

FIRBs

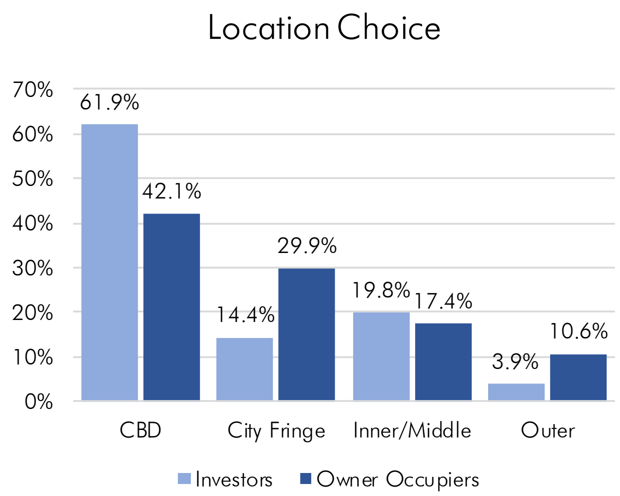
While the regulations around foreign investment in Australian property have tightened over the last 18 months there are still good opportunities for both overseas buyers and developers to take advantage of strong foreign interest. The predicted trend in overseas buyers preferring high density city-based apartments was borne out in the data showing foreign investors had a clear preference for CBD properties in high density developments[2].



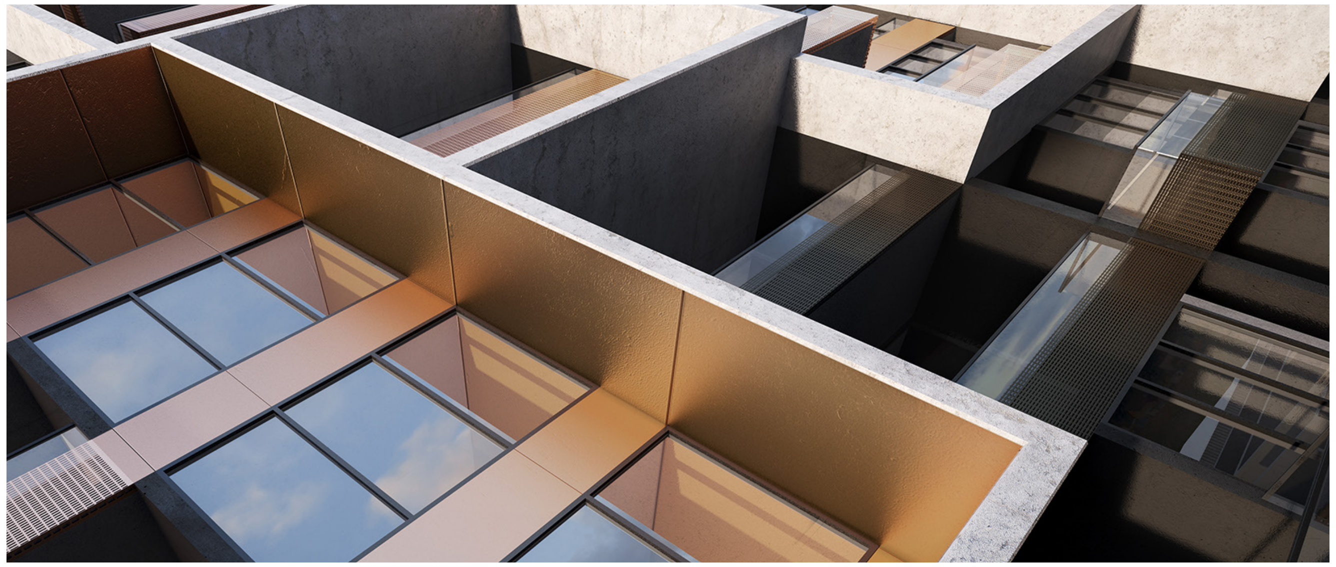
While the restrictions in foreign investment have slowed overseas interest in Australian property, international purchasers remain a strong influence on the Australian market particularly in the cities.[3] Access to transport, education, work and shopping ranked high on the preferences of foreign buyers in terms of location.

