NOVEMBER 2012 SYDNEY RESIDENTIAL APARTMENT MARKET SNAPSHOT

Knight Frank

Although the moderation in Sydney dwelling prices recorded in 2011 and early 2012 have largely stabilised, demand for new apartments remains modest to steady. The bulk of enquiry is concentrated in the $450k to $650k range for first home buyers and $650k to $850k for upgraders with significant demand stemming from Asian purchasers. While this is partly an extension of government stimulus focusing on affordable new supply, it is also being driven by price sensitive households looking for value before buying. Increased levels of affordability and lower interest rates are providing scope for demand to improve, although this is likely to be predominantly felt in lower price brackets.

Table 1
Population and Projected Growth Rates 2011 Census Data

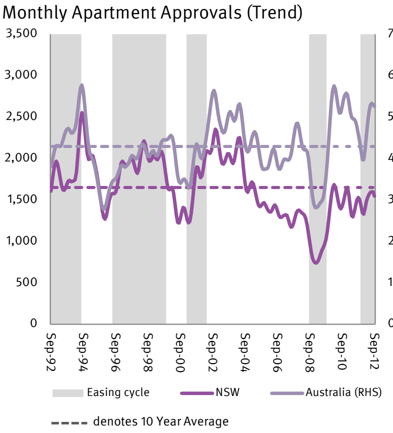
Market	Population	Number of People Living in Apartments	Average Number of People per Household	Forecast Annual Growth Rate 2011-16 (%)
Ring*				
Inner Ring	744,659	411,309	2.2	0.8%
Middle Ring	1,268,460	395,822	2.8	1.1%
Outer Ring	2,378,553	263,777	2.9	1.3%
Sydney SD	**4,391,672**	**1,070,908**	**2.7**	**1.2%**
Selected Major LGA's				
Botany Bay	39,356	17,750	2.6	0.5%
Ku-Ring-Gai	109,297	17,815	2.9	1.3%
Lane Cove	31,510	13,738	2.5	0.6%
Marrickville	76,500	28,611	2.3	0.7%
Parramatta	166,858	55,897	2.7	1.2%
Ryde	103,038	32,869	2.6	0.7%
Sydney	169,505	124,756	1.9	1.2%

Source: Knight Frank/NSW Department of Planning
*Rings as defined by NSW Department of Infrastructure, Planning and Natural Resources. Inner Ring includes the 11 LGAs within 5 kms of the Sydney CBD, Middle Ring the 15 LGAs between 5-20 kms from the CBD and Outer Ring the 17 LGAs beyond 20 km from the CBD

New Apartment Supply

New dwelling supply in NSW has been relatively soft over the last 10 years, however favourable interest rates and Government initiatives targeting new supply are starting to have a positive impact on development activity. Trend residential building approvals in NSW have increased by 12.6% since the start of 2012, however the gain has been more pronounced in the apartment sector, which has recorded growth of 17.6%.

Figure 1
Sydney Residential Market
Monthly Apartment Approvals (Trend)

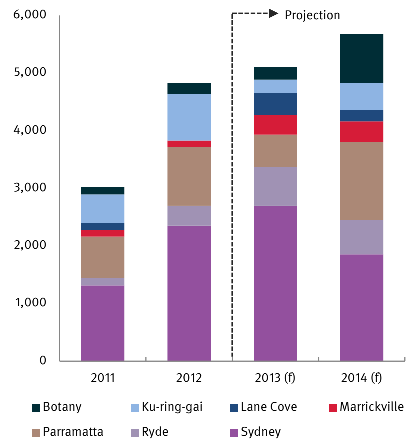


Source: ABS Cat 8371

Looking at specific apartment supply data for Sydney (sourced from Cordell Connect) indicates that apartment supply in 2012 is set to increase from 8,754 in 2011 to 10,520 apartments in 2012. These figures exclude apartment developments of less than 12 lots. There is potential for this supply to increase again in 2013 and 2014 with DA Approved projects sufficient to underpin a 13% increase in the per annum rate of new supply over the two years compared to the 2012 level. However with lending standards still remaining tight, off the plan sales in the order of 70% to 80% are generally required by the banks to de-risk projects and may constrain the rate at which DA Approved projects can progress.

