The QBE Australian Housing Outlook

2017-2020

QBE

About this report

Produced by BIS Oxford Economics for QBE Lenders' Mortgage Insurance.

This report provides an analysis and forecast of the key drivers influencing the residential housing market nationally, as well as across each of Australia's state and territory capital cities and selected regional centres. The analysis presents an outlook for the performance of the residential market, as measured by historical and forecast movement in the median house price and median unit price. The forecast annual percentage changes in the median house price and median unit price in the price forecast charts in this report are often rounded to the nearest whole number. Any reference to price growth in the text may not be identical to that indicated in the charts due to the impact of this rounding. The Australian Housing Outlook 2017 to 2020 report has been updated with reference to the recently published data from the 2016 Census. The regional weightings used in providing the weighted median house and unit price have been revised to account for the updated dwelling counts at the 2016 Census. The new weightings have resulted in some minor revisions to the weighted median house and unit prices since 2011, when the last Census dwelling stock count was undertaken. Revised population estimates and household counts (by age) resulting from the 2016 Census have resulted in an update to recent estimates of the underlying demand for dwellings. The analysis of this data has also provided insights upon which to base updated forecasts of underlying demand for dwellings in each state. The revisions to underlying demand have necessitated a reassessment of the dwelling stock deficiency or oversupply in each state (and forecasts), which in turn is a key component of the dwelling price forecasts.

Welcome to

The QBE Australian Housing Outlook 2017-2020

Houses versus units, capital cities or regional centres, there's never been a more compelling time to examine the Australian housing market

The detached house on a quarter acre block with a Hills Hoist in the backyard was always the typical Australian dream. But with units accounting for around 46% of all residential construction, significantly more in our major capital cities, it's clear that more of us are now considering life in an apartment.

One of the key themes in this year's QBE Australian Housing Outlook is the growing prevalence of units on the property landscape. In the background to this, the interplay between demand, supply and lending activity paints an evocative picture of a myriad of separate but interconnected property markets across Australia. Continued population growth, set against historic low interest rates, has been a key driver that has delivered the market to where it is today.

This is the 16th year we've partnered with BIS Oxford Economics to present the QBE Australian Housing Outlook. Inside, you'll find state and territory analysis and forecasts of house and unit prices for the next three years.

This year, we've added to our regional coverage to include Toowoomba in Queensland and Launceston in Tasmania. We've also revisited some key mining towns in Queensland and Western Australia for a pulse check of these markets. We shine a spotlight on regulator measures to influence investor demand and track the effect this is having on our property market.

We know the dream for Australians is to own their own home and for many that's a significant challenge. However, for some 105,000 homeless people, simply finding shelter is a daily battle. It's my hope that as we address the housing needs of our growing population, we can as a community also tackle the wider issue of homelessness.

You may have noticed this year's QBE Australian Housing Outlook has a new look and I'd like to invite you to take a closer look at the report and share your thoughts with us.

Phil White
CEO
QBE LENDERS' MORTGAGE INSURANCE

Table of contents

INTERACTIVE PDF

This is an interactive PDF designed to enhance your experience. The best way to utilise this PDF is through Adobe Reader. Click on the links above in the contents or use the buttons throughout to navigate the report.

Demand and supply

Keeping pace

Units now account for an increased share of demand as affordability, and perhaps lifestyle, inform property choices and accessibility

New South Wales outlook

Growing pains

Upswing in NSW property sector has partly fuelled the state's economic growth, but affordability remains challenging

Queensland outlook

Solid stock

Improving economic fundamentals are now emerging in Queensland's post-mining boom, but Brisbane is forecast for an oversupply of units

Economic outlook

Fundamentally sound

A downturn in residential construction likely to create a subdued national economy, while low interest rates support affordability in some markets

Buyer activity

A mixed market

Owner occupiers benefit from low interest rates, while investors are influenced by lenders

Victoria outlook

People power

Dwelling commencements set to ease, but Victorian economy likely to benefit from high levels of migration

Australian housing snapshot

Economic indicators 2020 forecast

Cash rate

1.75%

2017 **1.5%**

Employment growth

1.6%

2017 **2.2%**

Unemployment rate

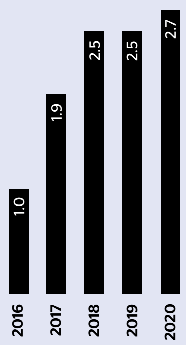
5.7%

2017 **5.7%**

Consumer Price Index (CPI) growth

2.7%

2017 **1.9%**



Gross Domestic Product (GDP) growth

2.9%

2017 **1.9%**

Overseas migration

231,900

year to March 2017

26.8%

from March 2016

Housing affordability

31.2%

at June 2017

Population

24,511,800

at March 2017

1.6%

from 2016

Borrowing rates 2020 forecast

Standard variable rate	Interest only - owner occupier	Housing investor rate	Interest only - investor
▲ 5.5%	▲ 6.0%	▲ 6.0%	▲ 6.5%
2017 **5.3%**	2017 **5.8%**	2017 **5.8%**	2017 **6.3%**

House commencements

‘000s pa	‘000s pa
105.8	**110.0**
10 years to 2012	five years to 2017

Vacancy rates

at June 2017

Sydney	Brisbane	Melbourne	Perth
◀▶ 1.8%	◀▶ 2.8%	▼ 2.2%	▲ 7.3%
2016 **1.8%**	2016 **2.8%**	2016 **2.7%**	2016 **6.0%**

Unit commencements

‘000s pa	‘000s pa
52.6	**94.0**
10 years to 2012	five years to 2017

Unit dwellings

as a proportion of total dwelling commencements

33%	**46%**
10 years to 2012	five years to 2017

Total dwelling commencements

153.4 ‘000s pa

10 years to 2012

204.0 ‘000s pa

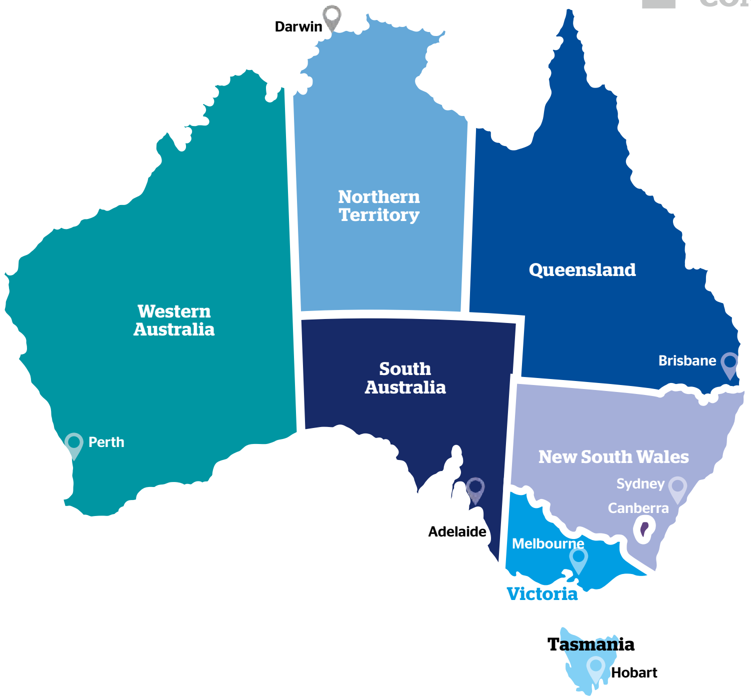
five years to 2017

States at a glance

	NSW	VIC	QLD	WA
Population at March 2017	7,837,700	6,290,700	4,907,600	2,576,000
2012-2017 growth	7.5%	11.8%	7.9%	7.0%
ANNUAL MOVEMENT 2016/17				
First home buyer (FHB) loans	-6.6%	-2.0%	11.2%	-6.5%
Non FHB loans	0.2%	0.7%	0.7%	-7.9%
Investor loans (value)	19.7%	13.9%	-1.6%	-17.6%

	Sydney	Melbourne	Brisbane	Perth
Median house price at June 2017	$1,177,769	$852,724	$550,840	$520,519
Annual movement (year to June 2017)	▲ 12.4%	▲ 13.7%	▲ 2.0%	▼ -7.5%
2017-2020 forecast growth % house price	▼ -0.2%	▲ 10.2%	▲ 7.1%	▲ 2.8%
Median unit price at June 2017	$790,063	$561,709	$414,812	$402,247
Annual movement (year to June 2017)	▲ 7.3%	▲ 7.8%	▼ -3.1%	▼ -0.8%
2017-2020 forecast growth % unit price	▼ -3.8%	▼ -4.8%	▼ -7.2%	▼ -0.6%
Affordability[1]	▼ 39.7%	▼ 36.2%	▲ 20.6%	▲ 20.2%

1 Percentage of monthly disposable household income for mortgage repayment. Mortgage repayment based on 75% of the median house price.



	SA	TAS	ACT	NT
Population at March 2017	1,721,000	520,100	409,100	245,000
2012-2017 growth	4.1%	1.6%	9.2%	4.8%
ANNUAL MOVEMENT 2016/17				
First home buyer (FHB) loans	-1.0%	0.3%	1.7%	30.4%
Non FHB loans	0.6%	13.1%	-0.3%	-12.1%
Investor loans (value)	-0.3%	12.8%	21.4%	-22.8%

	Adelaide	Hobart	Canberra	Darwin
Median house price at June 2017	$477,206	$424,264	$645,000	$540,000
Annual movement (year to June 2017)	▲ 4.2%	▲ 6.1%	▲ 4.1%	▼ -6.3%
2017-2020 forecast growth % house price	▲ 6.9%	▲ 10.8%	▲ 16.3%	▼ -0.9%
Median unit price at June 2017	$360,434	$331,317	$425,000	$470,000
Annual movement (year to June 2017)	▲ 6.8%	▼ -0.5%	▼ -2.3%	▼ -6.0%
2017-2020 forecast growth % unit price	▲ 3.2%	▲ 8.7%	▲ 2.4%	▼ -3.2%
Affordability[1]	▼ 20.5%	▼ 17.8%	▼ 14.8%	▲ 19.7%

On the horizon

Low interest rates and investor activity have been demand drivers, but regulator measures are set to dampen future price growth

The outlook for house and unit prices is likely to become more subdued over the next year or two. Many markets are now building too much stock, particularly units, after new dwelling starts peaked at a record 233,600 dwellings in 2015/16. Restrictions on bank lending to investors are expected to be an increasingly prominent feature of the outlook for the market over 2017/18. This will most likely reduce investor purchaser activity and slow price growth. Owner occupier demand is also expected to weaken, as the emerging downturn in new dwelling commencements translates into lower building activity over 2017/18 and 2018/19 and negatively affects the economy.

Demand and supply

Population growth has been strong. Net overseas migration inflows rose from 178,600 in 2014/15, to an estimated 215,000 in 2016/17. Slowing economic growth is expected to cause net overseas migration to ease to 175,000 by 2019/20. While lower than recent cycles, this figure is up compared to the long-term, 20-year trend of 171,100 per annum and is higher than most years through the 1990s and early 2000s. This will continue to fuel underlying demand for dwellings. New dwelling commencements rose to record levels in 2014/15 and 2015/16, and are still well above underlying demand. Only New South Wales, Victoria and Tasmania are expected to be in dwelling deficiency over the next three years. However, the excess stock in markets is more likely to be for units, which have accounted for the larger share of the upturn in new dwelling supply.

Lending environment

Low interest rates have helped drive up prices and investors have been a key source of demand. Successive initiatives by the financial regulators to dampen speculative investment has resulted in banks lowering loan-to-value ratios to investors, as well as charging higher interest rates to investors and for interest only lending. The latest restrictions on interest only loans are expected to cause a slowdown in investor lending over 2017/18. This is likely to have a negative effect on dwelling prices, with price falls expected in some cities.

Median prices

Median house price growth in **Sydney** and **Melbourne** is expected to weaken in 2017/18 due to lower investor activity in the market. This is expected to have a greater affect in Sydney, given its greater recent influence from investors. The emerging momentum in house price growth in **Canberra** and **Hobart** is forecast to continue in 2017/18. Modest house price rises are expected in **Brisbane** and **Adelaide**; with these markets being dampened by weak local economic conditions. The downturns in **Perth** and **Darwin** are forecast to bottom out in 2017/18 although any recovery is likely to be drawn out. Unit price growth is forecast to underperform house price growth. A disproportionately higher number of units being built in most markets will result in an excess supply in units. Restrictions on investor lending will also have a negative effect, given units are more favoured by investors.

Median prices by capital city quarter ended June 2017

Houses

	Sydney		Melbourne		Brisbane		Perth		Adelaide		Hobart		Canberra		Darwin	
	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR
Forecast growth (%)																
2017-2020		-0.2		10.2		7.1		2.8		6.9		10.8		16.3		-0.9
Forecast																
2020	1,150.0	1.3	940.0	2.2	590.0	2.6	535.0	1.9	510.0	3.0	470.0	1.1	750.0	2.7	540.0	0.9
2019	1,135.0	-2.6	920.0	2.2	575.0	1.8	525.0	1.0	495.0	1.0	465.0	3.3	730.0	5.8	535.0	0.0
2018	1,165.0	-1.1	900.0	5.5	565.0	2.6	520.0	-0.1	490.0	2.7	450.0	6.1	690.0	7.0	535.0	-0.9
Prior years																
2017	1,177.8	12.4	852.7	13.7	550.8	2.0	520.5	-7.5	477.2	4.2	424.3	6.1	645.0	4.1	540.0	-6.3
2016	1,048.0	2.5	749.9	7.5	540.0	5.3	562.7	-3.8	458.1	3.1	400.0	10.5	619.5	7.8	576.0	-5.6
2015	1,022.6	24.1	697.7	15.6	512.8	4.3	584.7	-3.0	444.5	2.1	361.9	1.2	574.5	4.5	610.0	-1.7
2014	824.0	17.3	603.6	10.5	491.6	6.3	602.8	5.8	435.4	6.3	357.8	6.0	550.0	1.9	620.8	1.4
2013	702.5	8.2	546.3	3.4	462.5	4.0	569.8	10.7	409.7	0.5	337.4	-2.1	540.0	5.9	612.0	7.4
2012	649.1	-0.4	528.4	-5.3	444.6	-2.9	514.7	-1.6	407.7	-3.0	344.5	-1.6	510.0	-1.9	570.0	10.7
2011	651.6	-0.4	558.2	-3.5	457.7	-5.7	522.9	-3.9	420.4	-2.2	350.0	-0.7	520.0	4.0	515.0	-7.3
2010	654.5	15.1	578.4	24.8	485.3	9.1	544.3	9.3	429.7	11.1	352.6	8.4	500.0	10.7	555.3	18.2
2009	568.6	1.2	463.5	0.1	444.8	-3.2	498.0	-1.9	386.9	-2.1	325.3	2.4	451.8	-3.8	469.9	11.0
2008	561.8	1.0	463.1	11.1	459.3	13.1	507.8	-1.8	395.0	16.0	317.7	5.6	469.5	6.1	423.3	7.2
2007	556.4	2.7	416.9	11.2	406.1	16.0	517.0	9.8	340.7	10.6	300.8	6.1	442.5	13.5	395.0	12.9
2006	541.7	-0.9	374.7	7.5	350.2	7.0	470.8	48.7	308.0	7.6	283.5	13.3	390.0	6.0	350.0	25.1
2005	546.6	0.9	348.6	4.0	327.2	2.1	316.6	13.8	286.1	6.8	250.1	6.2	368.0	-1.9	279.8	9.7
2004	541.9	6.7	335.0	7.0	320.5	29.1	278.2	15.6	268.0	16.4	235.5	58.8	375.0	13.7	255.0	23.8
2003	507.8	15.7	313.0	9.8	248.3	27.4	240.7	16.3	230.3	24.7	148.2	25.3	330.0	29.4	206.0	3.0
2002	438.7	20.8	285.1	18.7	194.9	17.9	207.0	12.1	184.6	17.6	118.3	4.8	255.1	21.5	200.0	7.0
2001	363.1	17.5	240.2	7.4	165.3	2.7	184.6	4.6	156.9	6.6	112.9	-0.3	210.0	14.1	187.0	-1.8
2000	308.9	14.3	223.6	14.2	161.0	6.7	176.5	6.8	147.2	11.2	113.3	6.7	184.0	15.0	190.4	8.2

Units

	Sydney		Melbourne		Brisbane		Perth		Adelaide		Hobart		Canberra		Darwin	
	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR	$'000	% VAR
Forecast growth (%)																
2017-2020		-3.8		-4.8		-7.2		-0.6		3.2		8.7		2.4		-3.2
Forecast																
2020	760.0	-0.7	535.0	-0.9	385.0	-2.5	400.0	1.3	372.0	1.9	360.0	1.4	435.0	1.2	455.0	1.1
2019	765.0	-2.5	540.0	-0.9	395.0	-2.5	395.0	0.0	365.0	0.0	355.0	2.9	430.0	1.2	450.0	0.0
2018	785.0	-0.6	545.0	-3.0	405.0	-2.4	395.0	-1.8	365.0	1.3	345.0	4.1	425.0	0.0	450.0	-4.3
Prior years																
2017	790.1	7.3	561.7	7.8	414.8	-3.1	402.2	-0.8	360.4	6.8	331.3	-0.5	425.0	-2.3	470.0	-6.0
2016	736.2	2.8	521.2	2.6	428.1	-0.8	405.7	-5.5	337.5	1.3	333.1	10.6	435.0	1.6	500.2	4.2
2015	716.0	15.6	508.0	4.9	431.8	4.3	429.3	-1.4	333.1	-2.1	301.1	-1.9	428.0	4.4	480.0	-1.0
2014	619.5	12.2	484.1	6.1	413.9	4.9	435.3	0.0	340.0	4.2	307.0	-1.0	409.9	0.0	485.0	4.5
2013	552.0	6.6	456.3	2.5	394.6	1.0	435.3	6.4	326.5	2.4	310.0	4.8	410.0	-2.4	464.0	6.7
2012	517.9	4.3	445.3	-3.2	390.7	-0.3	409.1	1.8	318.9	-4.5	295.8	1.7	420.0	0.0	435.0	2.4
2011	496.4	2.2	460.1	0.0	391.9	-2.6	401.8	-3.0	333.9	-0.4	291.0	-0.3	420.0	1.2	425.0	-2.9
2010	485.6	15.7	460.3	18.3	402.2	6.8	414.3	7.7	335.1	8.6	292.0	5.6	415.0	10.7	437.6	15.1
2009	419.9	3.0	388.9	4.4	376.5	-2.9	384.5	-0.9	308.7	4.6	276.4	1.1	375.0	7.1	380.1	15.5
2008	407.5	-0.1	372.6	7.7	387.8	11.4	388.0	0.9	295.2	11.9	273.3	9.9	350.0	-1.4	329.0	17.8
2007	408.2	1.6	345.9	12.7	348.2	13.2	384.5	11.3	263.8	14.7	248.6	-1.2	355.0	9.2	279.3	4.4
2006	401.7	0.8	307.0	6.2	307.7	10.2	345.6	34.2	229.9	5.0	251.7	12.0	325.0	4.2	267.5	32.1
2005	398.3	1.2	289.2	1.6	279.3	9.1	257.5	15.6	218.9	7.5	224.6	8.7	312.0	4.0	202.5	6.6
2004	393.7	3.4	284.5	1.3	256.0	20.6	222.8	6.0	203.7	12.3	206.7	45.0	300.0	15.4	190.0	20.9
2003	380.7	2.5	280.8	6.0	212.2	10.1	210.1	19.9	181.4	29.7	142.6	26.5	260.0	20.4	157.1	2.8
2002	371.5	13.5	264.9	19.0	192.7	4.0	175.2	16.4	139.8	11.4	112.7	10.4	216.0	39.4	152.8	7.8
2001	327.3	5.1	222.5	11.6	185.2	1.2	150.4	8.5	125.5	16.9	102.1	-11.6	155.0	9.2	141.8	1.1
2000	311.5	10.9	199.4	14.1	183.0	11.4	138.7	9.2	107.3	9.4	115.4	12.4	142.0	5.2	140.3	-8.0

Growing pains

Upswing in NSW property sector has partly fuelled the state's economic growth, but affordability remains challenging

Sydney house market

The Sydney residential market has been in significant deficiency since 2005/06 as rising migration has contributed to population growth and an increase in demand for housing.

Market conditions

Low interest rates and the persistent underlying shortage of dwellings, combined with a buoyant state economy, led to the median house price escalating rapidly at an average of 10.4% per annum in the six years to June 2017 to be $1,177,800. Over the 12-months to June 2017, price growth was focused in Middle (15.1%) and Outer (12.5%) ring Sydney suburbs, while Inner ring Sydney suburbs (7.8%) grew at a slower pace. Population growth remains strong, although there are signs of a rising net interstate migration outflow.

Significant capital growth and low interest rates have caused investor activity to surge, with the value of residential investor loans in New South Wales having grown at 9.8% per annum over the last decade. In comparison, the value of loans to owner occupiers grew by just 4.9% per annum over the same period.

Investors

Median house price growth peaked at 24.1% over 2014/15 before price growth slowed to just 2.5% in 2015/16. The easing in price growth over 2015/16 was despite the strong fundamentals of the Sydney market. The slowdown was a result of changes to bank lending policy in response to guidelines issued by the Australian Prudential Regulation Authority (APRA) to curb speculative investor lending. The value of loans to investors fell by 17% in 2015/16, partly offset by some growth in lending to owner occupiers.

However, a combination of a 50 basis point cut to interest rates in 2016 and some more favourable lending conditions for investors brought a 20% recovery in investor lending in 2016/17. New APRA guidelines were introduced in March 2017 specifically targeting interest only lending favoured by investors. This measure is anticipated to keep growth in investor lending in check through 2017/18, and cause price growth to weaken.