Owner Occupiers vs Investors

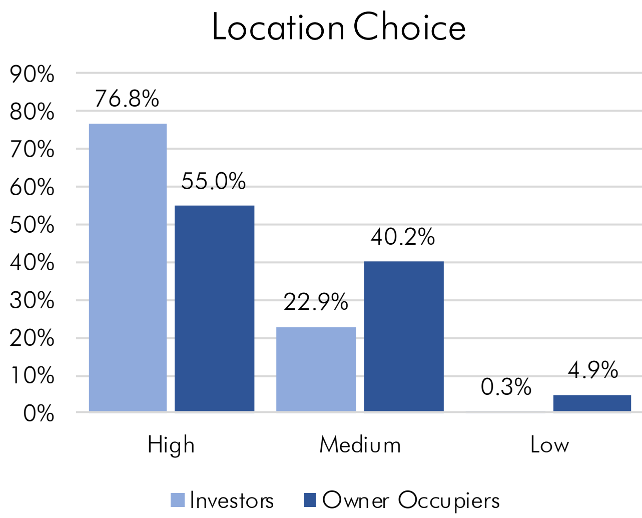
The clear trend here was that owner occupiers were more highly represented in lower density outer region developments compared to owner-investors who prefer high density CBD apartments. Investor interest is driven by a higher demand for inner city living due to employment, transport and lifestyle benefits, further reinforced by the development of the CBD as a lifestyle destination beyond traditional working hours.

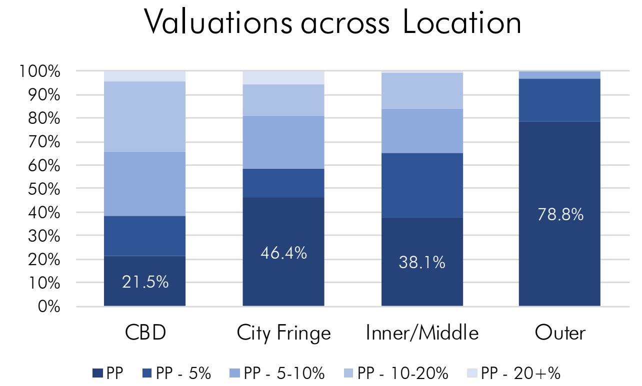


Swanston Central | Supplied by Hengyi Pacific



Central Park Box Hill | Supplied by H&F Property

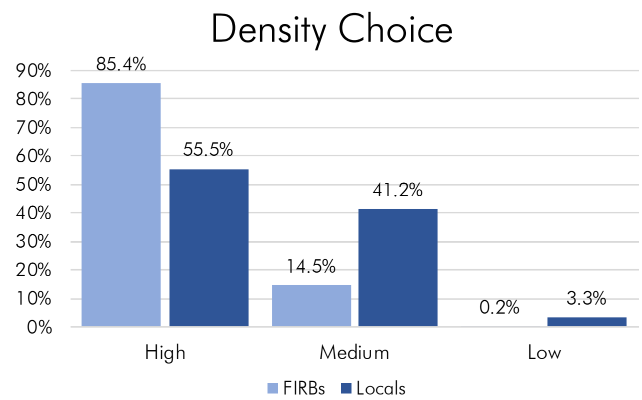




Valuation prices were rated as PP – purchase price or higher; PP – 5% (PP less 5%); PP - 5-10% (PP less 5-10%); PP – 10-20% (PP less 10-20%); PP – 20+% (PP less 20% or more).

Valuations

Falling valuation rates against property purchase prices have been a strong influence on development settlement rates. While there has been a general trend of falling values over the last 12 months this trend is more pronounced in CBD locations than in outer areas. What appears to be true is that high quality stock returns strong settlement results whether in the CBD or outer location, high medium or low density.



1 For the purpose of this analysis, density of developments is defined as High (>100 apartments), Medium (20-100 apartments) and Low (1-20 apartments or townhouses).
2 Project location was defined as CBD (within the confines of the city boundary), City Fringe (0-5km from the CBD, Inner/Middle (5-20km from the CBD) and Outer (>20km from CBD).
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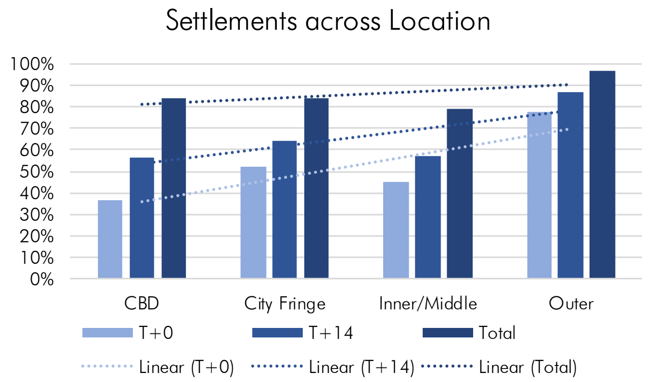
Settlements
As expected settlement rates were higher in developments that achieved strong property valuation results. While we experienced a variety of valuation results across all segments of project location and density, strong valuations were synonymous with higher final settlements.

This highlights the importance of valuation presentations. Ensuring valuations are timed to maximise the impact of development features and hosting these inspections with a knowledgeable and expert team makes a significant difference to valuation results and ultimately settlement success.

