EUREKA report

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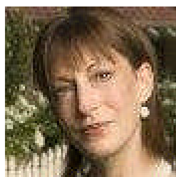

Clearance rates and reality

By Monique Wakelin

PORTFOLIO POINT: Investors should not interpret softening clearance rates as meaning the market is awash with bargains.

A lot of significance is being attached to nationwide property sales clearance rates, as the autumn market reached its highest volume levels so far this year in the lead up to Easter. It is normal for more properties to be offered prior to Easter, but this year when clearance rates showed a considerable dive in some sectors of the market, the doomsayers came out of the woodwork.

Before investors jump to conclusions, they need to analyse what the clearance signals are really telling us. Clearance rates are an unreliable measure of the overall robustness of the property market. Rather, they measure only two things reliably on a week by week basis: the volume of transactions and the extent of buyer demand relative to volume. Just as importantly, they reveal the extent to which the real estate industry is willing to report results!

A clearance rate of 70% or higher indicates that demand is significantly in excess of supply; 60–70% indicates a relative balance; and under 55% indicates a supply in excess of demand. These predictors only hold true if they are observed on a continuing week in, week out basis over a month or more. And, this is quite different from predictable episodes where market activity will be compressed or even absent, thereby causing a surge or decline in the auction clearance rate. For instance, it is wholly predictable that in the week or two leading up to Easter and the coinciding school holiday period and Labour Day holiday, that volumes of auctions will increase.

Even though the clearance outcomes are beginning to signal some movement towards a more level buying and selling playing field, they are not yet conclusive. It will take a month or so before any definitive predictions can be made more accurately. Also, different sectors of the market are showing quite different performances.

For instance, Melbourne had a record 1400 auctions listed for the weekend before Easter and returned a surprisingly strong 65–67% clearance rate. Sydney, which has been running at about 63%, fell to about 52%, but certain sectors and price brackets showed strong results. In Brisbane, the recorded clearance rate was 24%, which led to some alarmist statements about tumbling prices and over-inflated vendor expectations, a totally incorrect conclusion because the auction method is not the norm in Brisbane. Perth, which began to show price stabilisation by mid-2007, has continued that trend, while Adelaide and the ACT markets have shown prices remaining steady.

Undoubtedly, there are other factors influencing the latest results, in addition to seasonal influences, namely: some buyer hesitation brought about by rising interest rates and the emergence of tighter lending criteria; continuing low housing affordability; ongoing financial fallout from individual stock market losses and margin calls; and a degree of unrealistic vendor expectation in regard to selling prices. I think what is actually slowing is the abnormally high capital growth that defined some markets last year. This is encouraging for several reasons, not a precursor to doom!

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Remember, we rarely see auctions in the bulk of outer-urban fringe sales or in over-supplied, multi-unit development sectors. Why? Because auctions generally rely on demand exceeding supply, hence their popularity in prime, highly sought-after areas. But, where there is no scarcity value or in an over-supplied sector of the market, different sales techniques are a better option.

Higher volume does not equate to more quality assets becoming available at a lower price. In fact,

it is selected, prime inner-urban sectors of the capital city markets that are continuing to hold their price levels because demand is continuing to outstrip limited supply.

Even in Sydney – where across-the-board results would appear to show the country's lowest growth rates at around 5% for 2007 – the game hasn't changed that much for investors seeking prime assets. Independent Sydney property adviser Peter Kelaher, a member of the Property Buyers Association of Australia (PBAA), says the clearance rate has eased from about 62% to about 53%. The luxury end of the market – $5 million plus – has "gone a bit soft", but the demand for units and houses up to $3 million is very strong because of a lack of supply.

"The same is happening with units in the more sought-after precincts and priced between $400,000 and $1 million; and again, we are seeing demand outstripping supply," Kelaher says.

In Brisbane, PBAA member Meighan Hetherington says the Brisbane market does not have a strong auction culture, but where auctions are held, they are generally noted for pre-auction sales, making reported clearance rates a poor indicator of market activity. "There is no doubt that the Brisbane market is starting to soften and vendors are having to look at lowering their price expectations. This does not, however, indicate a drop in prices as much as the fact that growth rates have stabilised," Hetherington says.

She says the $1 million-plus upper end of the market is still very strong, with demand outstripping supply in very selected areas. The main stock increase has been in the $400,000–750,000 range, where the majority of buyers are active. "There is a strong sentiment that prices will drop due to uncertain economic circumstances. I suggest, in Brisbane at least, that prices aren't showing signs of dropping; instead, they just aren't going to grow at the high rates we saw last year," she says.

I cannot urge investors strongly enough to avoid interpreting lower clearance rates and moderating price growth as a signal that the market has become a "bargain bin". Instead, it means buyers can take the time to carefully consider their purchases without losing sight of the key selection criteria, and with the view that there is likely to be more quality stock on the market. Investors have the time to do this as we will not see a new influx of stock on to the market until the first or second week in May.

Property Q&A

This weeks questions cover:

- Should I buy in Sydney or a regional centre?
- What type of house and location attracts capital growth?
- An investment of last resort.
- Buying "seachange" real estate.

Sydney or the bush

I want to invest in property and keep renting in the inner Sydney rather than buy as an owner/occupier. Would it be better to invest somewhere outside of NSW "due to limited capital growth in Sydney", or whether something inside NSW would be easier to take care of. Townsville is one option. Predictions that property prices may fall in the next one to three years might mean I have to wait to generate more funds for the investment and enter a more stable market.

