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REALESTATE

CORONAVIRUS: CATASTROPHE, OR OPPORTUNITY?

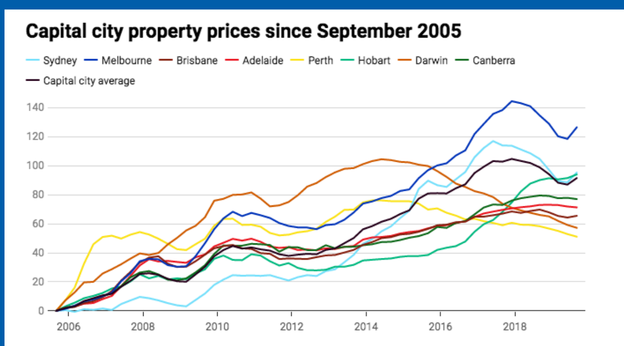
Contents

PROPERTY MARKET PERFORMANCE OVER THE PAST 5 YEARS

Over the past 5 years, the property market has seen the end of an era, with the end of the 2012-2017 property price boom hitting hard and the start of the COVID-19 lockdown period sending the property market into turmoil.

In 2012 in Australia, the mining boom was running out of steam and gradually coming to rest, and so the Reserve Bank turned to the property market as the next source of economic growth to sustain Australia. (Janda, 2020) The drastic rate cuts from the RBA, which went from 4.75% to 1.5% lead to a property price boom as demand skyrocketed, which defined the period from 2012 to 2017 (almost bubble like). However, in 2017 this boom ran out of finance and gradually property prices began to plummet. In Sydney, there were large drops of 15% in the property market, while Melbourne saw falls of 11%. (Janda, 2020)

The plunging property prices were saved only by the RBA again, which cut rates significantly, keeping property prices afloat and leading to a slight rebound in prices in 2019. In 2020, we can expect to see a significant drop in prices due to the lockdown period of COVID-19 and due to the recession and millions of jobs which are being lost. The graph below depicts the average property price growth since September 2005, showing the full extent of the 2012-17 price boom then the subsequent crash. (Janda, 2020)



FACTORS AFFECTING SUPPLY OF PROPERTY

There are a number of factors affecting the supply of property, including the demand for property - that is, if there is more demand then people will be more inclined to sell. We saw this throughout the property 2012-2017 boom as the amount of supply drastically increased to meet the increased demand. (Johnson, 2020)

Other factors include the amount of new properties being built:

The supply of housing is in a constant state of change. The amount of properties available may increase when people are moving—some may downsize, others may try to make more room for an expanding family, while others may purchase their first home.

Also, there may be an increase in development of new homes and units, increasing supply.

On the other hand, housing supply has the potential to drastically decrease during times of natural disasters such as earthquakes or floods, which often lead to the destruction of many properties.

There is, of course, a limit to the amount of supply due to the finite nature of the land available to profitably build on.

Currently, the primary factor affecting the supply of properties is demand, which due to the current pandemic is very low. This means there is an oversupply and relatively not many new houses will be appearing on the market due to the lack of suitable demand. This will lower property prices further.

FACTORS AFFECTING DEMAND FOR PROPERTY

There are a number of key factors affecting the demand for properties. The key behind the demand is that people look for properties which have a mortgage they can afford to pay back. This means that, for example, if interest rates are cut, borrowing power is increased, increasing demand.

The key factors which affect the demand for homes are concerned with incomes, demographics, interest rates, speculation, and taxation. There are, of course, others, but these are other factors which are concerned with serious investors.

In times of economic prosperity, we see a rise in the average income of households. This makes people generally more inclined to improve the quality of their housing, increasing demand. (Johnson, 2020)

Another key factor as to how demand is distributed is demographics, although this change is very gradual. (Janda, 2020) Demographic projections for the coming future predicts that the number of single independent people are likely to increase. This means that the demand for apartments and smaller houses is likely to rise, and general population growth will also ensure that there is steady demand into the future. Moreover, interest rates play a key factor in deciding whether many people will be able to take out a home loan and pay it back, hence we can see that when interest rates are low, there will be more demand as borrowing power is significantly increased. Of course, other factors include the speculation on the property market (as with most forms of investment) and the taxation and other various governmental policies such as the first home buyer scheme which encourage buying.

Currently, due to the coronavirus pandemic, we have seen two key demand factors coming into play. First, we are in a time of economic turmoil which has meant that millions of jobs have been lost. Hence the average income of households has dropped, significantly reducing demand from these households. (Johnson, 2020) However, on the other hand, interest rates have dropped to record lows, and so for investors and the upper echelon of our society, this presents itself as an excellent investment opportunity.

Overall, however, due to the general significant drop in demand, economists say that house prices could fall by as much as 20% (Sweeney, 2020) if the recession lasts longer than 6 months.