The strongest settlement rates across all projects were recorded through local buyers who were predominantly owner occupiers. FIRBs and owner-investors tended to be more highly geared purchasers and therefore more susceptible to market fluctuations and falling valuations. The implication here is that if developments have higher numbers of overseas buyers and investors more time should be spent investing in purchaser communications and relationship development through the settlement process to ensure greater settlement success.

Nominations and Cash Sales
Over the past 12 months we have seen an increase in the number of purchasers settling with cash and the number of purchasers nominating increase significantly. On average 30% of purchasers are settling with cash and up to 70% of purchasers nominating. With tough times on the radar ahead, every settlement counts.

Location vs Density
The data shows that there was an increasing trend in settlement success as project location moved from the CBD to outer regions though all regions had projects with strong settlement success. While higher numbers of local buyers who were owner occupiers lifted settlement results the key was to be offering quality stock that offered some unique features to purchasers. Location, access to amenities, transport and employment, and lifestyle options were most highly rated benefits by purchasers.



T+0 represents the nominated settlement day for a development. T+14 is two weeks after that date, and Total is the settlement rate at the end of KIN's involvement in the project.

The Golden Rules
Based on our privileged position to be directly involved in so many residential property developments across Australia, KIN Property offers the following "Golden Rules" for developers:

1. Engagement
Establish strong and regular communications with all purchasers, informing them of project progress and highlighting any changes to schedule. Accept that things will inevitably not go to plan throughout a long project. It is at these times that you need to stay in closest contact with purchasers.

2. Expertise
Leaders in any field make getting things right look easy. Bring the necessary expertise into your project settlement team whether you manage this process internally or externally. Seek out support with a proven track record of settlement success in the size and scope of development you are managing.

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3. Excellence
Commit to the valuation and pre-settlement inspection process. Present to valuers on the benefits of the development rather than allowing them to draw their own conclusions. Ensure that purchasers have a 5-star experience in their pre-settlement inspection by committing to zero defects and maximum impact prior to the purchasers viewing their apartment.

4. Finance
Through strong communication know the risk profile of every purchaser and provide options targeted to suit their needs. Seek regular updates on purchaser risk profile from your settlements team and arm them with the information they need to assist purchasers to completion.

5. Commitment
Developers of the most successful projects spend as much time strategizing settlements as they do sales. Commit to spending the time and money to ensure a strong settlement outcome in terms of risk management and satisfied purchasers.

KIN

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CBRE RESEARCH

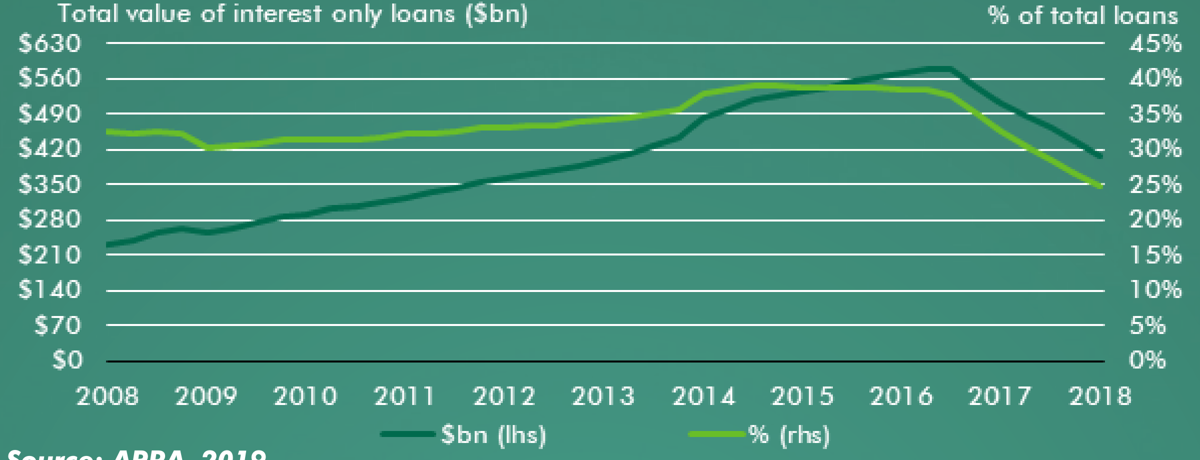
Known unknowns – where to now?

As we approach mid-year, the two great unknowns facing residential markets in 2019 - the final report of the Banking Royal Commission and the federal election - are behind us. The outcomes of both should provide a level of comfort to residential markets. Although credit availability remains tight, a more sustainable credit environment underpinning residential markets should result from the former. Signs are now emerging that a controlled relaxation of credit constraints is being managed. Expected interest rate cuts should provide a further boost. The Coalition's election victory means proposed taxation changes impacting investment property are off the agenda, while first home buyers have received a modest additional assistance package.