Since your first property purchase is purely as an investment you should have only one aim: to buy the best capital growth asset you can afford. Don't be distracted by new offerings in regional centres. The absolute key for a first investment is asset selection. Even a modest one-bedroom apartment in the right location – two to 12 kilometres from a major CBD – whether it's in Sydney or Melbourne, will show far greater capital growth, plus a high level of ongoing tenant and owner/occupier appeal over the long term, compared to any new developments in more remote locations. Ask yourself: why you prefer to rent in an inner urban location? The same reasons will apply to an ongoing, high-demand pool of other tenants. Even if you do look at regional centres as a more affordable entry point, then make sure they are major regional centres with a diverse economic base. Here you should apply the same selection criteria: established property, close to sought-after amenities and infrastructure, high land value location and some architectural scarcity. And please, don't waste valuable time trying to second guess what the property markets will do. Buy the best possible capital growth asset when you can afford. While prices may stabilise in some sectors of the market, remember that the best quality assets will always be sought after.

Which is the growth zone?

We are looking to buy a house within an established inner Sydney suburb. We are trying to decide between two areas within that suburb and wonder which one will show better capital appreciation. One is within walking distance of rail and key bus stops, borders townhouse and unit blocks, is close to other amenities, is in a slightly noisier and busy street and has a high chance of land rezoning for further townhouse development. The second property is away from bus and rail, is in a well-established, family-oriented, house-only area, away from amenities and has a minimal chance of rezoning. The purchase would be intended for the long-term. The house prices in the second area are around 10% higher than the first.

You are attempting to combine a lifestyle purchase with an investment edge. The first thing to do is apply the purpose test, which means determining the property's primary purpose. If it is to be a home first and foremost, then your decision is likely to hinge on more emotional criteria such as the amount of accommodation offered, the amenities and the ambience of the area, especially if the plan is a long-term one. If you have tracked the prices for each locations over several months, or even longer, and come up with a consistently higher general market value for properties in the second location, then there will be a reason for this. Don't simply compare one individual house with another, but look at what has happened in the wider precinct. On the surface, the second location appears to appeal to family-oriented owner/occupiers. Are there other key attractions, such as proximity to sought after schools, particularly attractive and architecturally consistent streetscapes and limited, intrusive surrounding uses such as busy shopping zones and high density developments? It is the property and location that will appeal to the vast majority of owner/occupiers the vast majority of the time that will show the best ongoing capital growth potential and buyer appeal.

A slice of a rural resort

I'm considering buying a unit in a resort development in country Victoria. The property would be positively geared for income purposes rather than capital growth. The buy-in price ranges from $200,000 to $500,000 with a guaranteed rental return of 6% for the first two years. This return is predicted to increase to 8% by the five year mark. I would intend using income gains to pay off the loan to build equity with a view to buying more properties in five years. This property would be a "cash cow" to support other investments – and gives me somewhere to stay free for a fortnight each year.

I urge you not to be dazzled by returns predicted for five years hence, particularly for a new development in what is generally a low capital growth location. A reasonable rental yield for an established, well-selected major metropolitan city property is 3–4% a year of capital value – depending on its location. The 6% yield for a resort-style, discretionary property, largely being built for holiday purposes, is a "sweetener" to attract buyers. This new development is in the vicinity of a rural area that is already noted for its over-supply of holiday accommodation and the new offering is a fair distance from the main centre of attraction, plus will be competing to attract visitors. When the rental guarantee runs out after two years, your property will revert back to a market rate of rent. I wish I had the crystal ball that could predict an 8% yield within five years for such a location!

I suggest you take that prediction with a large grain of salt. Determine a realistic market rate of rent for resort accommodation in that specific location without any developer guarantees or sales pitches. Also determine how many weeks of the year it is likely to be rented and at what price – again, without the developer's guarantees attached. This particular development is being touted as attracting weekend traffic. If your investment decision is being based solely on the percentage of income then you need to do some more homework. I will repeat my mantra that a good quality property stands on its own merit and doesn't need rental guarantees.

Seachange trends

I have owned an investment property in a beachside area in Western Australia since 1994. It is a holiday rental grossing about $20,000 a year, and expenses are about $10,000. Average prices in the area are between $800,000 and $1 million. Do you have any advice on trends in "seachange" real estate, particularly in regard to petrol prices, a potential economic downturn and rising interest rates?

Discretionary holiday properties can sometimes be the first to be sold when rising interest rates or other economic considerations begin to bite. Keep track of prices for comparable properties in the same area over several months, including how long they stay on the market before selling. There are two different aspects to "seachange" locations. One is where an area is largely a holiday destination with few permanent residents. This type of location often lacks sought-after facilities such as health and leisure facilities or reasonable proximity to a larger centre or capital city. If the area is weighted in favour of full-time owner/occupiers who have sought a specific lifestyle location, then this will drive ongoing demand and market prices in a more consistent manner. Look closely at where the demand for your type of property is likely to come from on an ongoing basis before you

make a final decision.

Note: We make every attempt to provide answers to readers' questions, however, answers are of a general nature only. Subscribers should seek independent professional advice for more in depth information that is specific to their situation.

Monique Wakelin is co-founder of Wakelin Property Advisory, **www.wakelin.com.au**, a Melbourne-based independent property acquisition and advisory company, and co-author of Streets Ahead: How to Make Money from Residential Property.

Do you have a property question for Monique Wakelin? Send an email to monique@eurekareport.com.au

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