COMPOSITION OF PROPERTY OWNERSHIP

In Australia in 2016, investor owned dwellings comprise 26.9% of all housing stock, with the average investor holding 1.28 homes according to Corelogic. Currently, 30% of households own a home without a mortgage (down from 40% in 1997-98), while 37% of households own a home with a mortgage (up from 31% in 1997-98). This is roughly in accordance with the rise in property prices since the 1990s meaning that buyers have to take out larger loans which then take long to pay back. Meanwhile, renters (either renting from a private landlord or a state housing authority) now make up 32% of Australian households – up from 30% in 2015-16 and 27% in 1997-98. Given that the demographics indicated that more and more people will have lone households, renting of apartments and units will continue to grow. (Beattie, 2020)

Age Demographic Split: (Beattie, 2020)

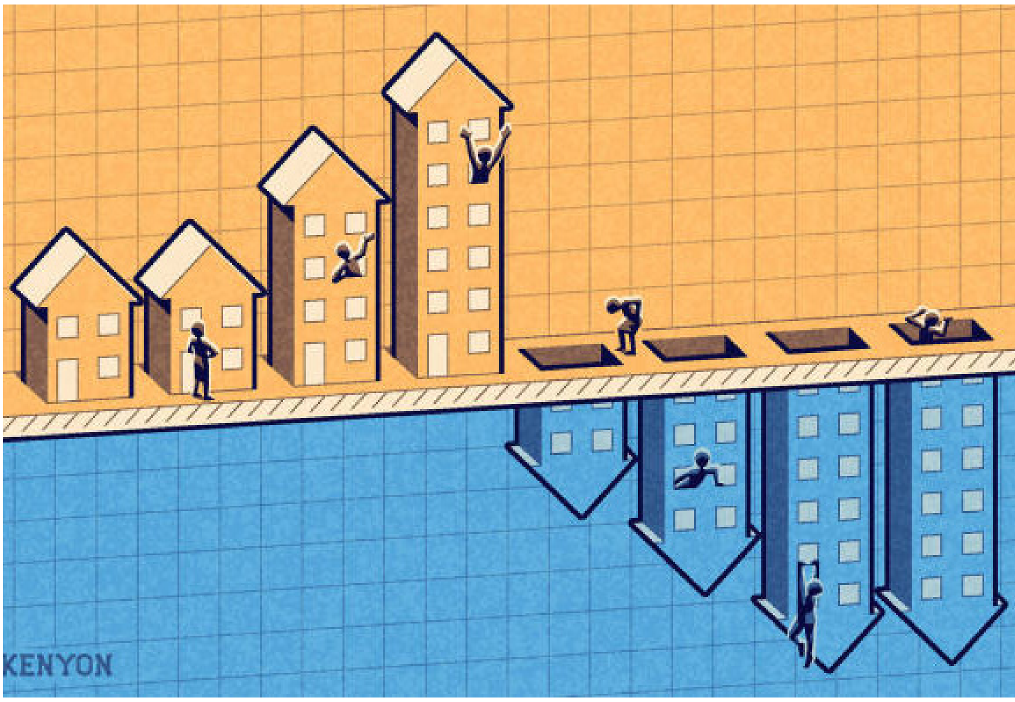
15 to 24: 10% home owners, 86% renters - Young independents do not have savings so rent.
25 to 34: 37% home owners, 61% renters - More people gain savings and can afford to buy.
35 to 44: 62% home owners, 37% renters - Large shift as people get married and consider family.
45 to 54: 72% home owners, 27% renters - Established families buy homes, independents rent.
55 to 64: 78% home owners, 21% renters - Trend continues
65 to 74: 83% home owners, 15% renters - Trend continues
75 and over: 84% home owners, 14% renters - Trend continues

EFFECT OF COVID-19 ON DEMAND

Amidst the COVID-19 crisis, millions of jobs have been lost worldwide. In Australia alone, over 300,000 jobs have been lost in the larger corporations, not including those lost in small businesses. This crisis means that the average income of households will drastically decrease, leading to a decrease in demand. When people have less money, their borrowing power is decreased and hence they cannot purchase properties. This will be catastrophic for the property market, which expects prices to fall by at least 10% later in the year, despite the interest rate cuts. Combined with the lockdowns and previous restrictions on the inspections of properties, COVID-19 will have a catastrophic affect on the demand in the property market. In terms of renting, there will also be a slump in prices as those who will be buying a property will be those taking advantage of the attractive interest rates, hence buying more homes rather than renting. Of course, currently the government has frozen evictions, and this may help tenants.

EFFECT OF COVID-19 ON PROPERTY SUPPLY

COVID-19 will no doubt lead to a short term oversupply in properties. This is because all the properties which were listed at the strong start to 2020 will now have a much smaller demand ground, hence there will be an oversupply leading to lower prices. Eventually this will even out as less people decide to list their property for sale in the hopes of securing a better price later in the year. (Sweeney, 2020)



Analysis: Effect of COVID-19 on Property

SHORT TERM EFFECTS OF COVID-19:

In the short-term, COVID-19 will be devastating for the property market. The treasury is predicting a 10% unemployment rate in the June quarter, and if this occurs then we could see a 20% drop in housing prices, according to AMP Capital. This would be catastrophic. (Sweeney, 2020)