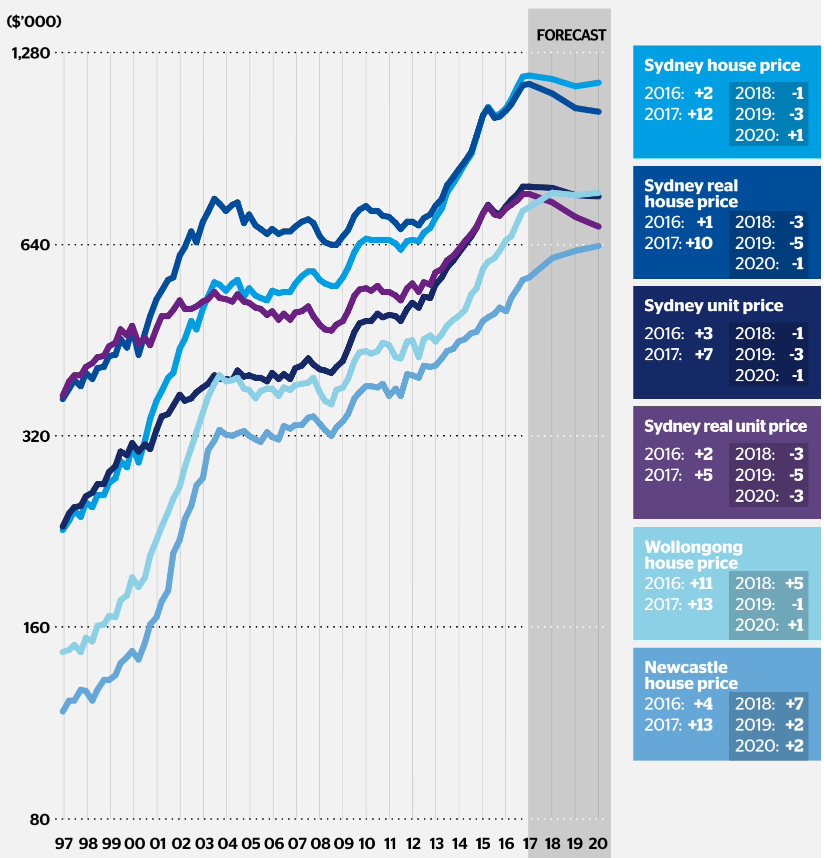
Owner occupiers

Growth of owner occupier loans is also expected to slow. New dwelling supply began to outpace underlying demand in 2015/16, although the market remains in overall undersupply. Rental vacancy rates are largely below the 2% mark, indicating a tight market. However, affordability has become increasingly strained. Mortgage repayments on 75% of Sydney's median house price at June 2017 accounts for 39.7% of average household disposable income. Although banks have been more aggressively courting owner occupiers by reducing the owner occupier variable rate by around 10 basis points in recent months, affordability is still a similar percentage to the previous downturn in the mid-2000s. The stamp duty exemption introduced in July 2017 to first home buyers, is expected to have little effect in Inner and Middle ring Sydney suburbs where median prices are well above the $650,000 threshold for a full stamp duty concession.

Outlook

With completions well ahead of demand, the state's dwelling shortage lowered to an estimated 39,300 dwellings at June 2017 and is projected to ease to around 12,900 at June 2020. While this will ease owner occupier demand, it will create challenges for investors, who are finding it increasingly difficult to obtain finance to be able to outbid owner occupiers. As a result, house prices are expected to decline by a cumulative 4% over the two years to 2018/19 before modest growth returns to take the median house price to $1,150,000 at June 2020.

New South Wales: dwelling prices



Sydney unit market

The upturn in new dwelling supply in Sydney since 2010/11 has been characterised by a proportionate increase in both house and unit supply. High density completions began to accelerate in 2012/13 with the share of total dwelling completions rising to 52% in 2016/17. This came mainly at the expense of medium density completions with a small fall in the share of detached house completions.

Median unit price

Price growth in the Sydney unit market continues to lag behind the house market. Sydney's median unit price rose by an estimated 8.1% per annum over the six-year period to June 2017 compared to price growth of 10.4% per annum for houses. After surging by 12.2% in 2013/14 and 15.6% in 2014/15, median unit price growth has started to flatten out. Regulatory changes announced in late 2015 had a greater impact on investor demand and in turn, the unit market. Median unit price growth eased to just 2.8% in 2015/16, but strengthened to 7.3% in 2016/17 as investor demand recovered, taking the median unit price to $790,100 at June 2017.

Outlook

With higher interest rates and lower loan-to-value ratios for investor lending, capacity for investors to enter the market or pay higher prices is limited. This will put downward pressure on unit prices as investors retreat from the market. Yields in Sydney are also at record lows. The large volume of new apartment construction taking place is likely to push vacancy rates up and put downward pressure on rental growth as the dwelling deficiency is slowly eroded. However, some support to price growth might be provided by first home buyers taking advantage of the recently introduced exemptions on stamp duty. Sydney's median unit price is forecast to decline a cumulative 4% over the forecast period to reach $760,000 at June 2020.

New South Wales and Sydney regions

Sydney median house price annual % change

Inner	Middle	Outer	Median
△ 7.8%	△ 15.1%	△ 12.5%	△ 12.4%

Regional New South Wales

In addition to local economic demand and supply factors, residential property prices in the Newcastle and Wollongong regions are often impacted by the residential cycle in Sydney. Relative housing affordability drives migration between the state capital and these regional centres.

Regional New South Wales centres

❶ Wollongong region: City commuters

Wollongong has a diversified economy with tourism and education playing a significant role in economic growth. The Illawarra region has benefited from deteriorating housing affordability in Sydney.

Wollongong is within commuting distance of Sydney CBD with around 20% of the Wollongong region's employed population working in Sydney historically. The latest 2016 Census data on place of employment has yet to be released, although given Sydney's lower unemployment rate relative to the Illawarra region, this share is likely to remain similar, if not increase.

The affordability gap between Wollongong and Sydney widened considerably in the initial stages of the Sydney upturn, making Wollongong increasingly attractive for Sydney residents. In June 2013, the median house price in Wollongong was 65% of the median house price in Sydney. Since then, this ratio eased to a low of 57% at June 2015, before rising back to 61% at June 2017. In this time, the median house price in Wollongong increased a cumulative 63%, or an average 13% per annum, to $732,800 at June 2017.

The median house price in Wollongong relative to Sydney is almost back to 2013 levels. This would indicate less scope for the median house price in Wollongong to significantly outperform the Sydney market going forward, despite lower house prices.

Outlook: Those looking to escape the deterioration of affordability in Sydney will find less incentive to migrate to Wollongong. Further price growth is still expected given its lower relative price, although Wollongong house price growth is forecast to slow. Wollongong's median house price growth is forecast to be 5% in 2017/18 before being largely flat over the following two years to take the median house price to $770,000 at June 2020.

❷ Newcastle and the Hunter region: Tourism and logistics hub growth

Recent declines in coal sector investment have created more challenging local economic conditions in the Hunter region, although global demand for thermal coal remains strong and this should keep production volumes up.

Newcastle's role as a logistics hub is also anticipated to continue to drive employment while other sectors such as tourism should increasingly offset continued weakness in the coal sector.

Newcastle experienced solid price growth in the five years to June 2017, averaging 7% per annum as purchaser sentiment improved and low interest rates supported market entry. Notably, this growth has lagged behind that of Sydney and Wollongong. Newcastle offers first home buyers a more affordable option. However, the distance from Sydney means that this advantage in affordability would not typically benefit a commuter population, and population movement into Newcastle needs to be driven by local employment fundamentals.

In line with rising prices, new building activity has been increasing. Nevertheless, the market remains tight with vacancy rates well below the 3% market balanced rate. The unemployment rate has improved, falling from a high of 8.4% in June 2015 to 6.2% in March 2017.

Price growth ▲ **7% pa**

Rental vacancy rates ▼ **2.3%**

Forecast house price ▲ **12%**

Unemployment ▼ **6.2%**

Outlook: The redevelopment of the Newcastle Interchange as well as the light rail line will encourage job creation and further investment in the area, and the outlook for the Hunter region economy remains positive. Price momentum is forecast to carry into 2017/18, with house prices projected to grow 7% before easing in the two years to 2019/20 in line with the Sydney market. The median house price at June 2017 of $568,700 is forecast to increase a cumulative 12% to $635,000 at June 2020.

People power

Dwelling commencements set to ease, but Victorian economy likely to benefit from high levels of migration

Melbourne house market

Record population growth has been the key ingredient of the Melbourne residential market upturn. High net overseas migration and record net interstate migration inflows have driven strong underlying demand.

The market has also been driven by low interest rates, rising rents and tight vacancy rates, resulting in strong investor and upgrader activity. A deficiency of dwellings remains across the Melbourne market despite surging new dwelling supply, and the median house price in Melbourne increased by a cumulative 56% in the four years to $852,700 at June 2017. Over the year to June 2017, price growth has been heavily concentrated in Middle (13.1%) and Outer ring suburbs (16.4%) while Inner (-1.5%) ring suburbs saw a price decline.

Price growth

Investors have been a feature of this upturn, which has been encouraged by tight vacancy rates and low interest rates. The impact of investor demand was evident in 2015/16, when annual price growth paused at 7.5% and investor demand fell by 13% as banks tightened lending policy towards investors. Median house price growth strengthened by 14% in 2016/17, corresponding with a 14% rebound in investor loans after interest rates were cut in 2016 and bank lending policy was reassessed. Another round of restrictions to investor lending and interest only loans is expected to cause investor lending to ease again from 2017/18.

Buyer activity

The rise in house prices has led to increasingly strained affordability, which has hampered first home buyer activity. The number of loans to first home buyers in Victoria has been reasonably flat, and trending slightly downwards over the past four years. In contrast, upgrader and downsizer activity has been robust, as rising house prices encouraged sales activity. Stronger first home buyer demand may emerge in 2017/18 with stamp duty exemptions making it easier for some to enter the market.

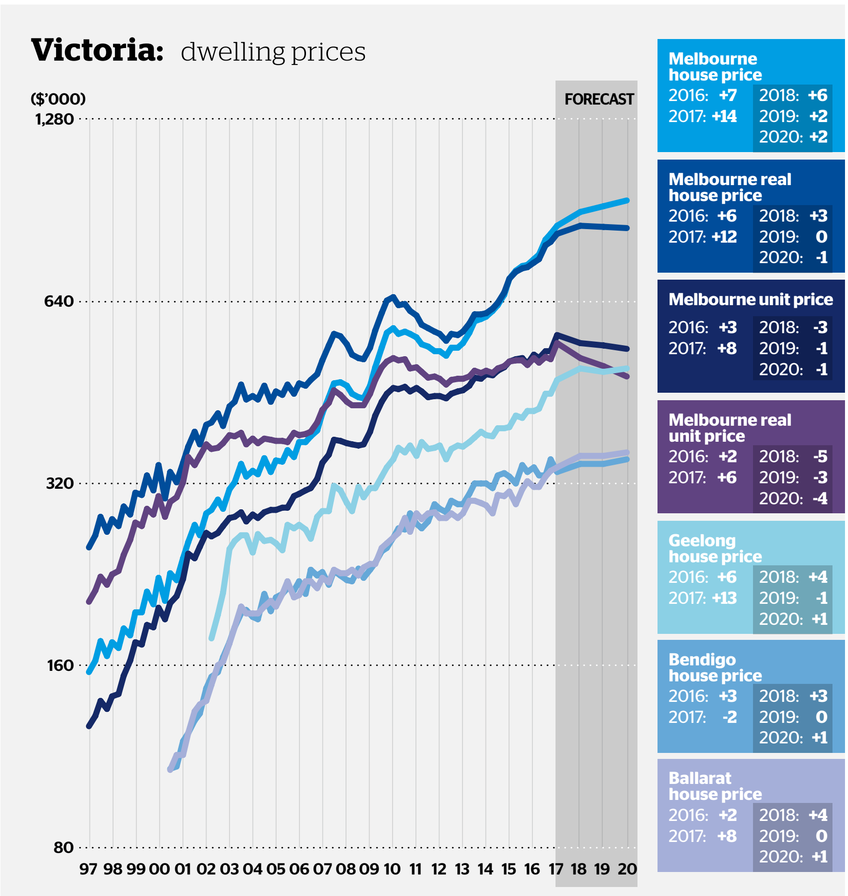
Demand and supply

Net overseas migration into the state has averaged 64,700 per annum in the past four years, while net interstate migration has also reached record highs, at an estimated 19,000 people in 2016/17 and an average 13,700 per annum in the past four years. Victoria has had the strongest population growth of all states which has supported strong underlying demand for dwellings.

Dwelling starts in Victoria peaked at 68,700 in 2015/16. Completions have also been rising and are now outpacing underlying demand. Dwelling completions will begin to fall away in line with the emerging downturn in dwelling commencements, but population growth is also expected to begin to ease, and the current deficiency of dwellings in the state is forecast to briefly transition to a modest oversupply in 2018/19.

Outlook

The house market is expected to outperform the unit market in Melbourne. The rise in unit completions in the past five years has been greater than house completions. In addition, the negative impact of regulatory initiatives aimed at investors and any rise to vacancy rates are also likely to have more of an impact on the unit market. With Melbourne's upturn in new dwelling supply not as strong for houses, the market for houses is estimated to still be in undersupply. As a result, moderate median house price growth of 6% is forecast in 2017/18 before price growth flattens out as Victoria's undersupply decreases and economic conditions slow. At June 2020, the median house price is forecast to be $940,000, a cumulative 10% increase over the three-year forecast period.



Melbourne unit market

The unit market has been largely flat over the four years to 2016/17. Over this period, Melbourne's median unit price grew a cumulative 8%, and in 2015/16 and 2016/17 was below 2% per annum. This reflects the growth in new unit supply with unit completions surpassing completions of houses in these two years.

Supply

Total new dwelling supply in Melbourne since 2011/12 has occurred on the back of surging unit construction. Unit completions rose from 44% to 60% of total dwelling completions between 2010/11 and 2016/17, and the unit market is estimated to have some level of oversupply. Record apartment completions are on track to continue in 2017/18 and will cause vacancy rates to increase and negatively impact rental growth and unit prices. These factors will dampen investor demand, which will be compounded by the current tightening in investor lending by the banks.

Outlook

The median unit price in Melbourne is expected to decline as the oversupply in units accelerates. The retreat of investors in this environment is forecast to see the median unit price decline by a cumulative 5% to $535,000 at June 2020.

Victoria and Melbourne regions

Melbourne median house price annual % change

Inner	Middle	Outer	Median
▽ -1.5%	△ 13.1%	△ 16.9%	△ 13.7%

Regional Victoria

The regional centres of Geelong and Ballarat are close enough to Melbourne to support regular commuter transit while Bendigo would attract infrequent commuters.

Conditions in the Melbourne market have an influence on the local residential market in the regional centres of Geelong and Ballarat. The construction of the Regional Rail Link has benefited all three centres. While it doesn't necessarily reduce the trip duration to Melbourne, a more frequent and reliable transport service is likely to make Geelong and Ballarat more desirable as residential centres.

Regional Victoria centres

❶ Ballarat: Infrastructure investment

Price growth

4.5% pa

Rental vacancy rates

2.5%

Forecast house price

6%

Unemploy-ment

4.5%

The median house price in Ballarat has grown by a cumulative 19% or about 4.5% per annum over the past four years. In the year to June 2017, price growth reached 8% taking the median house price to $340,000.

Population growth has been solid while the local economy has benefited from state government initiatives such as the development of the $48 million Ballarat GovHub, which relocates a number of government departments to the Ballarat CBD. The unemployment rate has decreased from 6.5% in June 2016 to 4.5% in March 2017 while vacancy rates remain tight at 2.5% in June 2017.

Outlook: Large infrastructure projects such as the Eureka Stadium development, the Ballarat Link Road and the Ballarat West Employment Zone should support employment and population growth, and therefore demand for dwellings over the next three years. The outlook for Ballarat remains positive and median house prices are forecast to rise a cumulative 6% to reach $360,000 at June 2020.

❷ Geelong: Employment shift to service sector

The median house price in Geelong increased 12.6% in the year to June 2017 to $475,000. The closure of the Alcoa operation in 2014 has largely been worked through while the losses in employment from the Ford manufacturing shutdown in late 2016 has been somewhat offset by gains in service sector employment.

The relocation of WorkSafe Victoria and the National Disability Insurance Agency to Geelong will boost employment while the construction sector will also be supported by new head office developments for each body. The unemployment rate was 6.3% in the March quarter 2017, an improvement from its peak of 8.4% in the March quarter 2015. Vacancy rates have also fallen to 2.2% in June 2017 indicating a tightening market.

Outlook: The outlook for the local economy is positive. Geelong will also continue to benefit from an affordability advantage over Melbourne. However, the recent strong price growth in Geelong and competition from Melbourne's outer western suburbs, which are closer to central Melbourne, is expected to limit stronger price growth. Geelong's median house price is forecast to grow 4% in 2017/18 as price growth in Melbourne also slows, before flattening out to be $495,000 at June 2020, representing a cumulative rise of 4% over this period.

❸ Bendigo: New infrastructure

The construction of the Bendigo Hospital has been one of the key employment drivers in recent years. Its impact on the local economy was significant, improving unemployment from 7.6% in March 2015 to 4.5% in March 2017.

Median house prices have also steadily risen in light of greater dwelling demand. The median house price reached $350,000 in March 2017 before easing slightly to $334,000 in June quarter 2017. Bendigo's vacancy rate remains tight, below the 2% mark, which suggests that rental dwelling demand remains strong.

Outlook: With the completion of the first phase of the Bendigo Hospital, the next phase consists of smaller scale works. There are also no upcoming projects of comparable size to maintain local economic growth and job creation. Without any significant economic drivers emerging, house price growth in the Bendigo market is expected to be limited at 3% in 2017/18. Growth is then expected to be flat with the median house price at $350,000 in June 2020 representing a total 5% increase.

Solid stock

Improving economic fundamentals are now emerging in Queensland's post-mining boom, but Brisbane is forecast for an oversupply of units

Brisbane house market

Median house prices

The Brisbane market has not experienced as steep an increase in price growth as seen in Sydney and Melbourne in the past five years. Low interest rates, relative attractive affordability and a moderate undersupply in the market nevertheless supported some buyer demand.

Over the four years to 2015/16, the median house price in Brisbane experienced moderate price growth of 5.0% per annum. However, as banks move to rein in investor lending, and unit completions continue to add record levels of dwellings to the market, it appears that sentiment has deteriorated. Vacancy rates are trending upwards and price growth eased to just 2.0% in 2016/17 to take the median house price to $550,800 at June 2017. Median house price growth in the year was minimal across Inner Brisbane (0.7%) and Outer Brisbane (1.0%), while being slightly stronger in the Middle ring suburbs (2.9%).

Demand and supply

Migration inflows into Queensland fell in line with the downturn in the state economy, and population growth has eased. The downturn also corresponded with a collapse in dwelling construction, which fell below underlying demand and a dwelling deficiency emerged. The resulting tight vacancy rates as well as healthy yields supported investor activity through to 2014/15, which in turn drove new dwelling building that began to exceed underlying demand from 2015/16.

Investors

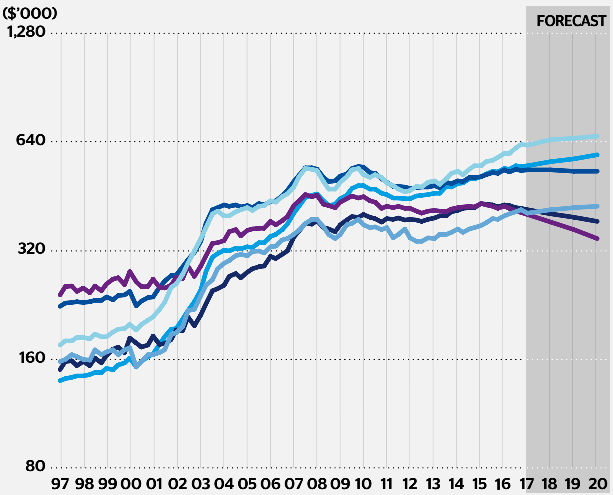
On the back of this investor activity, new dwelling completions have more than doubled from 13,650 dwellings in 2013/14, to an estimated 28,000 dwellings in 2016/17, and this has tipped the market into oversupply. Completions have been primarily for units, and this is where an oversupply in Queensland is expected. Compared to Sydney and Melbourne, investment lending has not recovered since falling in 2015/16, highlighting the retreat of investors due to the excess unit supply in the market.

Owner occupier demand has been somewhat buoyed by low interest rates, which in turn have improved affordability. Attractive affordability has also allowed more first home buyers into the market and there has been modest growth in the number of first home buyer loans in Brisbane over the past three years. The Brisbane market did not see the level of upgrader and downsizer activity rise as in Melbourne and Sydney given the slower price growth.

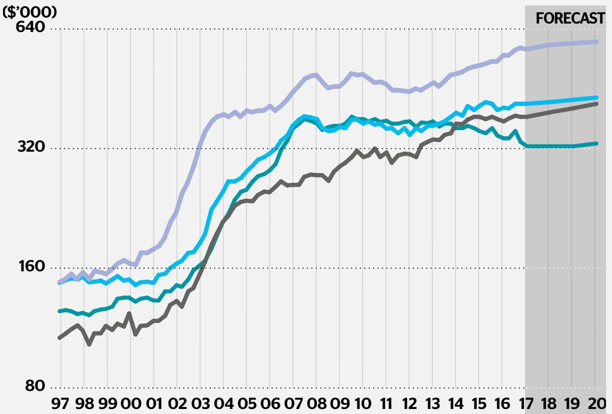
Outlook

Overall, the outlook for house prices in Brisbane remains moderate. The local economy will continue its slow transition away from mining and start to recover. Employment prospects should return with some improvements in public sector spending, as well as continuing growth in export sectors such as education and tourism. Underlying demand is forecast to strengthen a little and a downturn in new dwelling completions should see the oversupply in the market contained. Cumulatively, Brisbane's median house prices are expected to rise 7% over the forecast period to $590,000 at June 2020.

