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Falling home prices threaten \$20bn in annual foreign investment

by Geoffrey Rogow

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Behind the decline in home prices is a rush by property developers to build apartments.

ONE of the few bright spots in real estate amid a three-year global slump, Australia now faces falling home prices and fears of overbuilding.

A downturn in Australia's real estate market will add to concerns of a two-speed economy in the resource-rich nation. Mining profits are surging due to heavy demand from China and other fast-growing Asian countries, but consumer businesses and manufacturing have faltered under the weight of the swollen Australian dollar, which is trading near 30-year highs to the US currency.

It also could threaten foreign investors who have poured more than \$20 billion into the market every year since 2004, on average, according to data from Australia's Foreign Investment Review Board.

Said Alex Helme, a Singapore-based mining company employee who owns one investment property in Melbourne and two outside of Perth: "We're still optimistic given a lot of the local factors are still there thanks to China.

"That said, at this point, it has to feel like a long-term investment."

The combined average price of homes and apartments in Australia's capital cities is off 2 per cent from a year ago and 2.7 per cent this year, checking in at \$462,500, according to property research firm RP Data-Rismark. This comes as Australia's economy starts to cool, with the central bank recently downgrading its average growth forecast for the year to 2 per cent from 3.25 per cent.

Mortgages in which payments are late by 30 days or more reached an all-time high in the first quarter of 1.8 per cent, according to ratings firm Fitch Ratings. However, that level is still well below that of the US, which saw 8.4 per cent in the June quarter, according to the US Mortgage Bankers Association.

The figures mark a reversal for a market that never saw the same sub-prime lending fallout that continues to bedevil the US housing market. Wage growth from Asia's appetite for commodities, a rise in immigration and slow homebuilding drove the price of the average home in Australia up 150 per cent from 2001 to the start of this year, according to RP Data.

But construction has caught up. In Australia, according to the country's Bureau of Statistics, new-home construction has jumped 26 per cent in just the last year, as of June, to about 165,549 units, and is up 10 per cent from 2006. Driving the gains is Victoria, where home construction is up 40 per cent since 2006 at 54,476 units last year in the state capital, Melbourne, Australia's second-largest city.

About 10 per cent of the 120,000 new homes approved for construction by city governments in Australia in the past year were apartments in Melbourne, according to city administrators and the bureau of statistics.

"Melbourne is vastly oversupplied and underfinanced," said Andrew Donnelly, chief executive of global investment group Whiterock Capital Partners, which acts on behalf of international investors buying property in Australia. "Most of the projects that have been sold there are never going to see the light of day due to a lack of commitment from the major banks. Perth is undergoing a correction and is too much of a one-horse town."

Home and apartment prices in Melbourne are down 3.9 per cent this year to \$485,000. In the Western Australian capital of Perth, prices are down 2.4 per cent to \$461,000, according to RP Data-Rismark. Sydney has side-stepped some of the weakness, up 0.5 per cent over the past 12 months, but still off 1.3 per cent since the start of this year to \$515,000.

Behind the decline is a rush by property developers to build apartments for thousands of skilled migrants who are expected to seek work in the Pacific nation's booming mining industry. Melbourne is home to the headquarters of two of the world's biggest mining conglomerates, BHP Billiton and Rio Tinto. On the west coast, Perth lies at the centre of vast natural gas and iron ore fields that are supplying China with much of the raw material for its factories.

So far, Australia's big four banks - ANZ, Commonwealth Bank of Australia, Westpac and National Australia Bank - appear to be weathering the turn, though scrutiny could increase if the market worsens. The four hold more than \$850 billion, or more than 80 per cent, of Australia's mortgages, though Fitch estimated last year that they could withstand a price drop of up to 40 per cent.

While acknowledging the risks, the banks defend their exposure saying they have low loan-to-value ratios. In its latest third-quarter results, Westpac - Australia's second-largest lender by market value - said it doesn't have any immediate concerns about the recent price declines, with the bank "seeing relatively low levels of mortgage delinquencies" compared with other parts of the world, according to spokesman Paul Marriage.

"The big question is where does unemployment go, that's when you get the forced selling," said Ivan Colhoun, head of Australian economics and property research at ANZ, who finds solace in Australia's still-low 5.1 per cent unemployment rate.

Locally, buyers have already started to wane. In the last year, there were 90,210 first-home buyers across Australia, 35 per cent lower than the previous year and a seven-year low, according to BankWest, a Western Australia-based lender and unit of Commonwealth Bank.

Mr Donnelly, whose firm has sold residential property in Australia worth more than \$1.2bn to mostly overseas investors, says the market in Sydney and Brisbane could sidestep some of the weakness, largely because both fell behind in the recent development push.

Brisbane has also been weak, with prices off more than 6 per cent this year, but much of the drop stems from the devastation to the capital of Queensland state earlier in the year from a series of floods.