2019 – THE YEAR OF KNOWN UNKNOWNS

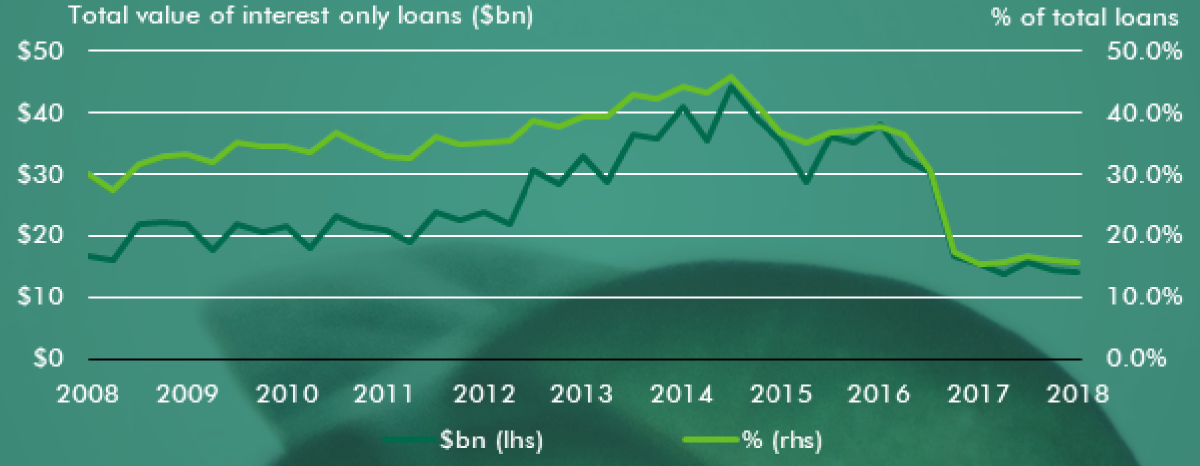
In CBRE's Real Estate Market Outlook 2019, Australia report, released in February 2019, we highlighted that Australia's major residential markets were either in or entering a period where prices were correcting and construction levels were declining. This was, however, off the back of several years of exceptional price growth for Sydney and Melbourne, and, for most other markets (save for Perth) more modest but still solid increases.

Fig 1: Total interest only Loans, Australian ADIs



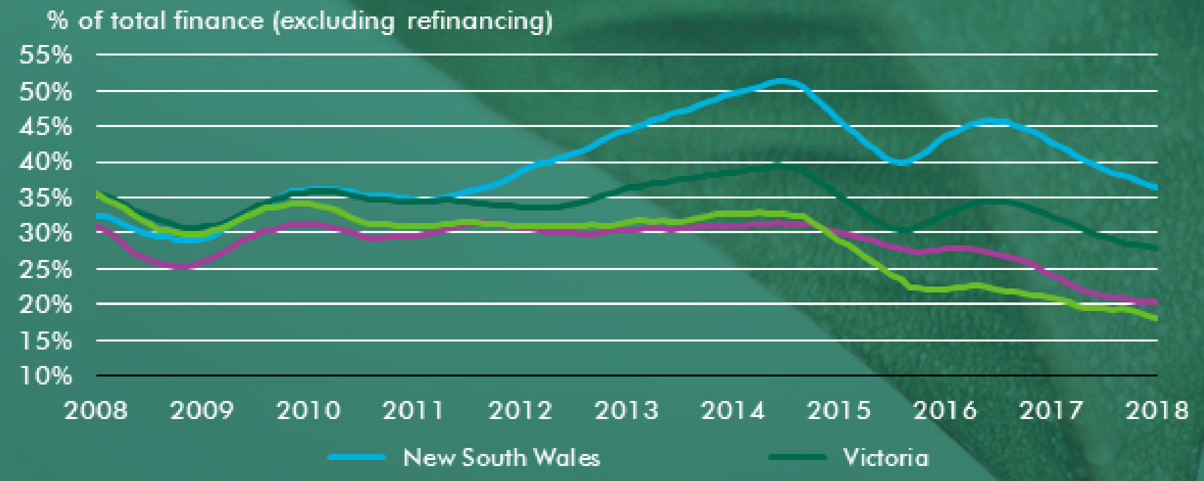
Source: APRA, 2019

Fig 2: New Interest only loans, Australian ADIs



Source: APRA, 2019

Fig 3: Residential investor finance, key states (rolling annual, excluding refinancing)



Source: Australian Bureau of Statistics, 2019

We did highlight, however, that there were a number of 'known unknowns' which had the potential to profoundly impact the residential markets in 2019 and beyond.

Key were:

1. the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and, more importantly, how banks and other lenders would react to these findings in terms of lending policy and therefore credit availability; and

2. a looming Federal election, with the ALP proposing significant changes to negative gearing and the capital gains tax discount on investment property. With the Coalition government returned to power, however, these proposed changes are now off the agenda.

The above is an extract only. If you would like to request the full report please contact Craig.

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