This would mean that property prices would plunge significantly and while this would present a golden opportunity to first home buyers and the public who have either maintained their jobs or have a significant deposit already, it means that investors are at risk of losing millions. (Johnson, 2020) Many thousands of people are currently losing their jobs, and hence the demand (as shown on the top left of this page) will plummet, along with the prices as those who were going to buy properties choose instead to save money. (Sweeney, 2020)

However, with many people unable to buy properties at this time due to job losses, as the lockdown ends and the economy restarts we could see this built up demand released, causing a spike in prices. This rebound is predicted by the RBA to occur in the second half of the year, and while it may not take us entirely back to where we started it will minimise the impact. (Johnson, 2020) In China, property transactions were at or around zero for the three weeks following movement restrictions and have since (two months later) recovered to 50% of their four-year average, according to PropertyUpdate.com. This is a positive sign that the short term effects of COVID-19 will not actually affect the market's actual value, merely compress it for a short while. On the other hand, we must note that Australia has just come out of the 2012-2017 boom and the only thing keeping prices up was RBA interest rate cuts, so we will have to wait and see the effects of rate hikes in the future.

So, while we can see that the situation is likely to get worse before it gets better, we can hopefully expect a rebound in the property market as fundamentals like immigration return in the second half of the year, or, in a worst scenario next year. (Landy, 2020)

Effect of COVID-19 on the Property Market

LONG TERM EFFECTS:

The important thing to note in this COVID-19 pandemic is that the essential fundamentals of the market are still present, or will return quite quickly. (Yardney, 2020) While it all depends on how long it takes for the lockdowns to end, for a vaccine to be discovered, etc., it is important to note that we will still see population growth keeping a steady demand. Although 60% of our growth is from immigration, (Yardney, 2020) we will see steady rebounds when immigration is reopened again. Moreover, interest rates are quite low currently and this will factor into the short term rebound that will lead us back to a more steady path. Australia is in a privileged position which will aid our recovery. (Yardney, 2020)

Another key factor to consider is supply of building materials. In the short-term we will see oversupplies in the major cities, however as we look to the future we can see that trade will become far more cautious, and so in some cases on the way back to normal we may see shortages of building materials for a property, hence balancing out the oversupply in the long term, and if a solution is not found there may be even be an undersupply due to wide reaching issues in global supply chains. (Yardney, 2020)

EFFECT OF GOVERNMENT INTERVENTION:

The 6 month moratorium on evictions

Currently, the Morrison government has banned commercial and residential landlords from evicting tenants who may be unable to meet their payments/obligations due to financial distress caused by the coronavirus crisis for the next 6 months. (Yardney, 2020)

But this situation is a double sided coin, because while renters may be worried about not being able to pay rent, the landlords themselves may be ordinary people who are investing, and they also may have lost their jobs and now stand at risk of losing their income. However, the government intervention is the best solution as we can obviously see the landlords having alternative housing available (their primary place of residence) while tenants may not. (Yardney, 2020)

In terms of the property market, the effect of this legislation will be that the rental market (at least in the short term) will be very unattractive to property investors as often they will not be able to make enough profit in the current situation to have a sustainable source of income. (Ballantyne, 2020)

However, it will cushion some of the rapid losses being caused by thousands of renters leaving their rental homes because they cannot pay, by ensuring the tenants can stay, and so landlords will have tenants and an income once the economic situation of their tenants improves and they can once more pay for the rent. (Davies, 2020)

Hence, while in the short-term this measure makes the rental property investment market unattractive, it acts as a stimulus for it to get back on its feet in the long-term.

Victorian Commercial Property Land Tax (Stamp Duty) Relief

Victorian Premier Daniel Andrews has announced a $500 million rental relief package to support tenants and landlords. (Farrer, 2020)

Out of the $500 million, $420 million of that will be distributed as stamp duty relief to landlords, who help their tenants with rental discounts or concessions.

In fact, a commercial landlord who has a turnover of less that $50 million, and who is suffering financial hardship (and eligible for JobKeeper) can apply for a 25% discount on their land tax if they help their tenants. Any remaining land tax is able to be deferred to march of next year. (Justice Connect, 2020)

This policy will seek to keep the rental property market alive (Farrer, 2020), while also promoting constructive discussions between landlords and tenants. This is beneficial for both parties involved, though it is important to note that someone else must be paying this (most likely tax payers).

OTHER POTENTIAL FURTHER INTERVENTION:

Right now, the primary topic on Australia's agenda when it comes to the economy is tax reform. Treasurer Josh Frydenberg has confirmed the government is taking a look at tax reform, and it is the general consensus that stamp duty will be the prime candidate for reform. (Irvine, 2020) Stamp duty has always been one of the more controversial taxes, as it deincentivises lots of spending - first home buyers must save for longer, etc. The reduction or even abolition of stamp duty would greatly reincentivise buying throughout the economy from things like motor vehicles to houses. Of course, this will hit some states hard as this is a major source of revenue, but it may be necessary to restart the economy. (Irvine, 2020)

This hole however may simply be filled by a wider GST etc. The key to this is that GST is generally unavoidable in our everyday lives, while on the other hand we aren't buying cars and houses every day, so the GST will become part of our lives and we will still have more incentive to buy

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