Brisbane and Gold Coast: dwelling prices



Regional Queensland: dwelling prices



Brisbane house price
2016: +5 2018: +3
2017: +2 2019: +2
2020: +3

Brisbane real house price
2016: +4 2018: 0
2017: 0 2019: -1
2020: 0

Brisbane unit price
2016: -1 2018: -2
2017: -3 2019: -2
2020: -2

Brisbane real unit price
2016: -2 2018: -5
2017: -5 2019: -5
2020: -5

Gold Coast house price
2016: +8 2018: +4
2017: +5 2019: +1
2020: +2

Gold Coast unit price
2016: +7 2018: +2
2017: +1 2019: +1
2020: +1

Sunshine Coast house price
2016: +6 2018: +3
2017: +4 2019: +1
2020: +1

Townsville house price
2016: -4 2018: 0
2017: -4 2019: 0
2020: +2

Cairns house price
2016: -1 2018: +1
2017: +2 2019: +1
2020: +1

Toowoomba house price
2016: -2 2018: +3
2017: +3 2019: +3
2020: +2

Brisbane unit market

The sharp rise in unit commencements has been concentrated in Inner Brisbane. Analysis of inner Brisbane apartment pre-sales over the past five years suggests that interstate and overseas purchasers have accounted for nearly half of demand.

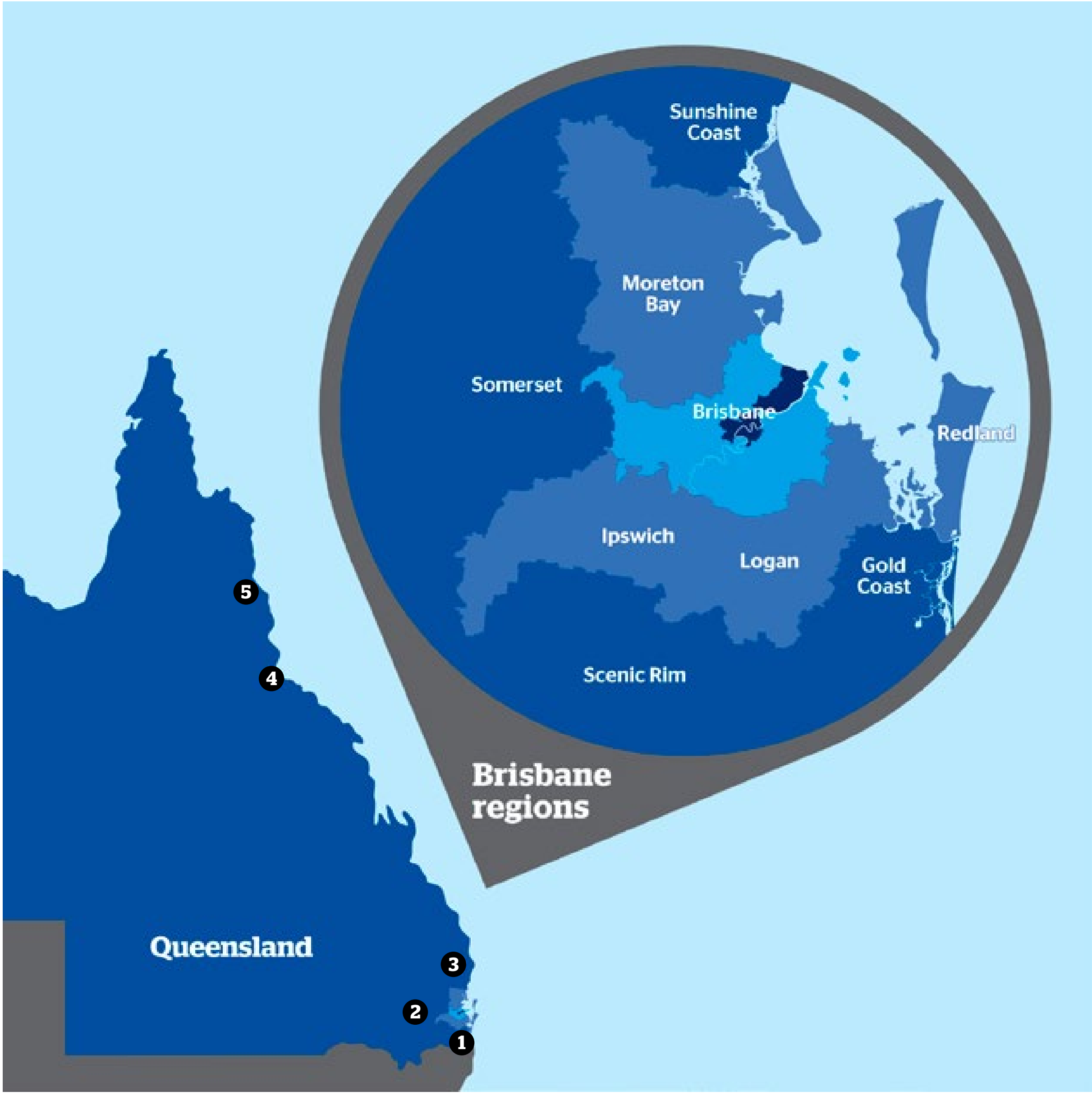
Together with demand from local investor purchasers, this has resulted in rental stock rising greater than tenant demand and escalating vacancy rates, particularly in inner Brisbane. Investors are now becoming discouraged and this has been compounded by banking restrictions on investor lending. As a result, the median unit price fell 0.8% in 2015/16 and a further 3.1% in 2016/17.

Outlook

With Brisbane's oversupply concentrated mainly in the unit market, unit prices are expected to remain on their downward trend. Unit completions are expected to ease but remain well above underlying demand as recently commenced projects are completed. This will increasingly apply downward pressure on rents and consequently prices. Greater competition for tenants of inner city apartments is forecast to cause investor owners to lower rents to try to draw tenants from more affordable city fringe locations. Those who are looking to sell are expected to also find it increasingly difficult as more apartments come onto the re-sale market.

Median unit prices are forecast to contract a further 7% on the June 2017 median, to $385,000 at June 2020. This will be a greater decline than seen in the unit markets in Sydney and Melbourne highlighting the estimated magnitude of unit oversupply in Brisbane.

Queensland and Brisbane regions



Brisbane median house price annual % change

Inner	Middle	Outer	Median
△ 0.7%	△ 2.9%	△ 1.0%	△ 2.0%

Regional Queensland

The regional Queensland markets of Gold Coast, Sunshine Coast and to a lesser extent, Toowoomba, have generally moved in line with the residential market in Brisbane.

Whilst the Townsville market is being dragged down by the downturn in mining investment, Cairns is seeing some positive signs from the strengthening tourism sector. Interstate migration flows from New South Wales and to a lesser extent Victoria have also supported demand for dwellings in the regional markets.

Regional Queensland centres

❶ Gold Coast: 2018 Commonwealth Games

The Gold Coast market is typically more expensive than the metropolitan Brisbane market given the price premium on its desirable beach and inland waterway locations.

The Gold Coast also offers a hinterland environment within commuting distance to Brisbane. Local economic conditions have been boosted by a number of infrastructure projects and related works associated with the 2018 Commonwealth Games, as well as the current upturn in residential building. The second phase of the Gold Coast Light Rail and the expansion of The Star Gold Coast casino and Pacific Fair have created further employment drivers. The Gold Coast's unemployment rate decreased from a high of 6% in December quarter 2014, to 5.3% in March quarter 2017. Vacancy rates were low at just 1.7% at June 2017.

The median house price in the Gold Coast has experienced strong growth of almost 7% per annum to reach $627,800 in the two years to June 2017. Growth in the median unit price has been slower, rising by 4.1% per annum in the past two years to $406,000 at June 2017. Unit price growth has lagged as unit completions have risen rapidly and take time to be absorbed.

Outlook: Market sentiment is expected to remain positive as local economic drivers keep employment strong. The Gold Coast median house price is forecast to rise a cumulative 6% in the next three years to $665,000 at June 2020, largely in 2017/18 (after the pre Commonwealth Games surge in investment) before slowing in 2018/19 and 2019/20. Unit price growth is forecast to be similar at a cumulative 5% over the forecast period to be $425,000 at June 2020.

Price growth
△
7% pa

Rental vacancy rates
▽
1.7%

Forecast house price
△
6%

Unemployment
▽
5.3%

❷ Toowoomba: Infrastructure boost

Toowoomba benefits from its position as the western gateway to South East Queensland as well as its prime location on the Melbourne to Brisbane freight route.

The local economy has outperformed the state economy for much of the last decade, supported by the agricultural, manufacturing and tourism industries. Several large infrastructure projects have also contributed to employment growth such as the construction of the Second Range Crossing and the development of Wellcamp Airport.

Overall, unemployment has remained largely unchanged at a healthy 4.9% in March quarter 2017 while vacancy rates hover around the balanced 3% mark. The median house price has been relatively flat at around $385,000 over the past two years to June 2017.

Outlook: Toowoomba will benefit from the work done on the construction of the Second Range Crossing due to open in late 2018, and the traffic it takes out of Toowoomba. The potential for increased freight activity at the new Brisbane West Wellcamp Airport could also contribute to local employment growth. In the medium to longer term, the Inland Rail project will further turn Toowoomba into a logistics hub, connecting Brisbane to Melbourne and to the rest of the interstate rail networks. This will add to growth in the local economy. Over the three years to 2020, the outlook for Toowoomba is for moderate growth of around 2.5% per annum, although this could be greater if these projects have a greater contribution to the local economy and population growth.

Regional Queensland centres continued

❸ Sunshine Coast: Construction and tourism

Demand in the Sunshine Coast benefits from interstate migration, particularly from downsizers/retirees from New South Wales. The local economy relies mostly on construction and tourism to underpin employment growth.

The Sunshine Coast is experiencing an undersupply of dwellings due to a prolonged period of low dwelling construction. Meanwhile, underlying demand appears to be recovering due to rising interstate migration. Vacancy rates remain tight with rents and prices seeing solid growth. The median house price has risen 5% per annum over the past two years to be $570,000 at June 2017.

Outlook: The outlook for Sunshine Coast remains moderate. Price growth is forecast to be modest in 2017/18 before flattening out. The construction of the Sunshine Coast University Hospital was a significant contributor to employment growth, but has now been completed. By June 2020, the median house price is expected to be $595,000; a total rise of 4% over the next three years.

❺ Cairns: Strengthening tourism sector

Cairns, together with Townsville, are the two main cities in Northern Queensland. The Cairns economy is heavily reliant on tourism to drive employment and growth and is less affected by the mining and resource industry than Townsville.

Local economic conditions have improved with a strengthening in the tourism sector due to a lower Australian dollar as well as strong migration inflows.

After a long period of low construction activity, dwelling completions have picked up. However, vacancy rates have tightened to 1.8% in June quarter 2017 suggesting a shortage of dwellings still firmly in place. On balance, house price growth has been flat, but is higher than the same quarter of the previous year, at $415,000 in June 2017.

Outlook: The outlook for Cairns remains moderate with the median house price forecast to be $430,000 at June 2020. This amounts to a 4% cumulative increase over the forecast period. Unemployment still remains relatively high at 6.7% in March 2017, and its price disparity with Townsville is also widening.

❹ Townsville: Mining investment decline

The Townsville economy is experiencing the drag of the decline in mining investments in regional Queensland and is also struggling to absorb the loss of other key employment drivers.

Fiscal consolidation by the Federal and State Government has seen public administration and defence related employment decline. The closure of the Palmer Nickel and Cobalt Refinery has also contributed to job losses, and the unemployment rate has climbed to 10.8% in March quarter 2017 while participation rates have fallen to record lows.

This has weighed on population growth and therefore demand. Vacancy rates remain high at 5.0% in June quarter 2017, above the balanced market rate of 3%. The median house price has also steadily declined and is down 14% from its peak in June 2010 to be $325,000 at June 2017.

Outlook: The Townsville median house price is expected to be at, or close to, bottom, and price growth is forecast to be flat over the two years to 2018/19 before the wider Queensland recovery shows some momentum. The median house price in Townsville is forecast to be $330,000 at June 2020.

Queensland regional mining centres

The mining investment boom in the early part of the decade benefited many regional centres throughout Queensland. Servicing the mining sector and the billions of dollars spent expanding capacity also brought wider investment and economic growth. As projects are completed and investment spending unwinds, many regional centres have struggled. Smaller localities such as the Isaac Region bore the brunt of the downturn compared to the larger, more diversified regional centres such as Gladstone and Mackay.

Gladstone and Mackay experienced a smaller boom and bust cycle compared to smaller centres such as the Isaac Region. Both are large centres with more diversified economic bases, and have performed better through the downturn. The median house price in Gladstone rose by 32% to its peak and by 16% in Mackay. Conversely, their median house prices are now 35% and 22% lower respectively at June quarter 2017. In contrast, the Isaac Region, which contains the smaller towns of Dysart and Moranbah, experienced a 97% rise in its median house price between December 2007 and March 2012. This surge was then followed by a large decline, which has taken the median house price 77% lower, to $153, 000 at June quarter 2017.

Both Gladstone and Mackay also had high levels of unemployment at 7.0% and 6.3% in the March quarter 2017 respectively. This suggests that these regions have a greater percentage of permanent residents who are less likely to leave when employment prospects decline. The 2.0% unemployment rate in the Isaac Region in March quarter 2017 reflects the temporary nature of residents in smaller mining centres. Without other employment opportunities in the smaller centres, the unemployed population leaves.

The volumes of sales in these mining centres have fallen significantly since the peak in the market in 2011/12. Property owners are more likely to hold their property than sell at a significant loss in a weak market.

Outlook

Sales volumes as well as price growth is likely to remain subdued for a number of years although there might be some brave investors entering these markets. The median house price in the Isaac Region has recovered slightly since bottoming out in March 2016, suggesting the worst is behind it. The market in Mackay looks to have also bottomed out. Its median house price also increased between December 2016 and June 2017, while vacancy rates tightened from over 9% in 2015, to 4.5% in June 2017. In contrast, Gladstone's median house price reached a new trough in June 2017.

Median house prices and unemployment rates

		MEDIAN HOUSE PRICE ($) SALES IN PRIOR YEAR				% CHANGE		UNEMPLOYMENT RATE (%)	
REGION		START OF UPTURN	PEAK	TROUGH	JUNE 2017 QTR	START TO PEAK	PEAK TO JUNE 2017	MARCH 2013	MARCH 2017
Isaac Region (MORANBAH, DYSART)	Median house price ($)	335k	660k	124k	**153k**	97%	**-77%**	1.0	**2.0**
	Sales in prior year	440	659	88	**199**				
	Date	DEC 07	MAR 12	MAR 16	**JUN 17**				
Gladstone Region	Median house price ($)	365k	480k	312k	**312k**	32%	**-35%**	4.2	**7.0**
	Sales in prior year	906	1,531	599	**599**				
	Date	MAR 09	DEC 11	JUN 17	**JUN 17**				
Mackay Region	Median house price ($)	370k	430k	325k	**337k**	16%	**-22%**	3.1	**6.3**
	Sales in prior year	3,832	3,251	1,781	**1,752**				
	Date	SEP 07	SEP 12	DEC 16	**JUN 17**				
Greater Brisbane	Median house price ($)	427k	551k	-	**551k**	29%	**0%**	5.7	**5.8**
	Date	DEC 08	JUN 17	-	**JUN 17**				

Small steps forward

Still facing challenging conditions after the mining investment boom, Perth's house prices are forecast for minimal growth

Perth house market

The decline in mining investment saw economic conditions weaken significantly in Perth. With further declines in mining engineering investment forecast, the state economy is expected to remain subdued.

Median house prices

Vacancy rates have trended upwards to 7.3% at June quarter 2017 while rents have fallen 13% in the past three years. Perth's median house price fell by 14% in the three years to June 2017 to be $520,500. The largest decline took place in the Middle ring suburbs (-9.2) while declines were also seen in Inner (-5.7%) and Outer (-6.2%) ring suburbs.

Demand

As mining investment weakened, the unemployment rate trended upwards to 7.6% in March quarter 2017, and is expected to remain elevated over the next three years. Fewer employment opportunities has led to a noticeable fall in net overseas migration, to an estimated 14,000 in 2016/17. This was down from its peak of 53,200 people in 2011/12. The net interstate outflow has also increased. Western Australia lost an estimated 11,500 people to other states in 2016/17, in contrast to a peak net gain of 11,400 in 2012.

The current downturn in the state economy and residential market has seen all segments of purchaser demand decline. Investors have particularly retreated due to the combination of falls in house prices and APRA's policy changes impacting investor loans.

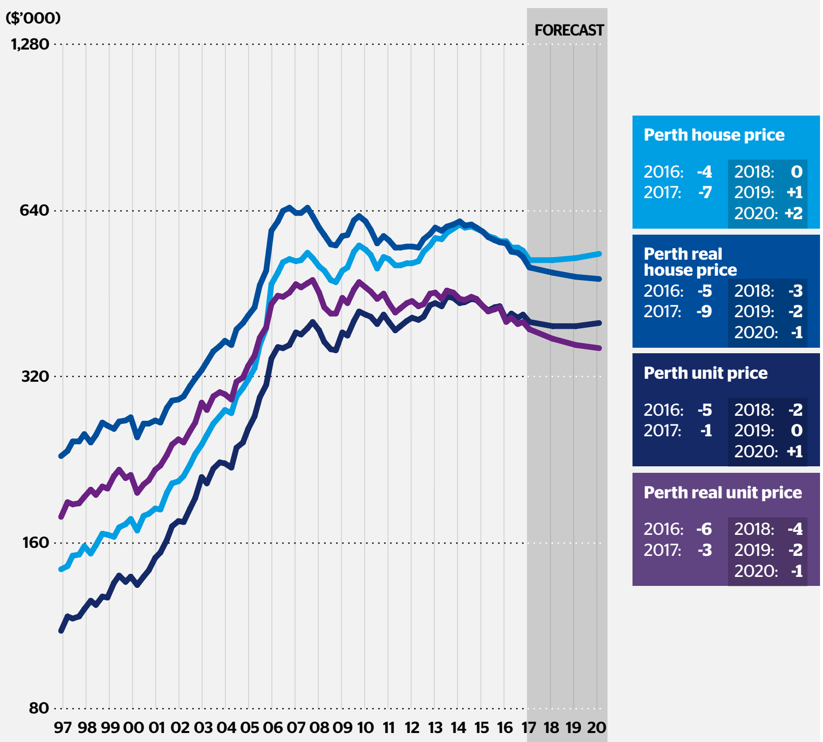
New dwelling supply

While the market started to slow after peaking in 2013/14, the lag in bringing houses and units to completion saw supply peak in 2015/16. During this period, underlying demand for dwellings went into a sharp decline as population growth slowed. There is now a significant oversupply of dwellings in Perth. Although dwelling completions have now peaked, they currently remain well ahead of underlying demand. The excess in dwellings across Western Australia was estimated at 24,900 dwellings in June 2017.

Outlook

Overall, the Perth market is expected to remain weak for some time. The rising excess of dwellings and subdued economic conditions will keep prices in check. However, the market is expected to be close to the bottom and prices are forecast to stabilise in 2017/18. As mining investment bottoms out over 2018/19, so will the state economy and house prices. The forecast median house price of $535,000 at June 2020 will represent cumulative growth of 3% over the next three years, although this will all take place at the end of this period.

Perth: dwelling prices



Perth unit market

The strong mining related migration into Perth, both overseas and interstate, has generally been temporary in nature. This boosted demand in the unit market, rather than houses. As population growth has reversed, unit rents and vacancy rates have also weakened causing the median unit price to fall by 7.6% over the past three years to $402,200 at June 2017.

Supply

The unit market has seen rising completions across Perth over the past three years. During this time the share of unit completions increased from 20% to 30% of total dwelling completions. While the total market is in oversupply, it is estimated that the oversupply is greater in the unit market.

Outlook

Both houses and units are forecast to experience minimal price growth. However, there appears to be greater downside in the unit market. The retreat of investors will have a greater impact on units, while the unit oversupply will keep price growth in check over the forecast period. The Perth median unit price is forecast to decline a total of less than 1% over the next three years to be $400,000 at June 2020.

Western Australia and Perth regions

Perth median house price annual % change

Inner	Middle	Outer	Median
▽ -5.7%	▽ -9.2%	▽ -6.2%	▽ -7.5%

Western Australia regional mining centres

Regional centres in Western Australia have been hit hard by the decline in resource related investment. The table below highlights price growth in the key regions of Port Hedland and Karratha, in comparison to Greater Perth. The local economies in these areas are largely dependent on the resource sector and while house prices grew significantly through the boom, they have borne the brunt of the downturn.

Port Hedland saw its median house price rise 154% between June 2007 and March 2013, reaching a peak of $1.125 million. The subsequent downturn has seen the median house price collapse by 80% to $220, 000 in June 2017. The unemployment rate has remained unchanged although the transient nature of the employed population means that many leave with the loss of employment not affecting local unemployment rates.

Karratha in the Pilbara region saw price growth of 177% up to its peak of $873,000 in September 2010. The downturn saw prices fall to $270,000 at the bottom of the market in September 2016. Since then, there has been a small recovery in prices, with the June 2017 median price being $303,000. The unemployment rate has also tightened to 1.5% in March quarter 2017 although it is not dissimilar to the 1.8% rate at March 2013, and has varied little in the period in between.

Migration flows have traditionally had a big impact on prices in the smaller regional centres. The narrow industry profile and smaller markets have seen bigger swings affect these centres in comparison to the more moderate cycle in Perth.

Outlook

Sales volumes in Port Hedland have increased since the median price peaked in March 2013. This highlights investors selling, or being forced to sell, despite the weak market. Karratha has also seen sales volumes and prices increase after the market bottomed out in September quarter 2016, suggesting it may be recovering. Without any large new investment in these centres, prices are unlikely to get close to their previous peaks in the short to medium-term.

Median house prices and unemployment rates

		MEDIAN HOUSE PRICE ($) SALES IN PRIOR YEAR				% CHANGE		UNEMPLOYMENT RATE (%)	
REGION		START OF UPTURN	PEAK	TROUGH	JUNE 2017 QTR	START TO PEAK	PEAK TO JUNE 2017	MARCH 2013	MARCH 2017
Port Hedland	Median house price ($)	442k	1,125k	220k	**220k**	155%	**-80%**	3.3	**3.3**
	Sales in prior year	318	206	250	**250**				
	Date	JUN 07	MAR 13	JUN 17	**JUN 17**				
Karratha	Median house price ($)	315k	873k	270k	**303k**	177%	**-65%**	1.8	**1.5**
	Sales in prior year	440	289	265	**314**				
	Date	JUN 05	SEP 10	SEP 16	**JUN 17**				
Greater Perth	Median house price ($)	478k	603k	521k	**521k**	26%	**-14%**	4.0	**6.5**
	Date	DEC 08	JUN 14	JUN 17	**JUN 17**				

Straight and narrow

Economically subdued but promising affordability suggests demand and prices are set for modest growth

Adelaide house market

Despite the weakness in the economy, there has been modest house price growth in Adelaide over the past four years.

Lower interest rates and prices at a relatively low base mean housing is reasonably affordable. Employment drivers, in the form of public infrastructure projects, have supported the state economy and demand. The median house price grew an average of 4% per annum from June 2013 to be $477,200 at June 2017. Price growth over this period has also been fairly even across Inner (4.5%), Middle (4.4%) and Outer (3.9%) ring suburbs.

However, economic conditions are weakening and population growth has slowed considerably. Net overseas migration has declined since 2013/14 while the interstate migration outflow has accelerated to a record high of an estimated 7,500 persons in 2016/17. The unemployment rate in South Australia remains high at 7.0% in June 2017, and is unlikely to improve in the short-term as automobile manufacturing in the state shuts down in October 2017.

Growth in lending activity has also weakened. From its peak in 2013/14, first home buyer loans fell by 38% during calendar year 2016 and the figures have not changed significantly since. Investor demand also fell in 2015/16 and has remained flat in 2016/17.

New dwelling supply

New dwelling starts peaked in 2015/16, encouraged by first home buyer incentives and stamp duty concessions for apartments in central Adelaide. Meanwhile, underlying demand has weakened with the slowing of population growth. South Australia has a modest oversupply of dwellings, which is expected to rise as population growth slows. This will alleviate upwards pressure on prices.

Outlook

Housing affordability remains manageable, which should keep demand from falling steeply as the state economy weakens and population growth slows. Price growth is expected to be minimal at an average of 2% per annum in 2017/18 and 2018/19 before conditions start to improve by 2019/20. Overall, Adelaide's median house price is forecast to grow 7% over the forecast period to reach $510,000.

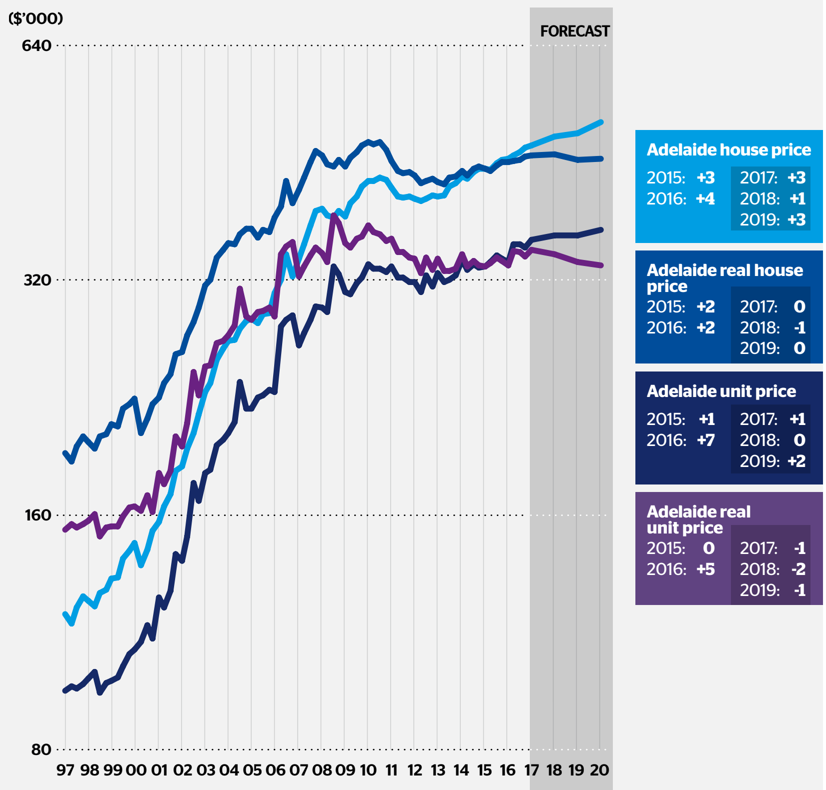
Adelaide unit market

Compared with the eastern state capital cities, Adelaide did not experience the same level of new unit building activity and the unit market is consequently forecast to move in line with the forecast for house prices. However, much like the other state capitals, investor activity is more prevalent in the unit market.

Outlook

Restrictions on investor lending have already started to affect investor demand in the state and as a result, the median unit price is forecast to show a modest cumulative 3% increase over the forecast period to reach $372,000 at June 2020.

Adelaide: dwelling prices



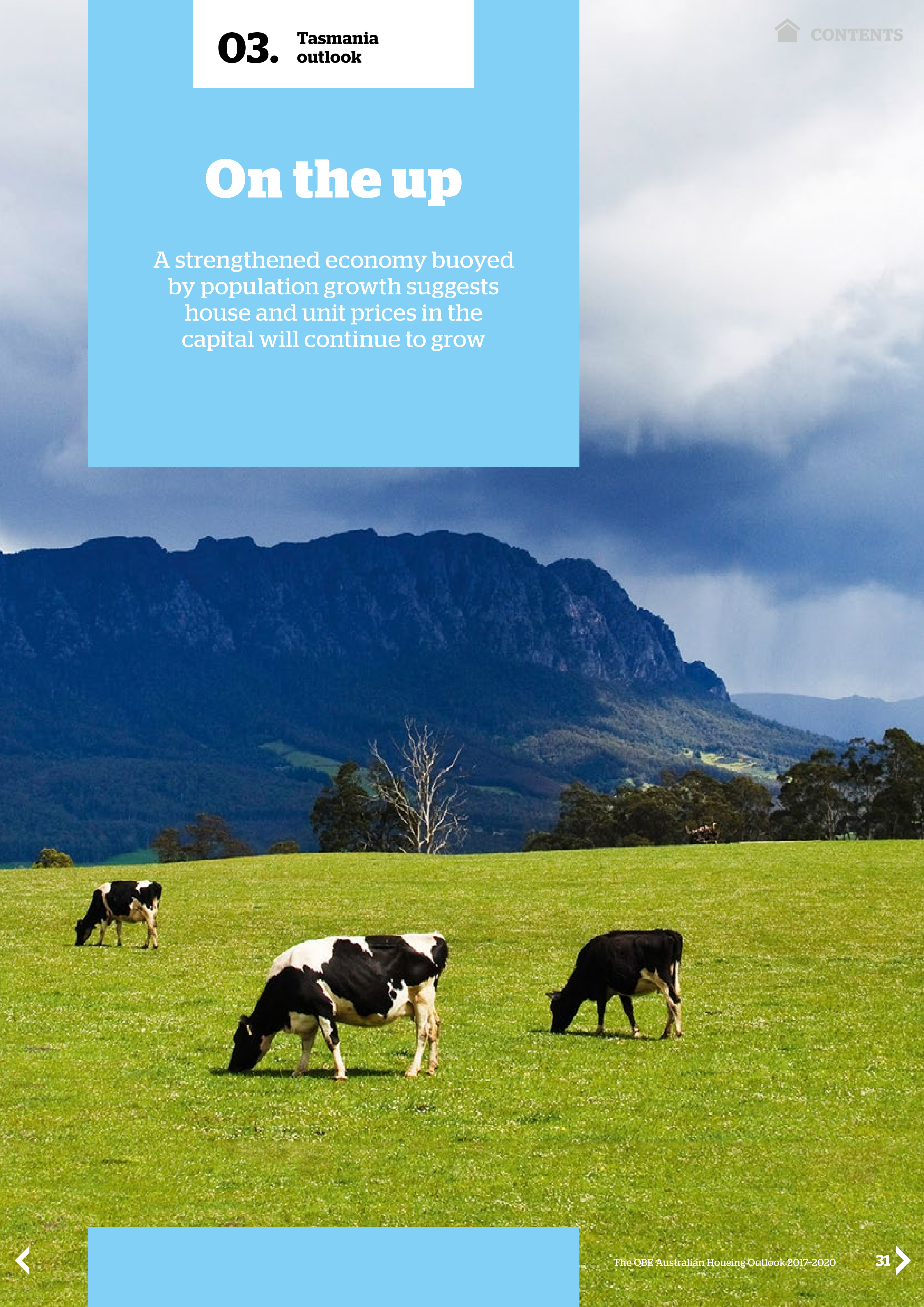
South Australia and Adelaide regions

Adelaide median house price annual % change

Inner	Middle	Outer	Median
△ 4.5%	△ 4.4%	△ 3.9%	△ 4.2%

On the up

A strengthened economy buoyed by population growth suggests house and unit prices in the capital will continue to grow



Hobart house market

Hobart's median house price rose by 10.5% in 2015/16 on the back of strengthening economic conditions. Underlying demand was driven by solid population growth. Hobart has the lowest median house price of the state capitals and its affordability advantage has been a key driver to interstate migration from increasingly strained affordability in Melbourne and Sydney.

Overseas migration remains elevated, while interstate migration moved from a net outflow to an inflow over the three years to 2016/17. Vacancy rates also tightened over this period indicating strengthening demand in the market. Hobart has traditionally captured between 40%-50% of Tasmania's population growth, but over the past five years has accounted for over 70% of state growth. This is indicative of the strong economic conditions in Hobart relative to the rest of the state. Hobart's median house price rose 6.1% in 2016/17, bringing the median house price to $424,300 at June 2017. Over this period, median house price growth has been strongest in Glenorchy (15%) and Hobart (10.6%) while prices fell in Kingborough (-0.7%).

Demand

After the expiry of first home buyer incentives in 2014, first home buyer demand has been relatively flat. The improvement in interstate migration has largely been driven by 'tree changers', downsizing from the more expensive Melbourne or Sydney markets while there could also be an element of people returning from the mining states. Strong price growth and strong rental growth (Hobart's vacancy rate was a low 2.0% in June 2017), together with low interest rates, have started to attract greater investor activity. According to the Real Estate Institute of Tasmania, sales to interstate buyers in 2016/17 were up 55% on a year earlier, which was evenly split between investors and owner occupiers. This indicates that there is strong demand from interstate investors as well as from increased migration.

New dwelling supply

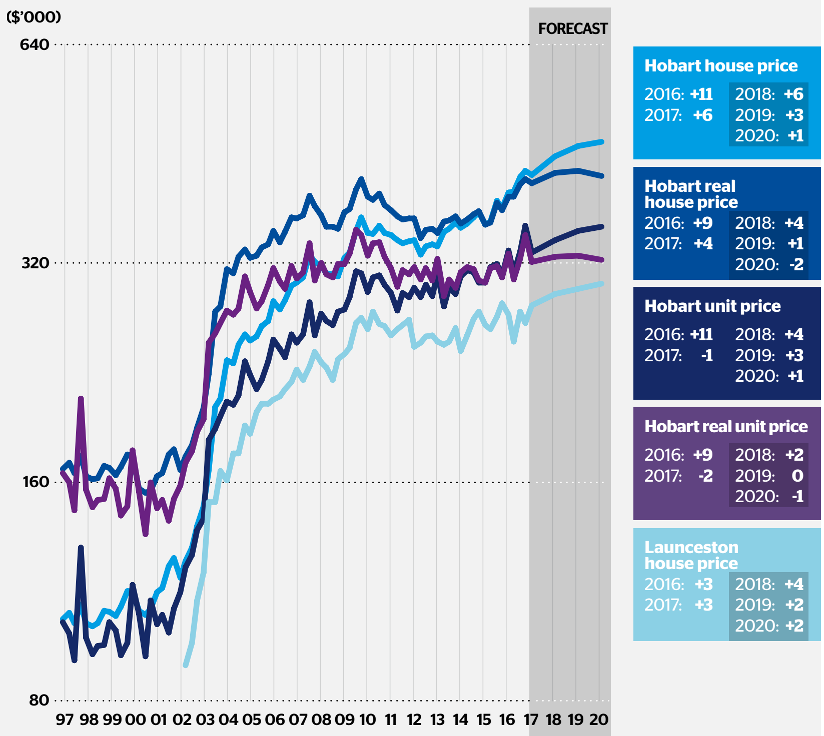
New dwelling completions across the state have been rising steadily. However, they have been broadly spread across the state. Hobart's share of completions has risen to almost 45% of total state completions, which is below its share of recent population growth.

Consequently, the Hobart market is estimated to be in aggregate undersupply. Given the disparity in population growth between Hobart and the rest of the state, it is likely that this undersupply is most pronounced in Hobart compared to the rest of Tasmania, which is estimated to be in oversupply.

Outlook

Overall, the recovery in the local economy and interstate migration is expected to keep price growth strong in 2017/18. The presence of an undersupply and a tight rental market will also keep upwards pressure on prices. Hobart's median house price is forecast to rise to $470,000 by June 2020, reflecting growth of around 4% per annum or a cumulative 11%, with most of the price growth occurring at the start of this period.

Tasmania: dwelling prices



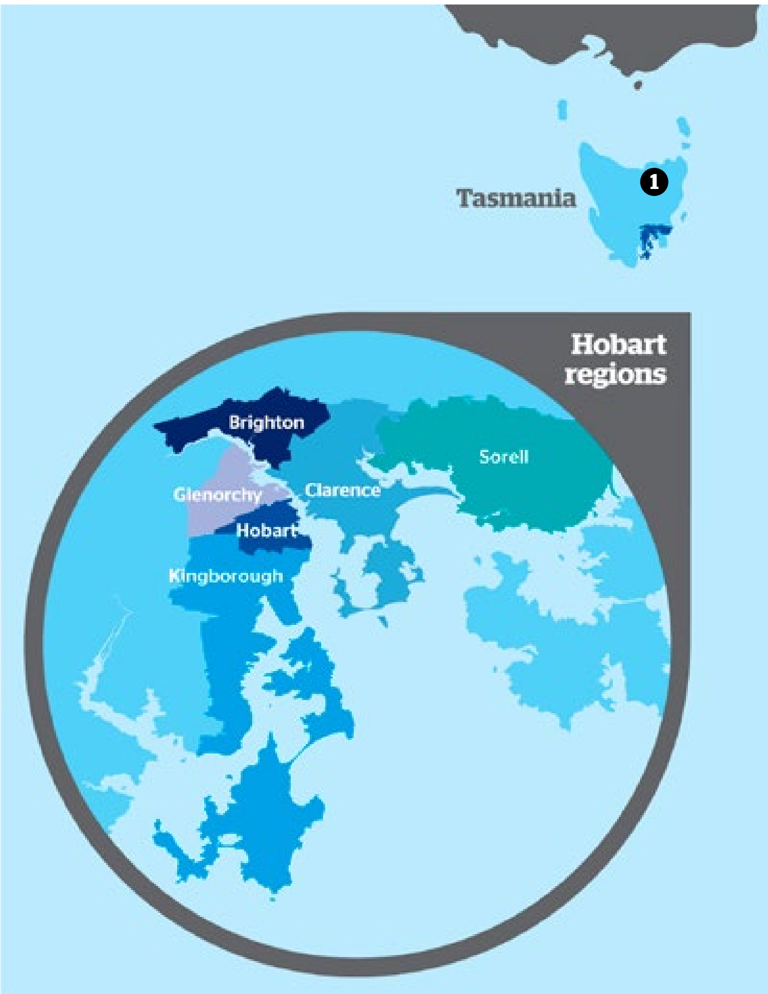
Hobart unit market

With a significantly smaller unit market than other capital cities, movement in the median unit price in Hobart has been variable. The upturn in the market in 2015/16 saw the median unit price surge by 10.6% before flattening in 2016/17 to be $331,300 at June 2017.

Outlook

Investors are not as large a part of the unit market as the other states so there is less impact from banks containing investment lending. Hobart has seen investor activity remain strong over 2015/16 and 2016/17. Tight vacancy rates and strong rental growth will support investor activity and by extension keep units in demand. The median unit price in Hobart is forecast to reach $360,000 at June 2020; a cumulative rise of 9% over the forecast period.

Tasmania and Hobart regions



Hobart median house price annual % change

Glenorchy	△ 15.0%
Hobart	△ 10.6%
Sorell	△ 1.0%
Brighton	△ 1.4%
Kingborough	▽ -0.7%
Clarence	△ 2.3%
Median	△ 6.1%

❶ Launceston: University of Tasmania Inveresk campus redevelopment

Launceston is the largest regional centre in North Tasmania. The local economy has lagged behind the recovery in Hobart over 2015/16 and 2016/17, with the unemployment rate in Launceston being 8.6% compared to 4.1% in Hobart.

The significantly smaller market relative to Hobart has also lent greater variability to the median price. Overall, house price growth has been 4.9% per annum in the three years to June 2017, with a current median house price of $280,000.

Outlook: The outlook for the local economy remains soft, although Launceston may receive a boost from the redevelopment of the University of Tasmania Inveresk campus over the coming years. Nevertheless, the strength of the Hobart economy has attracted people from the rest of the state as well as more interstate and overseas migration. Some spill over of population and price growth may occur in Launceston. However, price rises in Launceston are likely to be modest given a weaker employment environment. The median house price in Launceston is forecast to be $300,000 at June 2020, which is a cumulative 7% increase on the June 2017 median.

A promising future

Public sector job growth is likely to keep the economic outlook positive

Canberra house market

The Canberra house market has grown steadily over the past three years. The median house price rose 5.5% per annum over this period to $645,000 at June 2017.

Underlying demand for dwellings has been largely supported by population growth. The net interstate outflow has been shrinking over the past four years, with the 2016/17 period resulting in an estimated net inflow of 800 persons. The net overseas migration inflow has also increased to an estimated 2,200 over 2016/17 and appears to be largely related to growth in overseas students.

The Australian Capital Territory unemployment rate is tightening, indicating an improvement in local economic conditions. At March 2017, unemployment was 3.7% compared to 4.5% in December 2015. Improved demand has led to a tighter vacancy rate of 1.3% in June 2017.

New dwelling supply

Escalating new dwelling completions, spurred by low interest rates, first tipped the market into oversupply in 2012/13. The market has remained in moderate oversupply since then despite the increase in underlying demand over the past two years. Commencements over this period have been mostly of units with completions sustained at record levels. Total unit commencements have averaged 4,300 units per annum over the six years to 2016/17, compared to an average of 2,800 units per annum over the preceding six-year period. With an estimated oversupply of 900 dwellings at June 2017, it is likely that this is all units, while the housing market is in undersupply.

Completions of separate houses in comparison to units have fallen. Completions have averaged 1,100 houses per annum in the two years to 2016/17; lower than the average of 1,700 houses per annum over the preceding five years, and significantly below unit completions; which have averaged 2,600 per annum over the same two years to 2016/17.

Outlook

With Federal Government employment being the key driver of economic growth, the outlook for Canberra will be closely linked with public sector employment growth. Conditions in the house market are expected to remain largely positive, driven by population growth, an undersupply of houses and strong employment prospects. The median house price in Canberra is forecast to increase a cumulative 16% over the forecast period to $750,000 at June 2020. Canberra is forecast to have the strongest growing market of all the cities over this period.

Canberra unit market

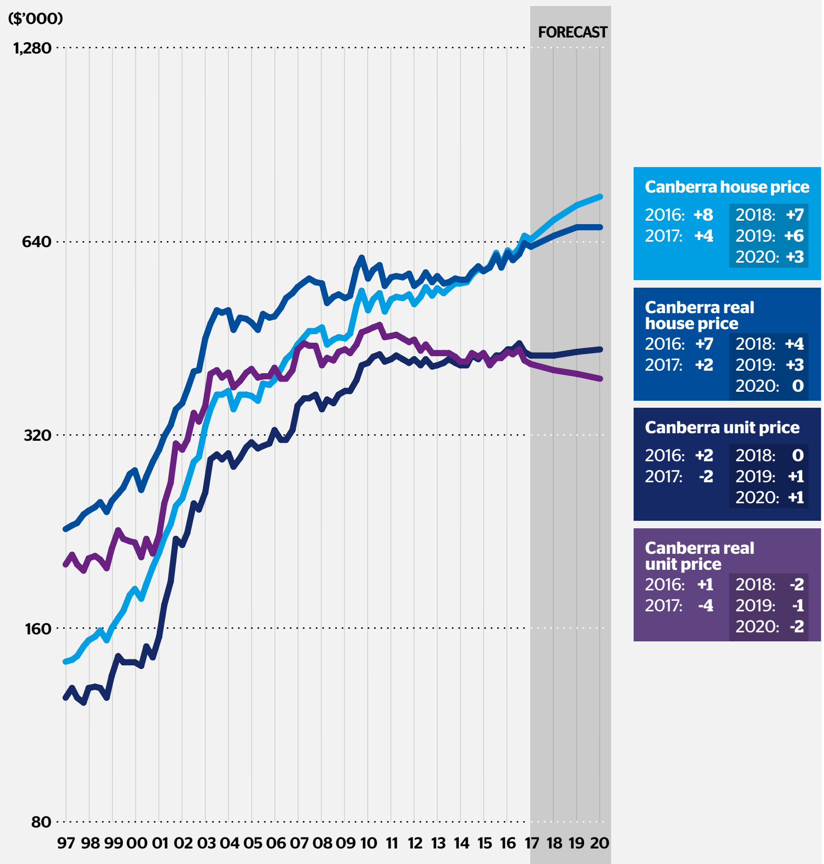
The surge in unit construction over the past five years has seen the unit market run into oversupply.

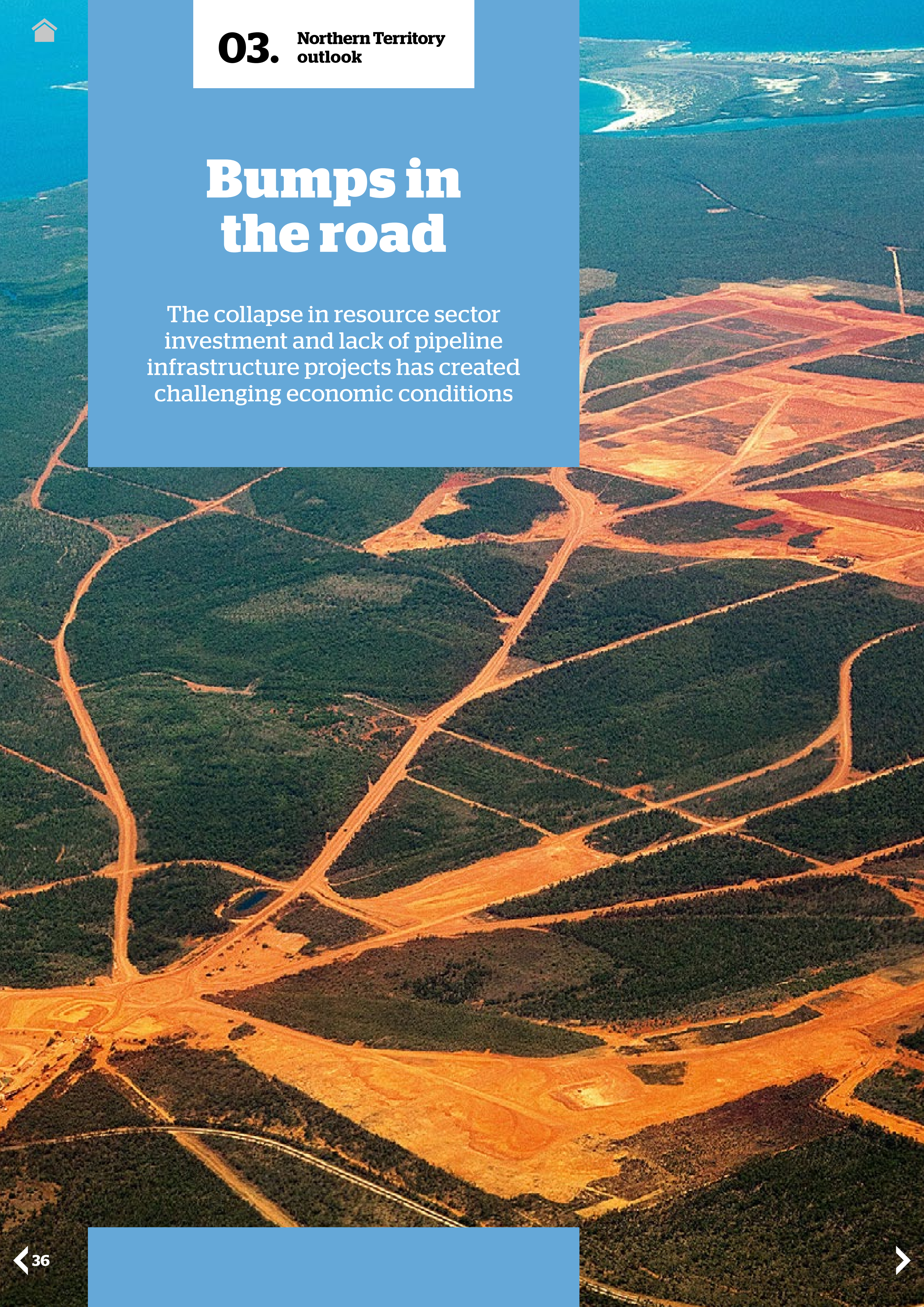
Over this period, unit completions have accounted for an increasing share of total dwelling completions, being 77% of the dwelling supply in 2016/17. With the oversupply firmly entrenched in the unit market, unit price growth has been relatively subdued. The median unit price at June 2017 of $425,000 has barely changed from $420,000 six years earlier at June 2011.

Outlook

With a persistent oversupply in the unit market, weaker unit prices may attract some purchaser demand from the house market. Improving affordability and yields may also attract investor activity and put a floor under unit prices. Unit prices are forecast to be flat over 2017/18 before seeing modest growth return in the following years. The median unit price is forecast to reach $435,000 at June 2020, a cumulative rise of 2% over the three-year period.

Australian Capital Territory: dwelling prices





Bumps in the road

The collapse in resource sector investment and lack of pipeline infrastructure projects has created challenging economic conditions

Darwin house market

The small size of the Darwin market makes it more susceptible to local events and the median price can be variable. Darwin also has a normally higher and more variable vacancy rate; a product of a transient working population.

Overseas arrivals peaked at 5,000 people in 2012/13 and fell to an estimated 600 in 2016/17. Similarly, the net interstate outflow has accelerated to an estimated 3,000 people in 2016/17.

Following strong price growth through the peak of the resource boom, the median house price has been in decline since 2013/14 and was $540,000 at June 2017. This is 13% below its peak in June 2014. Median house prices increased across Inner Darwin (+4.2%) and the Northern suburbs (+8.3%) while prices in Palmerston fell by 13.2% in the year to June 2017.

Demand

The Northern Territory grant to first home buyers for the purchase of established dwellings encouraged first home buyers to bring forward their purchase decision into 2014/15 and has now left a gap in demand (although a stamp duty concession remains in place). First home buyer activity has shown a slight recovery in the year to May 2017 indicating that first home buyer demand has stabilised.

Investor activity has continued to fall due to declines in both prices and rents. Restrictions to investor lending by the banks is also having an impact. Vacancy rates have trended upwards to be 6.9% at June 2017. The nature of the transient labour market in Darwin has seen unemployment rates remain steady, as people leave when employment deteriorates.

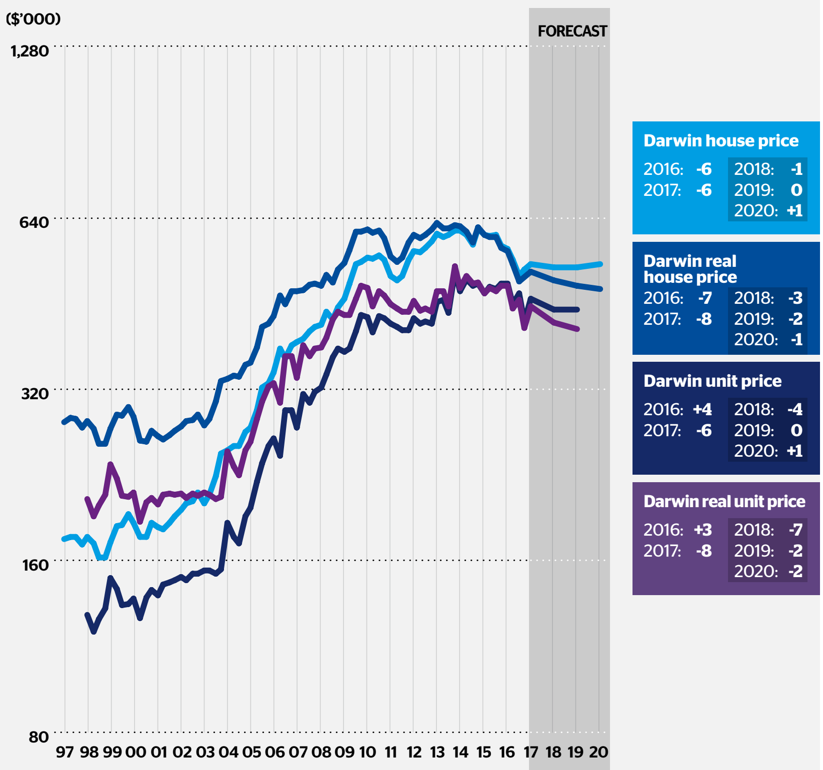
New dwelling supply

Dwelling completions in Northern Territory have remained at elevated levels since 2013/14, peaking in 2014/15 before falling back in the subsequent two years. Supply has been concentrated in the unit sector and is a product of investor demand for apartment stock and the inflow of temporary residents associated with employment in the mining sector creating rental demand. In this environment, underlying demand is now weakening and the oversupply in the market has accelerated. At June 2017, the oversupply is estimated to be 2,300 dwellings.

Outlook

With the decline in resource investment yet to fully bottom out, and an anticipated slow recovery, the outlook for Darwin is subdued. Further downward pressure on prices is expected in 2017/18 before the market bottoms out. Over the forecast period, few economic drivers will support population growth and demand will remain weak. The median house price is expected to fall slightly in 2017/18, before recovering from this decline by 2019/20 to be $540,000 at June 2020.

Darwin: dwelling prices



Darwin unit market

The unit market has been driven by demand for first home buyer owner occupiers as well as investors catering to the transient working population.

With an oversupply firmly in place, rising vacancy rates and negative rental growth, investor demand has weakened. The tightening of investment lending by the banks is likely to further affect investor activity, and the median unit price has fallen 6% over 2016/17 to $470,000 at June 2017.

Outlook

Elevated unit construction will add further downwards pressure on unit prices as the current construction pipeline continues to deliver units to a weakening market. The median unit price is forecast to decline by a cumulative 4% over the next three years to be $455,000 at June 2020.

04. National rental activity

A strong tenancy

Moderate rent rises are fuelling demand and supply, while tight vacancy rates keep investors keen

Rental price growth

Rent levels and growth varies substantially by capital city, depending on the balance of supply and demand. When there is strong rent growth and the cost to rent moves closer to the cost to purchase, an increased number of renters typically move into home ownership. However when property prices become less affordable, renting becomes more attractive, as it's difficult to enter the market as an owner occupier.

Renters are in a strong position in both **Perth** and **Darwin**, with rents falling substantially in the past two years. Population growth in these cities has eased in recent years, meaning fewer tenants. At the same time, there has been a high level of new rental stock completed. Rents are likely to remain affordable over the next two to three years and could delay long-term tenants coming to the market as first home buyers.

Renters in **Brisbane** and **Adelaide** have seen almost no change in rents in the past year. With a rising oversupply of dwellings expected in both markets, rents may begin to fall. Tenants may also look to find value by upgrading to a better dwelling for the same rent. This will leave older apartments to experience the weakest rental demand.

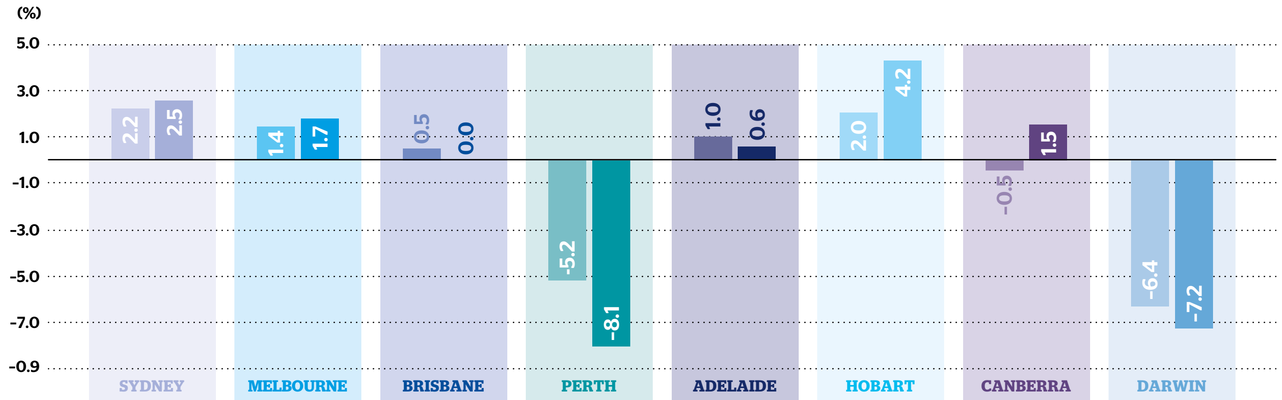
Canberra and **Melbourne** rents grew around the 1.5% mark during 2016/17. **Sydney** and **Hobart** rents grew by 2.5% and 4.2% respectively. With a deficiency of stock, renters in these cities must pay more to secure a rental dwelling, with landlords holding the upper hand.

Outlook

Strong house and unit price growth in Sydney and Melbourne will keep many renting who may prefer to buy. This should support tenant demand for rental properties, although the prospect of more supply may dampen rental growth. In Hobart, the improving local economy and population inflows has the potential to fuel rental growth. Rent rises in Canberra will be more modest, with the housing market dampened by greater rental options for units. Landlords in Adelaide and Brisbane will need to become more competitive to attract tenants, as migration into these cities remains below long-term averages. In Perth and Darwin, further declines in rents are expected to occur due to oversupplies of stock.

Annual rental growth year to June

2016 2017



Vacancy rates

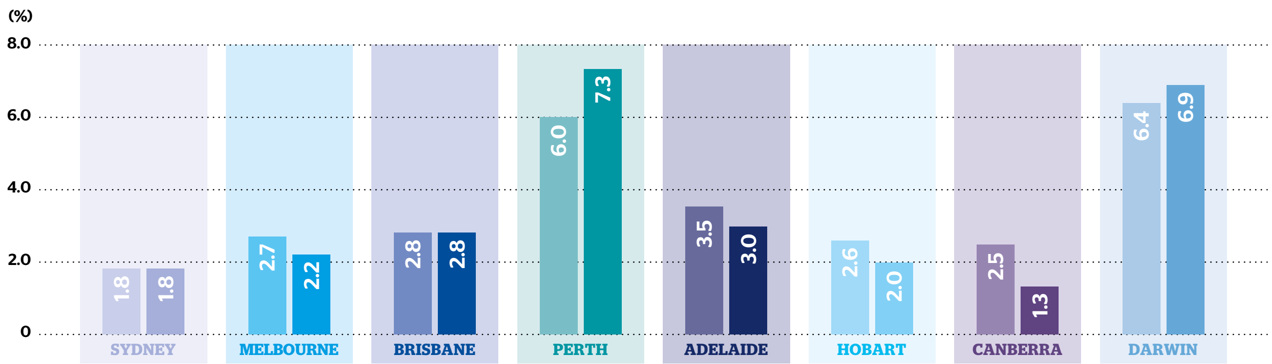
The vacancy rate in each city is a measure of the balance of rental demand and rental supply. A vacancy rate of 3% in a market is considered balanced, where rents on average will rise broadly in line with inflation.

Sydney and **Melbourne** continue to experience tight vacancy rates. The deficiency of rental stock in Sydney has kept the vacancy rate at just 1.8% and Melbourne's strong population growth has reduced the vacancy rate from 2.7% at June 2016 to 2.2% at June 2017. Strong demand from **Hobart** and **Canberra's** renters have also kept vacancy rates tight.

Renters in **Brisbane** and **Adelaide** have experienced close to balanced markets in recent years. The vacancy rate in Adelaide was 3.0% at June 2017, while Brisbane's vacancy rate was 2.8%. Rising new supply that is on track to outpace population growth in both cities, has the potential to push up vacancy rates.

Very high and increasing vacancy rates in **Perth** and **Darwin** of 7.3% and 6.9% respectively, reflect the reduction in demand from tenants and consequent oversupply of rental dwellings in these cities.

Residential vacancy rates at June quarter



Rental yields

Sydney has the lowest indicative rental yield across the capital cities at just 2.1%. Given rental yields are so low, it appears that investors have been purchasing with the expectation that the recent strong capital gains will continue. Similarly, **Melbourne's** rents have underperformed against strong price rises, reducing indicative rental yields to 2.3%. It is capital growth that has encouraged investors in the Melbourne market.

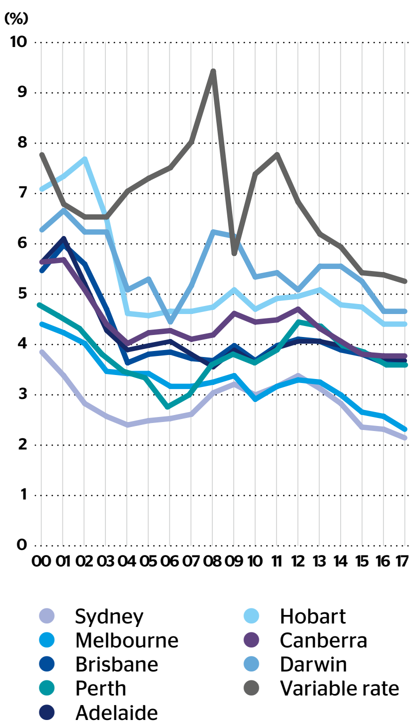
The cities of **Brisbane**, **Adelaide**, **Perth** and **Canberra** have indicative rental yields in a similar band, ranging from 3.6 to 3.7%. Brisbane, Adelaide and Canberra have experienced a tightening of yields in recent years as price rises have outpaced rental growth. In contrast, as Perth's house prices have fallen faster than rents, indicative rental yields have risen.

Darwin and **Hobart** have some of the highest indicative rental yields, which reflects their smaller markets and increased volatility. Hobart's yields have tightened to 4.4% due to strong price growth in 2017. Similar to Perth, Darwin's prices and rents have also fallen. Rents have contracted at a greater rate, resulting in a lower yield, from 5.6% in 2013 and 2014 to 4.7% at June 2017.

Outlook

Yields in all capital cities are below the 15-year average. This is partly due to mortgage interest rates also being lower with the gap between rental yields and mortgage repayments being narrower in a long-term sense. In some instances, selected properties in individual markets are likely to be positively geared, particularly as many purchasers can obtain a discount off the current standard variable rate. Nevertheless, where yields are well below mortgage rates, renting becomes more affordable than buying and investing also becomes less attractive as it becomes more difficult for rental income to help subsidise mortgage obligations.

Indicative house rental yields



Fundamentally sound

A downturn in residential construction likely to create a subdued national economy, while low interest rates support affordability in some markets

Low interest rates have boosted affordability, but strong price growth is only occurring in those regions where economic conditions and population growth have performed well. At the national level, the economy is expected to provide little support to the residential market, with economic growth forecast to be relatively subdued over the next three years.

Economy

The economy is forecast to continue to grow at a similar moderate pace to that seen over the past four years. Falling resource sector investment since the peak of the mining boom is only partly being offset by growth in other sectors of the economy. The result is a generally soft labour market, and although the unemployment rate is now close to 5.6%, most of the jobs growth over the past five years has been part-time, while underemployment is near record highs. New dwelling commencements have now started to fall and will be a drag on the economy, adding to the weakening mining investment. The unemployment rate is forecast to drift up to 6% and remain at this elevated level until mid-late 2019, when dwelling construction and mining investment bottom out. Signs of an acceleration in the economy is then expected from 2019/20.

Interest rates

Interest rates have been steadily reducing since 2011, as economic conditions remain subdued and inflationary pressures remain benign. The current cash rate of 1.5% is at a record low, as is the standard variable rate of 5.2%. However, it should be noted that low risk borrowers with a loan-to-value ratio below 80% can typically borrow at a significantly lower discounted rate. Published indicator rates by the Reserve Bank suggest a typical discount on the standard variable rate by the banks of 75 basis points, while many smaller lenders are offering variable rates below 4%.

Interest rates for investors and interest-only borrowers have increased over the past two years in response to regulatory pressure, with an interest rate differential opening up between rates available to owner occupier borrowers, and investors and interest only borrowers. However, any increase to the cash rate is not expected until 2019/20 when emerging signs of a strengthening in the economy are expected to appear.

Affordability

Low interest rates have improved affordability in all capital cities for owner occupiers, with the exception of Sydney and Melbourne, where substantial house price growth has more than offset the influence of lower borrowing costs. This has caused affordability to deteriorate to previous record lows in these two cities. Weak local economic conditions are preventing any major upturn in prices in the other capital cities, despite the relatively attractive affordability.

State of play

Gross Domestic Product (GDP)

Australia has recorded annual economic growth, as measured by growth in real Gross Domestic Product (GDP), around the 2.5% range over the past four years to 2016/17. This is below the 3.6% average in the decade leading into the Global Financial Crisis. The boom in resource sector investment that peaked in 2012/13 is now negatively affecting the economy. Balancing the economic challenges has been growth in mining exports. Dwelling construction has also risen in response to strong population growth and undersupply, while tourism, agricultural and education exports have increased as a result of a fall in the Australian dollar since 2013. New South Wales and Victoria have been the stand out economies.

Consumer spending

Growth in consumer spending (private consumption expenditure) has been solid, averaging 2.4% per annum in the five years to 2016/17. In comparison, wages growth has been subdued. Households have been maintaining consumer spending levels by dipping into their savings, resulting in the savings ratio falling. This trend of consumer spending growth being higher than wages growth cannot continue indefinitely. If wages growth continues to remain subdued, households are likely to become more conservative and reduce growth in their expenditure.

Employment

Employment recorded healthy growth of 2% through the year to July 2017, particularly over the past five months. The unemployment rate tightened only marginally to 5.6% at July 2017, being down just 0.1 of a percentage point over the year. The unemployment rate has remained in the 5.6%–6.1% range since 2012/13. This highlights that there is still considerable underemployment in the labour market.

Inflation

Soft demand, spare capacity, intense competition and weak wages growth has kept a lid on inflation, with growth in the Consumer Price Index (CPI) of 1.9% over 2016/17. The potential for employees to seek higher wages growth is limited while the slack remains in the labour market. Businesses have also responded to the slower growth in the economy by focusing on keeping costs down.

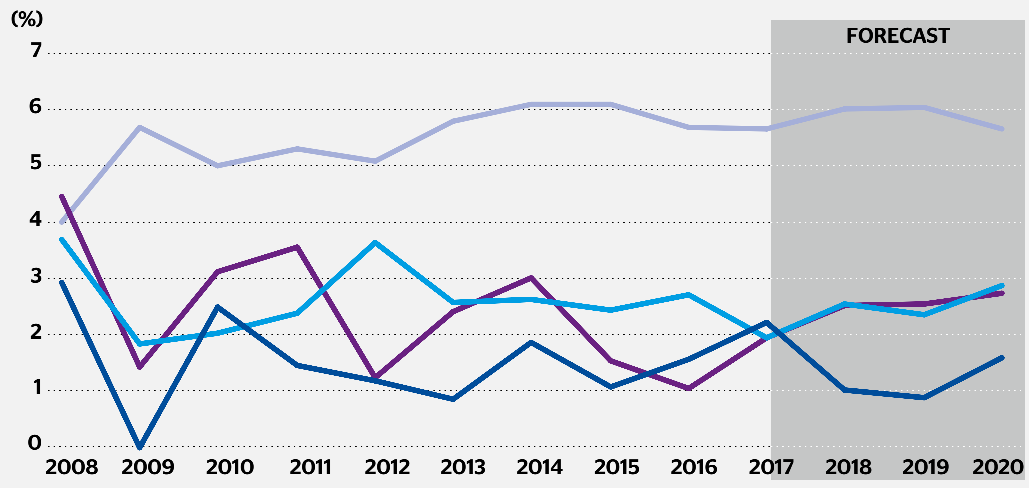
Global climate

The Trump administration in the United States was elected on the promise of a boom in infrastructure spending and tax cuts, which would benefit the global economic outlook. Growth in China, Australia's major trading partner, continues to remain strong and support commodity prices. This is tempered by Chinese Government concern about the pace of credit growth and capital outflows. The European economy is showing some improvement, while Japan's monetary and fiscal stimulus is having a limited effect. Tensions in the Korean peninsula have escalated recently and any significant increase could affect global markets.

Outlook

The emerging downturn in residential construction will join weakening mining investment as an additional drag on the economy. Other sectors continue to slowly pick up the baton of economic growth, although are not enough to accelerate economic and employment growth. GDP growth is forecast to stay soft at around 2.5% annually to 2020, but will begin to strengthen by the end of this period. By 2019/20, declines in mining investment and dwelling construction are expected to bottom out and will start to pick up, with businesses beginning to invest as excess supply in the economy is soaked up. The unemployment rate is forecast to remain around, or just under, 6% to 2020. This will limit wages growth and keep inflation in the Reserve Bank's preferred band of 2%–3% per annum. As conditions begin to pick up around the turn of the decade, employment growth and eventually wages growth will strengthen, as will inflationary pressures.

Key economic indicators[1]



2020 FORECAST

GDP Growth
△ 2.9%
2017 1.9%

Employment Growth
▽ 1.6%
2017 2.2%

Unemployment Rate
◁▷ 5.7%
2017 5.7%

CPI Growth
△ 2.7%
2017 1.9%

1 Employment growth to August and unemployment rate as at August.

Interest rates

Changes to the cash rate

The most recent changes to the cash rate were 25 basis points reductions in each of May and August 2016, taking it to 1.5%. The cuts were in response to weak economic conditions. In its minutes that follow each decision, the RBA judged that residential price growth was sufficiently contained and the interest rate reductions were unlikely to re-ignite excessive price growth in Sydney and Melbourne. At this level, the indicative standard variable rate used by the banks for owner occupier residential loans sits at 5.2%.

Variable rates are moving independently to the cash rate

Traditionally, there has been a consistent margin between the cash rate set by the RBA and the standard variable lending rate set by the banks. However, the gap has widened in recent years as the cost of funding for banks has increased since the Global Financial Crisis. Banks have also differentiated between customers by offering a discounted variable rate for borrowers with lower risk.

Regulatory influences

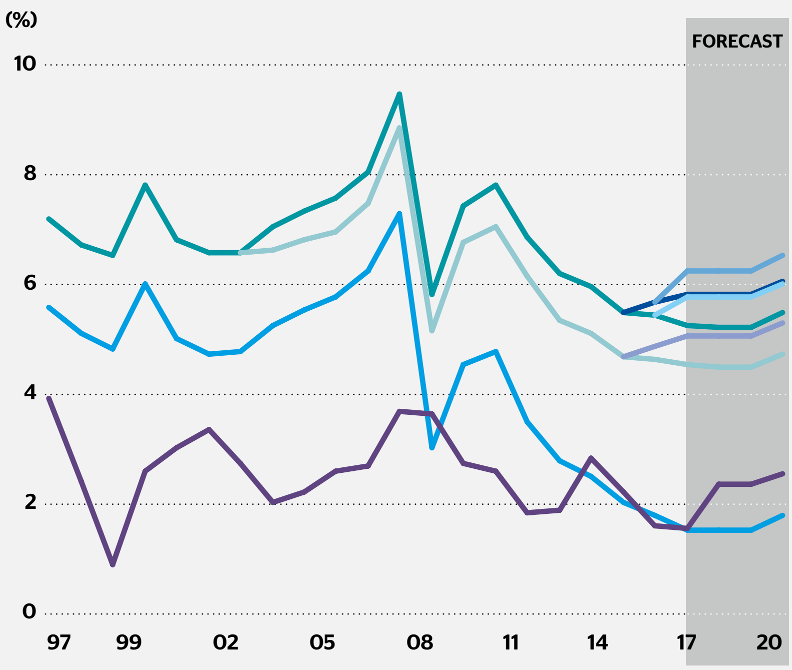
Increased regulatory requirements have also influenced lending rates outside of movements to the cash rate. The requirement by the APRA to provide more stability to the financial system has had an impact on the setting of interest rates. Since December 2014, APRA has progressively increased oversight, mandated the strengthening of bank balance sheets, and tightened lending guidelines, with a focus on containing growth in investment lending.

The result has been an increased differentiation in lending by the banks between owner occupiers and investors. Maximum loan-to-value ratios offered to investors have been reduced, and investors now pay an interest rate premium of about 55 basis points over the equivalent owner occupier rate. More recently, an increased regulatory focus on interest only borrowing, which is more favoured by investors, has resulted in a further premium for interest only loans (100 basis points over the standard variable rate for investors). In contrast, approved owner occupiers can still receive varying discounts to the standard variable rate on their borrowing.

Outlook

When setting the cash rate the RBA considers interest rate movements outside of changes to the cash rate and how they have influenced borrowing costs overall. In this regard, there have already been out-of-cycle rises in the past two years, albeit mainly for investor and interest only loans. Moderate economic growth is expected to continue, with the unemployment rate forecast to remain close to the 6% mark, and there will be little wage and inflationary pressure. The cash rate is forecast to be stable at 1.5% for much of the next three years. The RBA is forecast to begin to tighten interest rates toward the end of 2019/20 with a 25 basis point increase in the cash rate to head off inflationary pressures as signs emerge of a strengthening economy. This will take the standard variable rate to 5.45% by June 2020. Equivalent increases are expected in other lending rates, although further pressure by APRA could result in additional out-of-cycle changes.

Indicator lending rates[1] as at June



2020 FORECAST

Cash rate △ 1.75% 2017 1.50%	**Housing rate** (Discount investor) △ 5.30% 2017 5.05%
Housing rate (Variable) △ 5.45% 2017 5.25%	**Interest only** (Owner occupiers) △ 6.00% 2017 5.75%
Housing rate (Discount variable) △ 4.70% 2017 4.50%	**Interest only** (Investors) △ 6.50% 2017 6.25%
Housing rate (Standard investor) △ 6.05% 2017 5.80%	**CPI baseline** △ 2.51% 2017 1.55%

1 Forecasts for interest rates outside the standard variable rate are set at a consistent margin to the standard variable rate. These have the potential to change relative to the variable rate.

Housing affordability

While the demand and supply balance is important in determining pressure on prices and whether rents rise or fall, there is an upper limit on how much of a household's income can be spent on mortgage repayments. As it becomes more difficult to service a mortgage on a property, further price growth becomes less possible unless incomes rise or interest rates reduce by a sufficient enough margin to make purchasing more affordable.

Affordability has deteriorated considerably in **Sydney** and **Melbourne** since 2012/13 due to strong house price growth. The ratio of mortgage repayments on a median priced house to average household disposable income is 39.7% in Sydney and 36.2% in Melbourne at June 2017. This is close to each city's previous highs, indicating limited scope for continuing solid price growth.

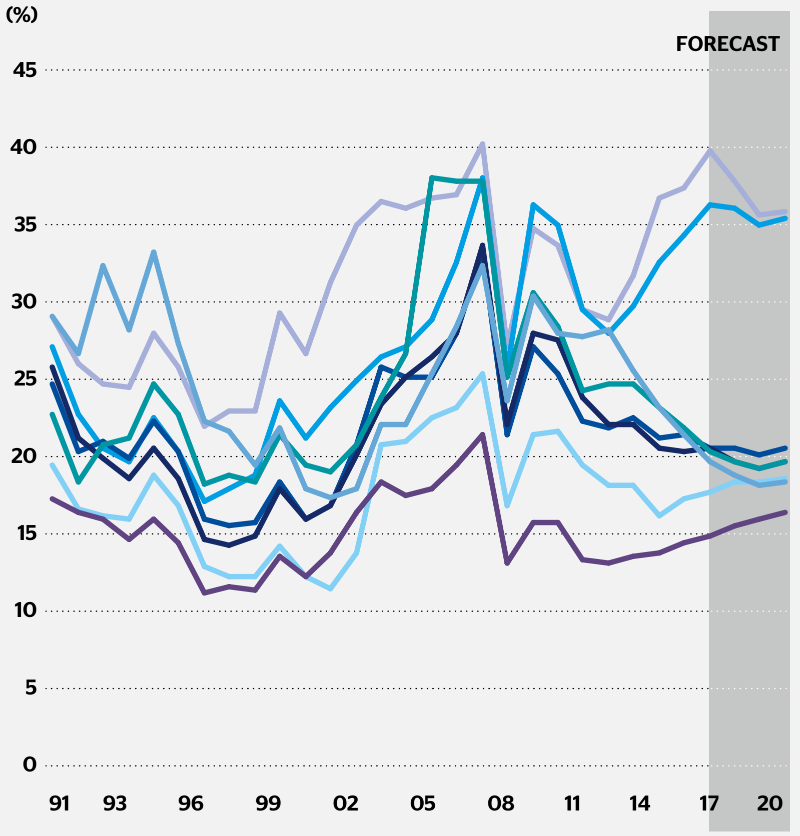
Affordability has also become more difficult in **Adelaide**, **Hobart** and **Canberra** over the past 12 months, again due to rising prices. Nevertheless, affordability is at levels similar to that seen in the early 2000s. In contrast, price reductions in **Perth** and **Darwin** have made purchasing a dwelling more affordable. **Brisbane** has remained at around the mid-point of its historical range.

Outlook

Low affordability in Sydney and Melbourne should begin to impact on the potential for purchasers to take on a larger mortgage and bid up prices too much further. Moreover, it makes these markets vulnerable to rises in interest rates, as the most recent purchasers may have stretched themselves to buy their dwelling.

Notably, the better affordability in other cities is having a limited impact on prices. Weaker economic conditions and little growth in household incomes has made buyers more reluctant to overcommit on a loan. The better relative affordability should mitigate some of the downward pressure on prices in oversupplied markets and in resource-sector exposed markets such as Perth, Darwin and to a lesser extent Brisbane.

Housing affordability[1]



2020 FORECAST

City	2020 forecast	2017
Sydney	▽ 35.8%	39.7%
Adelaide	▽ 19.7%	20.5%
Melbourne	▽ 35.4%	36.2%
Hobart	△ 18.5%	17.8%
Brisbane	◁▷ 20.6%	20.6%
Darwin	▽ 18.3%	19.7%
Perth	▽ 19.6%	20.2%
Canberra	△ 16.3%	14.8%

1 Housing affordability is shown as mortgage repayment based on 75% of the median house price. See Appendix for full definition.

06. Buyer activity

A mixed market

Owner occupiers benefit from low interest rates, while investors are influenced by lenders

Residential property loans

First home buyers make up the smallest sector of the market, upgraders and downsizers traditionally make up the largest group, while investors in recent times have taken over as the largest buyer group in some states.

First home buyers

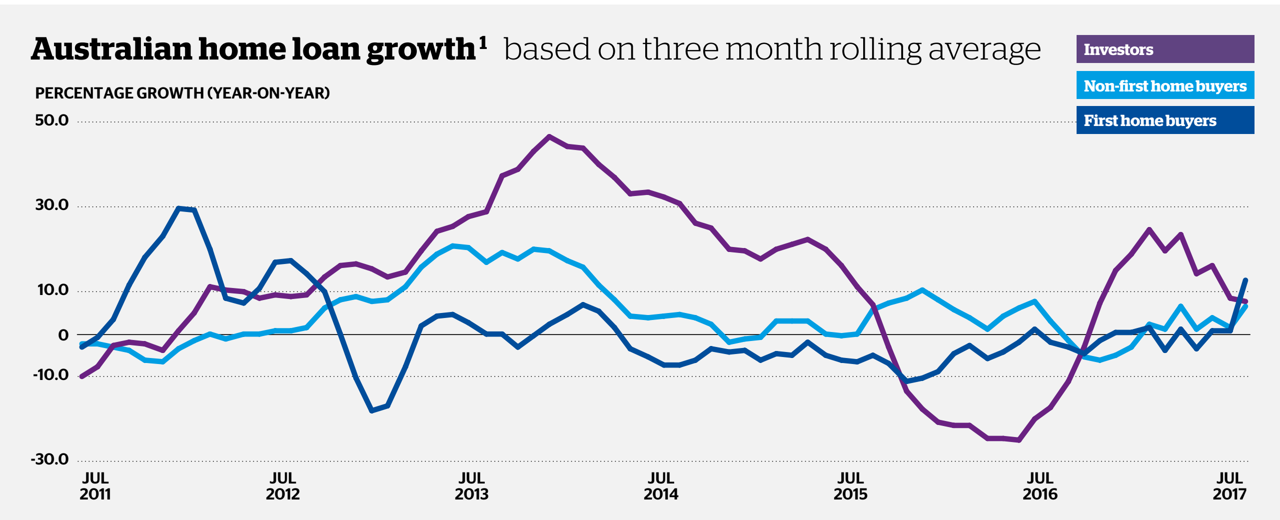
First home buyer demand nationally has been declining since the end of calendar year 2014. While the rate of decline has reduced somewhat recently, there were still 0.4% less first home buyer loans in 2016/17 than the previous year. Rises in house prices in some markets have made the deposit hurdle more difficult for first home buyers on lower incomes, despite lower interest rates making it easier to service a loan. Notably, signs of a strengthening in first home buyer demand is emerging, with loans to first home buyers in the three months to July 2017 being up by 13% on the same period a year earlier.

Non-first home buyers

Loans to non-first home buyers nationally showed a steady increase over 2015/16, but this flattened out in 2016/17, with a small 0.1% decline. The flat performance masks the changes occurring amongst the states, with some showing particularly strong non-first home buyer activity and other states with large declines, resulting in no net change at the national level. There has been some signs of improvement in recent months and this could be the result of owner occupier demand coming in to fill the gap as investor demand slowed.

Investors

Growth in loans to investors peaked in 2014 and steadily eased before a 17.2% decline was recorded in 2015/16. Despite tightening bank lending policy toward investors, loans to investors are again increasing, with an 11.1% rise over 2016/17. This will be mainly investors returning to the market after interest rates were cut in 2016. Supporting this growth is also likely to be a large rise in investment grade apartments in Melbourne, Sydney and Brisbane. The loan to the investor is typically made to the purchaser as the apartment is completed and the purchase is settled. However, demand has been slowing in 2017 as banks tighten lending policy toward investors.



1 Investor activity based on value of lending, owner occupier data based on number of loans.

First home buyers

First home buyer demand is important because it creates demand for entry-level properties, facilitating broader demand by encouraging current occupiers to upgrade through the value chain. As a result, incentives have often been put in place to promote first home buyer demand during times of market weakness.

There is also some evidence to suggest that an increasing percentage of first home buyers, particularly in the higher-priced cities of Sydney and Melbourne, are purchasing an investment property as their first home as a stepping stone into the market.

Nationally, first home buyer loans for owner occupation declined by 0.4% over 2016/17, remaining fairly flat over the past two years. **New South Wales** (-6.6%) and **Western Australia** (-6.5%) showed the greatest declines in 2016/17 and more modest declines were recorded in **Victoria** (-2%) and **South Australia** (-1%). The **Northern Territory** experienced an increase from 460 loans up to 600, as falling prices improved affordability for first home buyers. **Queensland** (+11.2%) also showed an improvement, while the **Australian Capital Territory** (+1.7%) and **Tasmania** (+0.3%) showed a slight uplift. The solid rise in Queensland may be reflective of increased net interstate migration inflows. South East Queensland has often been the refuge for migrants from Sydney during times when housing has become unaffordable to first home buyers in the city.

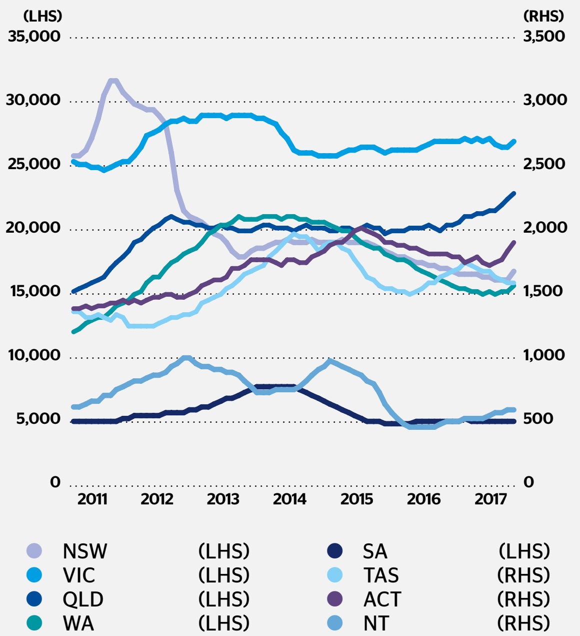
First home buyer incentives

Table below shows existing state and federal government incentives offered to first home buyers. It refers to grants available specifically to first home buyers and not broader grants and incentives first home buyers can also access. Where stamp duty concessions are offered, the maximum concession is indicated. It should be noted there are some purchase price limits for grant eligibility which vary by state. The most recent changes have been the introduction of stamp duty concessions in New South Wales and the increase of the 50% concession in Victoria to 100%. Price thresholds of $650,000 and $600,000 respectively apply to receive the full concession. In NSW, all home buyers are no longer required to pay stamp duty on lenders mortgage insurance.

Outlook

State governments have moved away from grants for existing dwellings and towards grants for new homes only. This is to support supply of new dwellings and discourage competition for existing stock. The two least affordable states, New South Wales and Victoria, introduced full stamp duty concessions for established dwellings from July 2017. As a result, loans to first home buyers in these states in July 2017 increased annually by 46% and 19% respectively. The price threshold for the concession in New South Wales of $650,000 is below the Outer ring Sydney median house price of $784,000. This suggests benefits will be felt by the more affordable unit market. In Victoria, the $600,000 threshold for the exemption is only slightly below the Outer ring Melbourne median house price of $618,000, indicating affordable houses are likely to experience increased demand.

Number of first home buyer loans for owner occupation by state moving annual totals



First home buyer incentives at Sept 2017

STATE	ESTABLISHED HOME GRANT: CASH GRANT	ESTABLISHED HOME GRANT: STAMP DUTY CONCESSION (MAX)	NEW HOME GRANT: CASH GRANT	NEW HOME GRANT: STAMP DUTY CONCESSION (MAX)
NSW	$0	**$0**	$10k	**$24.7k**
VIC[1]	$0	**$15.5k**	$20k	**$15.5k**
QLD[2]	$0	**$8.8k**	$20k	**$8.8k**
WA	$0	**$13.0k**	$15k	**$14.4k**
SA	$0	**$0**	$10k	**$21.3k**
TAS[3]	$0	**$0**	$20k	**$0**
ACT	$0	**$0**	$7k	**$0**
NT	$0	**$24.0k**	$26k	**$0**

1 Expiring 30 June 2020.
2 Expiring 31 December 2017.
3 First home owner grant to revert to $10,000 after 30 June 2018.

Upgraders and downsizers

Upgraders and downsizers have historically represented the largest component of residential demand, comprising 42% of total residential lending activity in the past 15 years. This is two to three times the size of the first home buyer market.

Since bottoming out in 2011 and 2012 in all states, upgrader demand strengthened over the four years to June 2016, and has shown almost no change nationally over the 12 months to June 2017. However, growth in upgrader demand varies by state.

After strong growth in 2015/16 of over 13%, the number of upgrader and downsizer loans rose by just 0.2% and 0.7% in **New South Wales** and **Victoria** respectively. Similarly, **South Australia's** numbers increased by 0.6% after a stronger 2015/16 (+3.5%). While the number of upgrader and downsizer loans in **Queensland** were 0.7% higher, this increase was similar to the previous year (+0.8%).

A big rise in upgrader and downsizer loans occurred in **Tasmania** over 2016/17, with a 13.1% increase on a year earlier. This strong level of activity has supported strong house price growth, particularly in the capital.

In contrast, **Northern Territory** (-12.1%) and **Western Australia** (-7.9%) have experienced reduced activity from this large segment, which is reflected in their poorly performing residential markets.

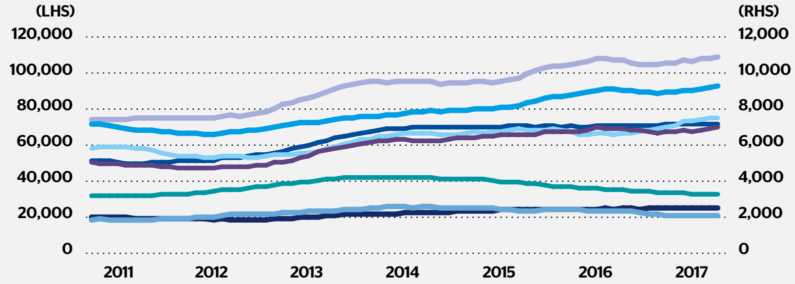
The number of upgrader and downsizer loans in the **Australian Capital Territory** was almost the same in 2016/17 compared to the previous year (with only 19 fewer loans in total).

Outlook

Low interest rates are expected to continue to support upgrader/downsizer demand in markets where there is a dwelling deficiency. Flat-to-rising prices encourages the selling of an existing dwelling to trade up or trade down. Where there have been price declines (Western Australia and Northern Territory), upgrader/downsizer activity is likely to continue to weaken.

Number of upgrader/downsizer loans by state

Moving annual totals



Investors

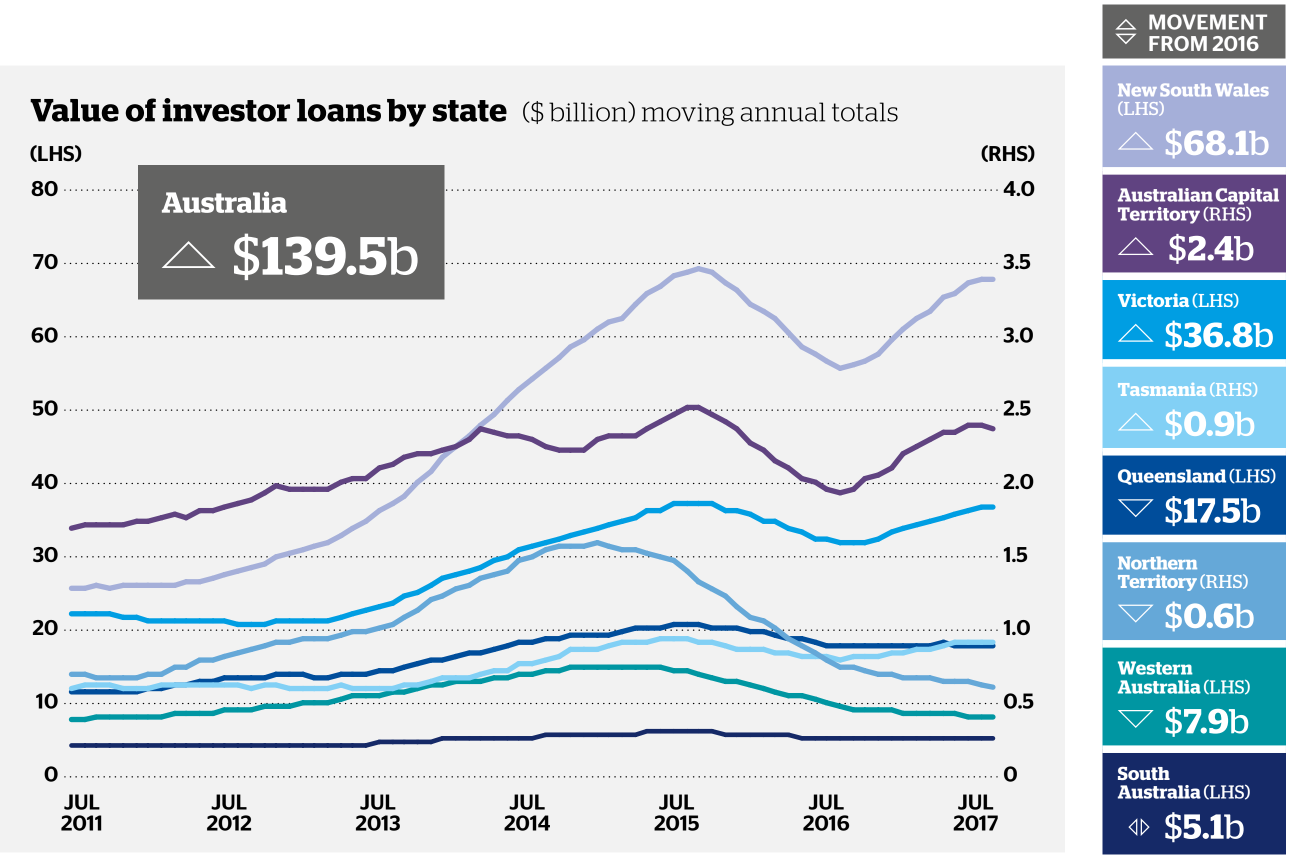
There will always be a proportion of the population who require rental accommodation. This includes people who move for work or lifestyle purposes, are not ready or do not want the financial commitment of owning a home, cannot afford to purchase a home, or chose to rent in one location and own a dwelling in another. Investors in residential property make up a significant proportion of the market, and can have a wide-ranging impact.

Investor environment

Investor purchasers became the largest segment of all residential loan activity nationally in 2014/15, accounting for 51% of total residential loans. In response to concerns about the level of speculative investment taking place, APRA issued guidance to financial institutions to reduce higher risk lending and contain investor lending growth. The result was that banks increased interest rates to investors relative to owner occupiers and the RBA reports an indicative 55 basis point premium above the equivalent owner occupier standard variable rate. Banks have also increased interest rate buffers and tightened loan-to-value ratios in their lending criteria. When the changes were first implemented, the value of loans to investors nationally fell by 17% in 2015/16.

However, loans to investors recovered over 2016/17, rising by 11.1%. With growth in investment loans falling below APRA's threshold, banks began to re-asses their lending criteria. The RBA also reduced the cash rate by 50 basis points in 2016, thereby offsetting the earlier increase in investor loan rates in response to APRA directives. Completions of investment-grade apartment stock are also at record levels in Sydney, Melbourne and Brisbane, and it is likely that finance for these dwellings is now being approved and committed.

New South Wales and **Victoria** have been the main beneficiaries of the rebound in investment lending, with the value of investment loans rising by an annual 19.7% and 13.9% respectively. **Tasmania** (+12.8%) and the **Australian Capital Territory** (+21.4%) also showed strong annual growth in investor loans. **Western Australia** (-17.6%) and the **Northern Territory** (-22.8%) recorded the biggest declines in investor loans, while the states of **Queensland** (-1.6) and **South Australia** (-0.3%) showed little net change over 2016/17.



Foreign investment

The total value of residential dwellings approved for purchase by the Foreign Investment Review Board surged tenfold, from $6.09 billion in 2009/10 to $60.75 billion in 2014/15 and continued to rise to $72.4 billion in 2015/16. This was largely concentrated in New South Wales, Victoria and Queensland.

Overseas based buyers can only purchase a new dwelling for investment, while temporary residents can purchase an established dwelling for owner occupation, but this must be sold upon leaving the country. Notably, a reduction in foreign investment in residential property is expected when the data for 2016/17 is published, with a number of measures being introduced to curtail foreign buyer demand.

Slowing price growth and low yields, as well as tighter lending policy towards overseas buyers is likely to divert some investment elsewhere. Additionally, New South Wales, Victoria, Queensland, and Western Australia have imposed a surcharge on stamp duty of 8%, 7%, 3% and 4% respectively to foreign purchasers, although the Western Australia surcharge will only apply from 1 January 2019. New South Wales also introduced a 0.75% land tax surcharge for foreign residential owners for 2017, which will increase to 2% from the 2018 land tax year (with an exemption available for principal place of residence in 2018). Victoria has a 1.5% absentee owner (primarily foreign owners) land tax surcharge. Nevertheless, Australia remains a favoured destination for foreign investors, who are attracted to Australian property as a means to geographically diversify out of their own country into a stable and transparent market, as well as take advantage of relatively affordable housing in Australia compared to many other international cities.

In August 2017, the Chinese Government restricted outward foreign investment in real estate. This will not apply to individual investors of dwellings in Australia, but businesses looking to undertake residential development. In the short-term, this is unlikely to have a significant impact on the Australian market. However, in the medium-term it has the potential to delay the next round of projects, causing supply to tighten up sooner and drive stronger rental growth.

Outlook

Investor demand faces a number of headwinds, and is expected to decline in 2017/18 as tightened lending practices and increased constraints on foreign buyers continue to take effect. The resulting slowing price growth will further discourage investors. If domestic investor demand was to continue to strengthen, this is expected to be met by further restrictions by APRA. Similarly, continued strong demand from foreign investors is likely to also be further discouraged by federal and state government policies.

Spotlight:

Regulator policy and investor demand

The Australian Prudential Regulation Authority is a major player in determining investor lending practices

Initial tightening of APRA policy

In November and December 2014, APRA released a practice guide on residential mortgage lending, which set out sound risk management practices for this type of lending and wrote to the banks emphasising the importance of rigorous mortgage lending standards. APRA's letter identified specific areas of prudential concern, including serviceability assessments and portfolio growth of investor loans. APRA introduced an annual growth cap of 10% for investor loans as a risk indicator that would require further supervisory action.

In July 2015 APRA made a further announcement to increase the capital required for Australian residential mortgage exposures. This change meant that the average risk weight on Australian residential mortgage exposures increased from approximately 16% to at least 25% from 1 July 2016.

Response

In response to these requirements, and to keep portfolio growth in investor loans below the benchmark 10% growth, banks responded with a combination of measures. Investor demand was rationed by measures such as tighter underwriting practices, restricting lending to overseas borrowers, charging higher interest rates for investor loans (compared to owner occupier loans), and decreasing loan-to-value ratios to investors. As well as the rise in investor interest rates, interest rates were increased across all loans by around 20 basis points in November 2015 to maintain returns on capital.

These measures had the desired effect and caused investor demand to weaken considerably. The value of loans to new residential investors in 2015/16 fell by 17% on a year earlier. At the same time, investors who subsequently moved in as an owner occupier had their loans re-classified as owner occupier loans to receive the lower interest rate. The net result of the lower investor demand and reclassification of loans was a 2% annual reduction in portfolio investor loans in the year to June 2016. This was well below the 10% benchmark limit on growth, and price growth in the key markets of Sydney and Melbourne slowed. Notably, the gap in investor demand was partly filled by demand from owner occupiers, which increased by 6% in 2015/16 after recording an annual rise of only 1% the year prior.

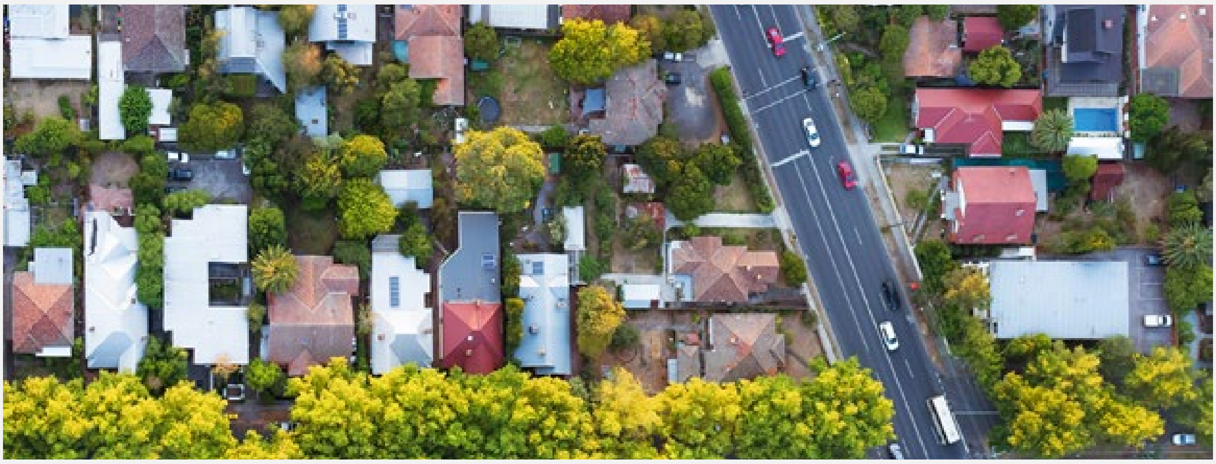
Recovery in investor demand

With investor loan growth falling well below the APRA 'speed limit', some banks began to re-assess lending policy toward investors, including increasing loan-to-value ratios. A 50 basis point cut to the cash rate by the RBA in 2016 also counteracted the APRA-related rise in investor interest rates, bringing them back to where they had been a year prior. Investor demand subsequently began to recover, with the value of new loans to investors in 2016/17 up by an annual 11%, and portfolio growth in investor loans rising to 6%, still below the APRA benchmark.

Recent APRA policy changes

At the end of March 2017, APRA initiated additional supervisory measures aimed at improving the quality of new mortgage lending and reducing the growth of investor lending. These limited the proportion of new interest-only loans, which are typically favoured by investors, to 30% of total new residential mortgage lending (after being at around 40%). More prudent lending practices were also emphasised.

Banks have responded by increasing interest only lending rates, particularly for investors. At the same time, lenders have sought to become more competitive in the owner occupier market with a 10 basis point reduction in owner occupier variable lending rates.



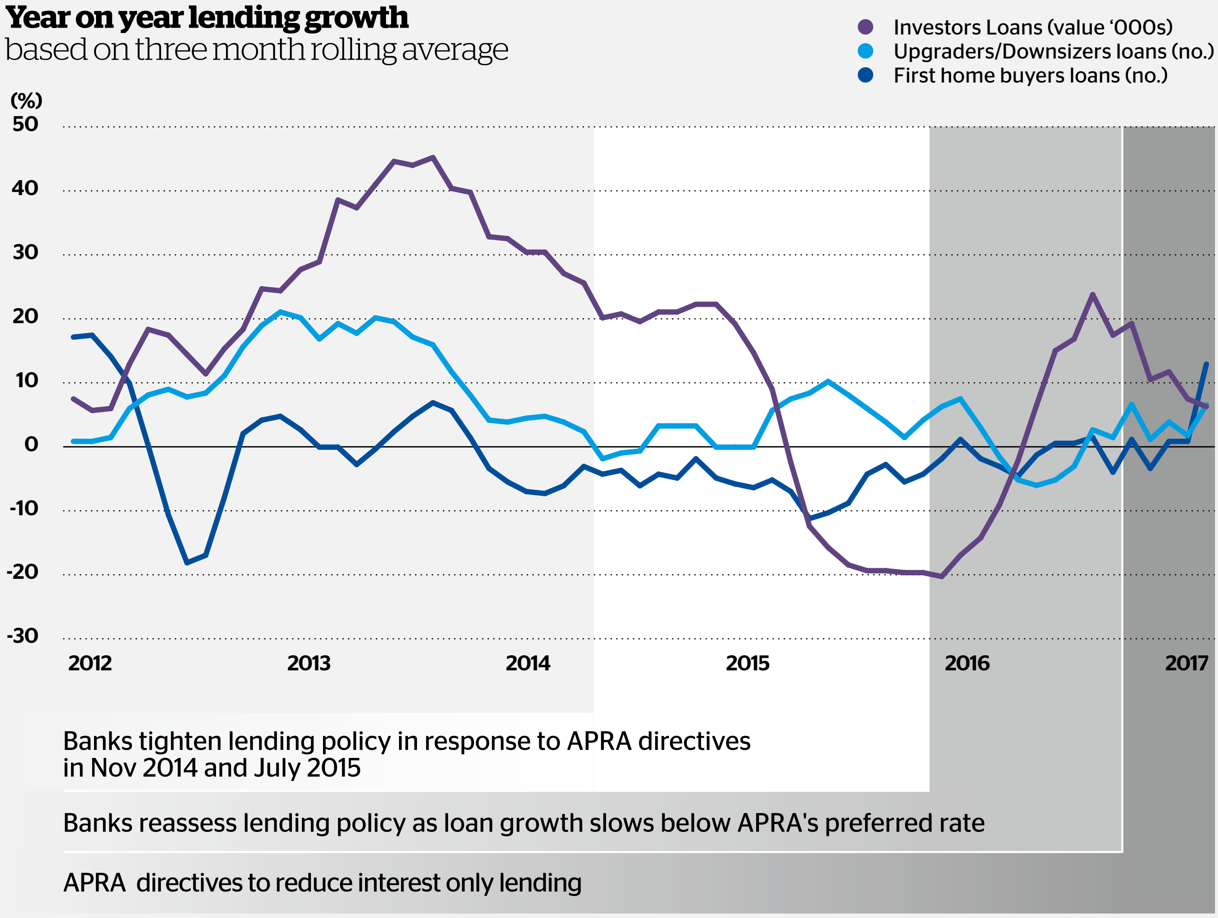
Outlook

As with the first round of APRA-initiated tightening in lending policy through 2015/16, the most recent measures are expected to curtail additional investor demand, while also reducing the purchasing capacity of investors in the market.

After recording double digit rises earlier in 2017, loans to investors in the three months to July 2017 were up only 6% on the same period a year earlier, while zero year-on-year growth was recorded in July 2017 itself. As a result, owner occupiers are now less likely to be outbid by investors. After recording annual declines in the prior months, loans to owner occupiers between April 2017 and July 2017 were up by 13% on the same period a year earlier. First home buyers, who are more likely to be competing with investors for entry-priced properties, are now showing a stronger recovery, particularly in New South Wales and Victoria, where stamp duty exemptions were introduced from 1 July 2017. Loans to first home buyers in July 2017 were up by 46% and 19% on a year earlier, with year-on-year growth also shown across most of the other states.

Despite improving owner occupier demand, overall residential lending is likely to decline slightly as investor demand continues to weaken. Assuming investor lending falls at a similar rate to 2015/16 (i.e. a 17% decline) in response to the most recent APRA initiatives, a further 13% increase in owner occupier lending will be required to offset the decline in investor activity. Given owner occupier loans are already at near-decade highs and oversupplies are emerging in most states, this rate of growth is unlikely to be achieved over the year. As a result, total finance for residential property is likely to decline over 2017/18 as these changes are absorbed by the market. Price growth is likely to slow while demand for new investment dwellings is also expected to weaken.

Year on year lending growth
based on three month rolling average



Keeping pace

Units now account for an increased share of demand as affordability, and perhaps lifestyle, inform property choices and accessibility

The interaction of demand and supply drives price growth and new dwelling construction.

Dwelling balance

If dwelling supply is not meeting demand (a deficiency), then this will drive price growth and more dwelling commencements. Where supply exceeds demand (an oversupply), price growth is more subdued, and new dwelling construction is weaker.

Underlying demand

Underlying demand for new dwellings is driven primarily by population growth, which is a combination of natural increase (births minus deaths) and net overseas migration. Migration between the states, net interstate migration, also contributes to population growth in each of the states. The ebbs and flows in migration will impact more directly on the market, as migrant arrivals will typically require a roof over their head when they arrive.

Compositional trends

The composition of underlying demand has been steadily changing. Generation Y households (those aged 20-34 years old) have shown an increasing preference to live in units, which are typically more affordable than houses (for renting or buying), as well as located close to high-amenity locations, such as the Central Business District and suburban town centres. Baby Boomers (aged in their 50s to their 70s) are also increasingly downsizing to smaller dwellings as they reach retirement age, although the numbers at this stage are still not significant. Overall, this is leading to units accounting for an increased share of demand. However, the sustainability of this trend will depend on whether Generation Y households continue to remain in units as they enter their late 30s and 40s, or move into houses.

Net overseas migration

Rising overseas student enrolments and strong employment growth driven by a boom in mining investment have been catalysts for record net overseas migration into Australia, which has averaged a net inflow of 217,400 per annum in the 10 years to 2016/17.

National trends

Net overseas migration inflows have ebbed and flowed with economic conditions, peaking at 300,000 in 2008/09 and bottoming out at 178,600 in 2014/15.

Outside of further growth in overseas student numbers, other inflow sources of net overseas migration are expected to remain soft. Conditions for subclass 457 visa migrants have been tightened, while a strong New Zealand economy has eroded inward migration from New Zealand. Strengthening economic growth in other major regions, such as the United States and Europe, will also increase their attractiveness relative to Australia.

State trends

New South Wales and **Victoria** together have accounted for 61% of overseas migration into Australia in the past decade, with **Queensland** and **Western Australia** accounting for another 30%. However, the share of overseas migration captured by Queensland, Western Australia and the **Northern Territory** (0.8% share in the past decade), has declined in recent years as resource sector employment has tailed off.

Without the boost from resource sector related migration, the share of overseas migrants settling in **South Australia**, **Tasmania** and **Australian Capital Territory** has remained around the long-term average.

Net overseas migration to Australia annual average

2008-2017	217.4k
Forecast 2018-2020 ▽	190.0

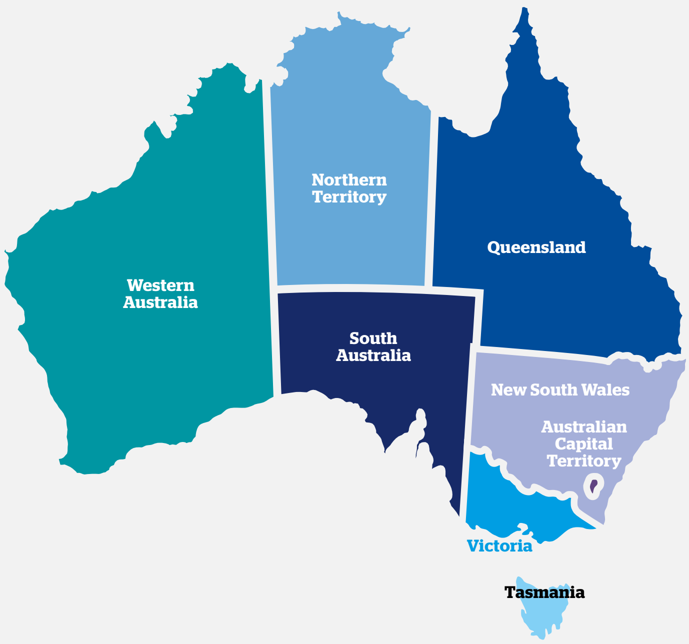
STATE SHARE	2008-2017%	2018-2020f %
NSW	32.3	▲38.6
VIC	28.7	▲32.3
QLD	16.5	▼13.3
SA	5.5	▼4.9
WA	14.4	▼8.6
TAS	0.6	▲0.7
NT	0.8	▼0.4
ACT	1.1	▲1.2

Outlook

Without a significant improvement in Australia's unemployment rate to attract employment-related migration, net overseas migration inflows are forecast to ease from an estimated 215,000 in 2016/17, to an average 190,000 per annum in the three years to 2019/20. While down on record levels of the past 10 years, net overseas migration will remain above the long-term average.

The lower net overseas migration inflows are expected to be felt by Queensland, Western Australia and Northern Territory, as migrants who had travelled to work on mining projects return home as the projects are progressively completed. In comparison, net overseas migration into the other states is forecast to remain around the average of the past decade.

Annual net overseas migration



State	2008-2017	Forecast 2018-2020
New South Wales	70.3k	△ 73.3k
South Australia	12.0k	▽ 9.3k
Victoria	62.4k	▽ 61.4k
Tasmania	1.4k	▽ 1.3k
Queensland	35.8k	▽ 25.2k
Australian Capital Territory	2.5k	▽ 2.3k
Western Australia	31.2k	▽ 16.4k
Northern Territory	1.8k	▽ 0.7k

Net interstate migration

Movement of population between the states changes in line with the house price differential and prospects for employment across the states. Reduced population flows overall also occur when economic conditions deteriorate and limited job prospects elsewhere encourage people to stay where they are.

New South Wales: In New South Wales, net interstate outflows have improved from a long-term (2000–2017) average of 18,400 per annum to 13,400 per annum in the past decade. Strong house price growth and reduced affordability is now causing the net outflow to rise, and as economic conditions begin to pick up in other states, living in New South Wales, and particularly Sydney, becomes less attractive.

Victoria: Victoria has benefited from a strong economy and more affordable housing relative to Sydney, and this is attracting population from the other states. Net inflows were an average 6,800 per annum over 2008–2017, and are estimated to be 19,000 in 2016/17, which will be both a record for the state and the highest of all the states.

Queensland: The mining downturn caused net inflows into Queensland to weaken to 10,600 per annum in the past decade (from 18,200 per annum over 2000–2017). In 2016/17, the net inflow is expected to rise to an estimated 16,000, likely largely comprising migrants from New South Wales escaping high house prices.

South Australia: In South Australia, net interstate migration outflows have increased as employment conditions have become more challenging. The net interstate migration outflow of 4,100 per annum over the past decade masks a rising trend that has resulted in the state's net interstate migration outflow rising to an estimated 7,500 in 2016/17.

Western Australia: In Western Australia, the net interstate migration inflow of 1,900 per annum in the past decade masks the impact of the boom and bust mining cycle where net inflows peaked at 11,400 in 2011/12, and net outflows most likely peak at an estimated 11,500 in 2016/17. With employment growth weak as mining investment winds down, the state's net interstate migration outflow has been rising.

Tasmania: In Tasmania, interstate migration reverted from a net outflow to a net inflow in 2015/16, and is expected to come in at a net inflow of 500 in 2016/17. Improved affordability relative to Sydney and Melbourne appears to be resulting in increased "tree change" migration to Tasmania.

Australian Capital Territory: In the Australian Capital Territory, interstate migration is on track to revert from a net outflow to a net inflow, estimated at 800 persons in 2016/17; largely a result of a more stable employment environment.

Northern Territory: Economic conditions in the Northern Territory have worsened as resource investment falls back. The subsequent fewer job opportunities are keeping the Territory's net outflow elevated. The Northern Territory lost an estimated 3,000 people to net interstate migration in 2016/17.

Annual net interstate migration

	2008-2017	Forecast 2018-2020
New South Wales	-13.4 k	▽ -18.7 k
South Australia	-4.1 k	▽ -4.8 k
Victoria	6.8 k	△ 11.0 k
Tasmania	-0.3 k	△ 0.6 k
Queensland	10.6 k	△ 17.8 k
Australian Capital Territory	0.1 k	△ 0.6 k
Western Australia	1.9 k	▽ -5.3 k
Northern Territory	-1.6 k	△ -1.2 k

Outlook

Net interstate migration outflows from New South Wales are forecast to increase and net inflows into Victoria are forecast to decrease from their 2016/17 levels, as high house prices in Sydney and Melbourne, and improving state economic conditions elsewhere, reduce the attractiveness of these two states. The main beneficiaries are expected to be Queensland and, on a smaller scale, Tasmania and Australian Capital Territory, where the attraction of an improved employment outlook and lower relative house prices increasingly attract population. Continued weak employment conditions in Western Australia, South Australia and Northern Territory are expected to result in the net population outflow from these states remaining elevated.

Supply – Commencements

New dwelling starts in Australia have been at record levels in the past three years to 2016/17, peaking at 233,600 dwellings in 2015/16. Dwelling starts are forecast to remain elevated in 2017/18. As these dwellings are progressively completed, some states will experience a rising oversupply, while in other states, the existing deficiency will be reduced.

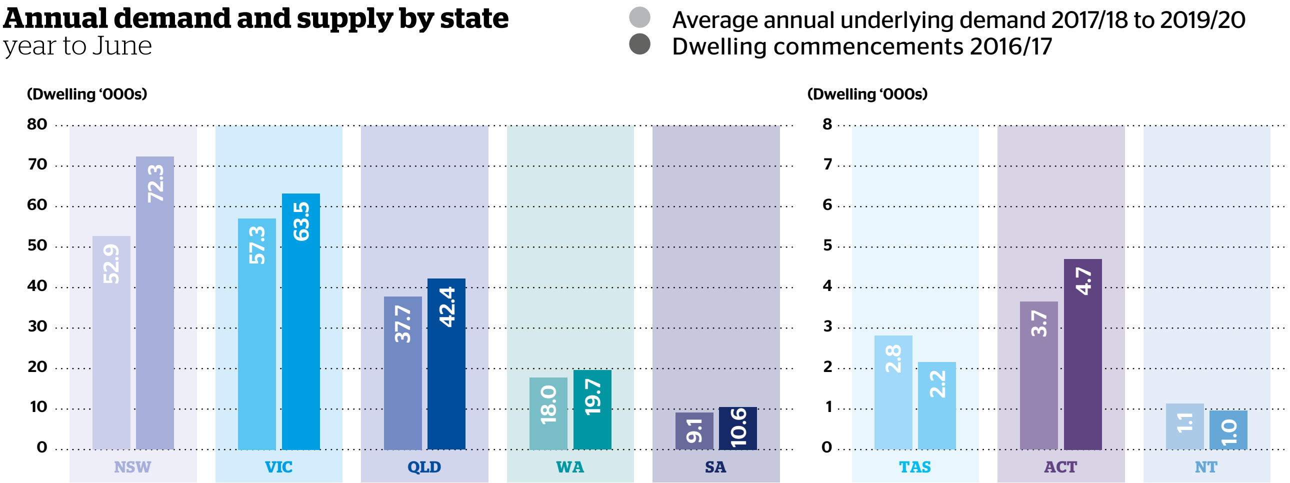
New South Wales: A prolonged period of low construction in the late 2000s saw New South Wales accumulate a significant underlying dwelling deficiency, which is currently the highest of all states. The recovery in construction was met with rising population growth and it was only in 2015/16 that dwelling completions outpaced underlying demand. The deficiency is now slowly being eroded, although was still high at an estimated 39,300 dwellings at June 2017 and will reduce further.

Victoria: Dwelling completions in Victoria have been ahead of underlying demand since 2009/10. Completions have surged over the past four years, averaging 57,600 dwellings per annum, compared to 44,600 per annum over the preceding decade. The rise in supply has been mostly met by rising underlying demand and the dwelling undersupply has been eroded very slowly. The dwelling undersupply was estimated to be 5,800 dwellings at June 2017 and will progressively move closer to balance as supply remains strong.

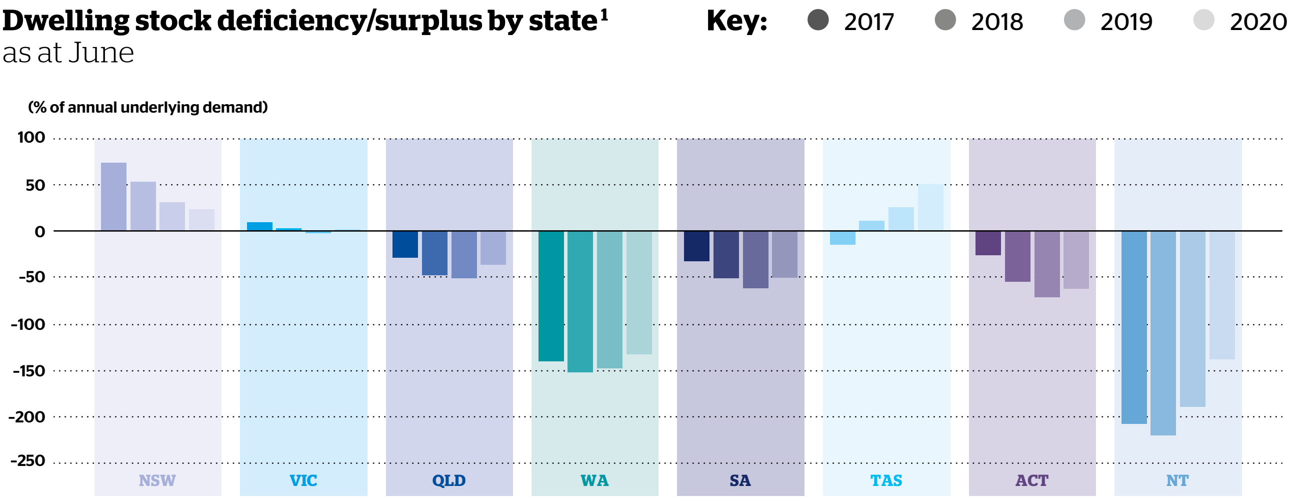
While the market will be close to balance, the recent level of unit construction suggests that an oversupply of units will emerge, while the house market will remain in undersupply.

Queensland: Like Melbourne, record unit construction in the inner city has seen an oversupply emerge in the unit market. As a share of total dwelling completions, units have increased from a long-term average of around 32%, to 50% in 2016/17. This has seen the market in aggregate tipped into an estimated excess of 10,400 dwellings at June 2017. Over the forecast period, completions are projected to ease, although underlying demand is also forecast to remain weak. This will see the oversupply remain elevated and only start to be absorbed by 2019/20. The oversupply will likely be concentrated in the unit market.

Annual demand and supply by state
year to June



Dwelling stock deficiency/surplus by state[1]
as at June



1 A positive percentage represents a dwelling deficiency and a negative percentage represents a dwelling surplus.

Supply – Commencements continued

South Australia: South Australia moved into oversupply in 2015/16 as completions ramped up and underlying demand remained flat. The dwelling oversupply is estimated to be 2,800 dwellings at June 2017. The current pipeline of construction will likely see dwelling completions outpace demand in 2018/19 and oversupply increase.

Western Australia: Weak economic conditions in the post mining boom period caused underlying demand to fall steeply. At the same time, completions ramped up, eroding the existing dwelling deficiency and creating an underlying surplus estimated at 24,900 dwellings in 2016/17. With new dwelling construction now also collapsing, the surplus is expected to rise only a little further before beginning to be absorbed by 2019/20.

Tasmania: The Tasmanian market has generally remained in a long period of oversupply with low population growth keeping demand subdued. However, the resurgence of economic growth in 2015/16 has seen demand pick up and the oversupply significantly eroded. Over the forecast period, an undersupply is expected to emerge and increase to 2019/20.

Australian Capital Territory: Strengthening demand and a sharp reduction in dwelling completions in 2015/16 saw the oversupply in the Australian Capital Territory market narrow over the year. However, dwelling completions are increasing again and are forecast to exceed underlying demand and see the oversupply stretched out further.

Northern Territory: Rapidly weakening underlying demand has seen the oversupply in the Northern Territory market accelerate despite a decline in dwelling completions. Over the forecast period, demand is expected to stabilise although the surplus is expected to persist.

Outlook

After peaking in 2015/16, new dwelling commencements nationally eased by an estimated 8% in 2016/17. Tightening of lending policy toward investors is resulting in lower off-the-plan sales for apartments and lower new apartment commencements. Detached housing commencements are also weakening in a number of states where an excess supply has emerged. Lower deficiencies or rising oversupplies over 2017/18 are expected to cause dwelling commencements to continue to slowly ease from their recent record levels to 162,000 dwellings by 2019/20, which is high relative to the 20-year average.

Supply – Composition

There has been a clear shift towards greater unit construction since 2012/13. The shift has been in response to rising unit demand, which has been underpinned by a combination of factors.

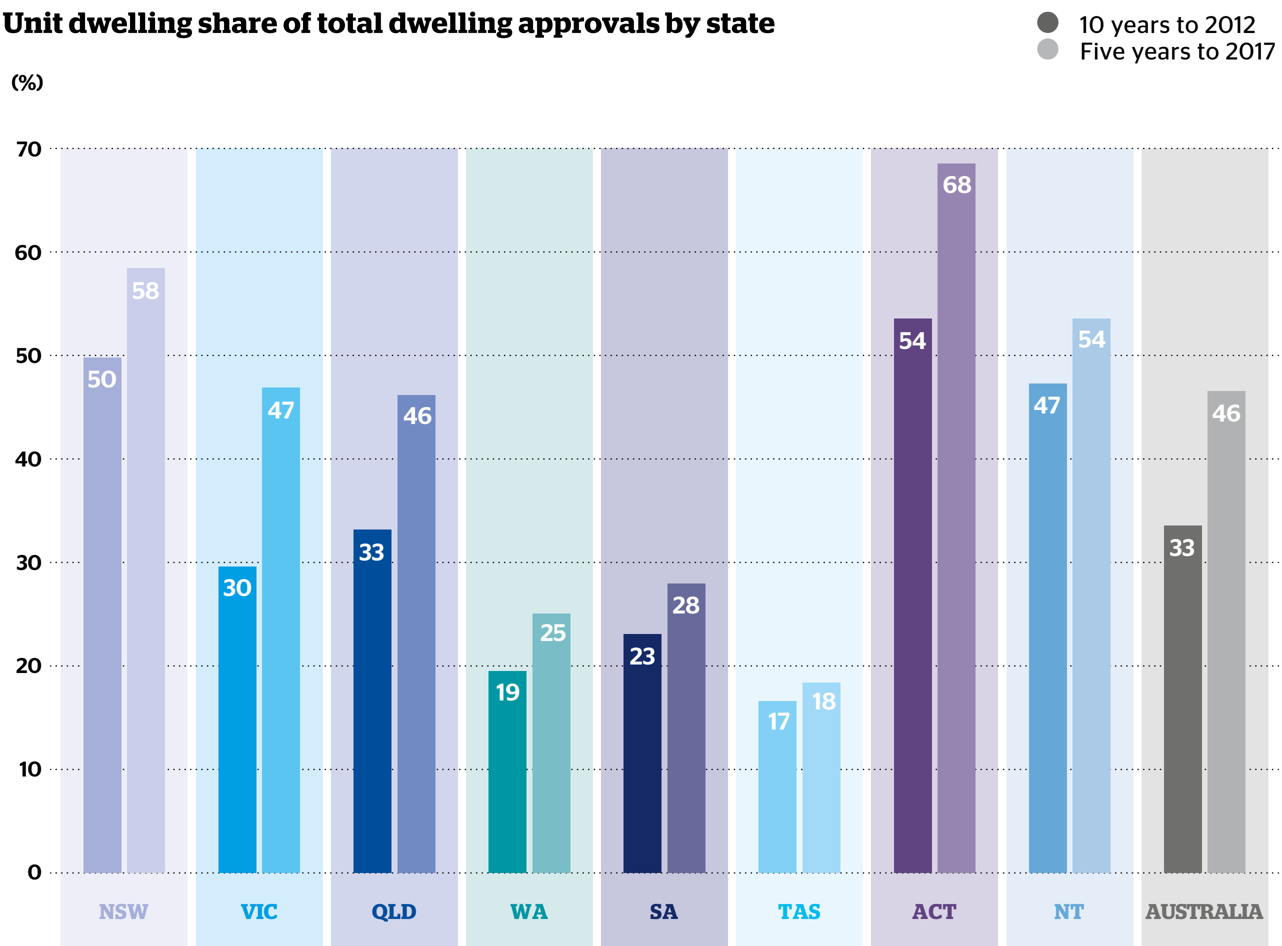
There has been an increasing preference to live in smaller dwellings, particularly across the younger age groups while rising downsizer activity has also contributed. Furthermore, deteriorating house affordability, particularly in Sydney and Melbourne, has seen demand funnel into the more affordable unit market. At the purchaser end there has been rising investor demand, with units typically favoured by investors. Unit activity accounted for 33% of total dwelling approvals nationally in the decade to 2011/12, rising to 46% in the five years to 2016/17.

The largest increase has occurred in Victoria (where unit activity accounted for a 30% share in the 10 years to 2011/12, and rose to a 47% share over the past five years), ACT (54% share rising to 68%) and Queensland (33% share rising to 46% share). The share of unit approvals in New South Wales and Northern Territory increased, although units have always accounted for a large share of new dwelling activity, while the gains were less pronounced in the remaining states.

Outlook

The rise in unit construction suggests that any oversupply in most states will be largely concentrated in the unit sector. Moreover, with a strong unit pipeline in place (as reflected in building approvals), unit completions will remain high over the next year or two. The excess supply will discourage investors and decrease unit demand from this segment of the market. Increasing restrictions placed on lending to investors are also expected to have greater ramifications for unit demand than for housing demand.

Unit dwelling share of total dwelling approvals by state



08. Glossary of terms

Dwelling market:	Includes both houses and units.
First home buyers:	Australian Bureau of Statistics (ABS) data on loans to first home buyers are derived from returns submitted by financial institutions to APRA at the time of the loan approval. A first home buyer is defined as "a borrower entering the owner occupier home ownership market for the first time". The definition includes all first home buyers obtaining a loan (and not just those eligible for grants).
Foreign investors:	Overseas resident purchasers. Foreign investors can only buy a new dwelling, while a temporary resident can purchase an established dwelling that must be sold upon returning home. The Foreign Investment Review Board (FIRB) reports the number and dollar amount in billions approved for residential purchases (which includes the entire value of buildings where 100% of dwellings have been pre-approved for overseas buyers, although all of these may not have been taken up) for investment by temporary residents and people overseas.
House market:	Detached or separate dwellings that do not share a wall with adjoining dwellings.
Housing affordability:	Housing affordability in this report is defined by the mortgage repayments on a 25-year loan of 75% of the median house price at June 30 each year, at the prevailing June 30 standard variable rate, as a percentage of average household disposable income. Average household disposable income is derived from the National Accounts data, based on aggregate income divided by an estimate of the number of households.
Interest rates:	Interest rates are set by the Reserve Bank of Australia (RBA) as the mechanism for maintaining economic conditions at a level compatible with stable, low, inflation. The RBA sets the "overnight cash rate", against which financial institutions reference their lending rates. Higher interest rates reduce spending in the economy and reduce inflationary pressure. If inflation pressures are benign, then lower interest rates can encourage more spending and economic growth.
Median price:	Refers to the mid-point of sales that have taken place in a period and is considered a better indicative measure of prices than the average, which can be more influenced by extreme results. Movements in the median price can also be influenced by changes to the composition of sales in between periods. Consequently, the Australian Housing Outlook median price refers to a "weighted median", which is a median weighted by the geographical distribution of the housing and unit stock. It is considered that the weighted median better corrects for the effect of an imbalance in the sales in the period. The raw sales data is sourced from PriceFinder.
Net migration inflow:	When the total number of migration arrivals is greater than the total number of departures.
Net migration outflow:	When the total number of migration departures is greater than the total number of arrivals.
Real median price:	The median price after accounting for the impact of inflation. The real median price allows for a better comparison of price growth over time as, during periods of high inflation, significant rises in the median house price may be underpinned by the inflation rate and do not necessarily reflect a strong market.
Indicative rental yield:	The rental yield of a dwelling is the rent divided by the value. However, actual rent and values data for individual dwellings in unavailable. Consequently, an indicative yield is calculated as the median three-bedroom house rent divided by the median house price. The indicative yield slightly understates actual rental yields, as the median house price is reflective of the whole market (investors and owner occupiers) while rents are reflective of just properties in the investment market. Investment properties are more likely to be priced below the median house price of all dwellings, although achieve a typical rent. Nevertheless, movement in the indicative yield should correspond with actual yields. We have compared the rental return with the cost of financing by using the measurements for indicative rental yield and the standard variable interest rate respectively.
Residential market:	Same as dwelling market.
Unit market:	Includes all forms of multi-unit dwellings including townhouses, villa units, semi-detached dwellings, terraces, flats and apartments.
Vacancy rate:	The vacancy rate is calculated as the number of unoccupied rental dwellings as a percentage of the total rental stock and is sourced from a survey of state Real Estate Institute members. The vacancy rate in each city is a measure of the balance of rental demand and rental supply. A vacancy rate of 3% in a market is considered balanced, where rents on average will rise broadly in line with inflation. A vacancy rate of 1% indicates a tight rental market that will result in strong rental growth. A vacancy rate of 7% indicates an oversupplied rental market that will result in rental declines.

Source directory

PAGE	TITLE	SOURCE
PAGE 9	Median prices by capital city	PriceFinder data, REINT, BIS Oxford Economics
PAGE 11	New South Wales: dwelling prices	BIS Oxford Economics, Australian Bureau of Statistics (ABS) and PriceFinder
PAGE 15	Victoria: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 19	Brisbane and Gold Coast: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 19	Regional Queensland: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 25	Perth: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 29	Adelaide: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 32	Tasmania: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 35	Australian Capital Territory: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 37	Darwin: dwelling prices	BIS Oxford Economics, ABS and PriceFinder
PAGE 38	Annual rental growth	ABS
PAGE 39	Residential vacancy rates	Real Estate Institute of Australia
PAGE 39	Indicative house rental yields	Real Estate Institute of Australia, PriceFinder, BIS Oxford Economics
PAGE 41	Key economic indicators	ABS, BIS Oxford Economics
PAGE 42	Indicator lending rates	Reserve Bank of Australia, BIS Oxford Economics
PAGE 43	Housing affordability	ABS, Reserve Bank, Real Estate Institute of Australia, BIS Oxford Economics
PAGE 44	Australian home loan growth	ABS
PAGE 45	Number of first home buyer loans for owner occupation	ABS, BIS Oxford Economics
PAGE 45	First home buyer incentives	State Government State Revenue Offices, BIS Oxford Economics
PAGE 46	Number of upgrader/downsizer loans by state	ABS, BIS Oxford Economics
PAGE 47	Value of investor loans by state	ABS, BIS Oxford Economics
PAGE 49	Year on year lending growth	ABS, BIS Oxford Economics
PAGE 51	Annual net overseas migration	ABS, BIS Oxford Economics
PAGE 52	Annual net interstate migration	ABS, BIS Oxford Economics
PAGE 53	Annual demand and supply by state	ABS, BIS Oxford Economics
PAGE 53	Dwelling stock deficiency/surplus by state	ABS, BIS Oxford Economics
PAGE 55	Unit dwelling share of total dwelling approvals by state	ABS, BIS Oxford Economics

Acknowledgments

Report and forecasts

BIS Oxford Economics

Creative design

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Thanks to:
Touk Vongpraseuth, Paul Jewell, Michael Savery, Paul Coloe, Bettina Pidcock, John Bernstein, Holly Morgan, Simon Stevens, Ben Shute, Sarah Steel, Nicole Lawler, Fraser Hannan, Tim See, Roy Awan, Naomi Power, Paul Dennis, Amanda Bozelle, Tony Siharath, Amanda Goulder.

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