Specifically, Sydney LGA is expected to provide a relatively large proportion of new supply, particularly in Zetland. However with current vacancy rates in the Sydney and Inner West LGA's estimated to be sub 2% and rental growth exceeding 5%, it is anticipated the area will appeal to investors. Investor attraction will also be enhanced by the large proportion of residents who rent in Sydney LGA (60% compared with only 30% for greater Sydney).

Figure 2
Sydney Apartment Supply – select LGAs
Number of estimated units*



* Forecast comprises DA Approved projects of minimum 12 units in size
Source: Knight Frank/Cordell Connect

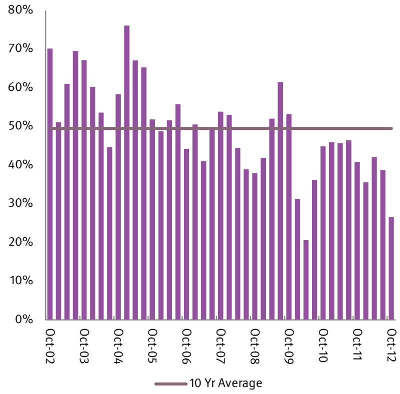
Buyer Demand

In line with the generally cautious mood amongst households, demand for new apartments has been steady, albeit with some inconsistencies between locations and product type. With buyers remaining price sensitive and continuing to focus on value for money, the price band between $450k and $850k continues to receive the bulk of active enquiry. At the lower end of this scale, first home buyers are particularly quick to absorb any sub $550k product, especially given the government initiatives targeting new apartments at the affordable end of the market. Specifically this has included increasing the grant for new dwellings to $15,000 in addition to transfer duty exemptions. The cost of buying compared to renting is also starting to favour the buying option for first time buyers given the improved affordability following the moderation in median dwelling prices, lower interest rates and higher rents.

Figure 3

Cost of Buying vs Renting

Cost premium of servicing loan on median Inner Sydney unit over renting (%)*



*Based on 80% LVR and adopting 3 year fixed interest rate and 25 year term

Source: Department of Housing/RBA/Knight Frank

Projects such as Ruby Tower in Zetland, where prices start from $460k, have been well received with Knight Frank taking 24 deposits in 10 days. Although larger units are generally taking longer to sell, demand has been solid for select developments with unique location characteristics. Pacific Bondi Beach was an example of a particularly well received prestige development, with all apartments except for some penthouses having now sold.

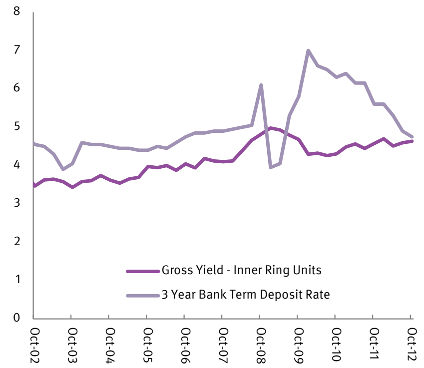
While the level of investor demand is yet to show a material response to lower interest rates, particularly following the expiry of the NSW Home Builders Bonus at the end of June 2012 that took some urgency out of the market, it is investors that continue to underpin the bulk of new apartment demand in Sydney. Agents currently report more than half of active enquiry is sourced from the investor segment of the market. However there is scope for this part of the market to become more active in the coming year. The differential between gross apartment yields and mortgage rates has materially closed over 2012 and will close further if the cash rate continues to decrease. In addition, the lower cash rate is reducing the appeal of cash as an investment class, which will increase the tendency for investors to start rotating out of cash. The growing awareness of people to use self managed super funds is also a growing source of demand from investors.

Local Asian buyers, particularly Chinese, are currently accounting for around 50% of demand. Asian investors continue to view Sydney as a safe haven that is well supported by a strong rental market. FIRB laws also mean that offshore Asian buyers in an investment capacity are excluded from the established market, therefore directing demand to new product. Asian investors have shown a strong tendency to focus on apartments with efficient access to shopping and rail facilities, with locations such as Ryde, Chatswood, Rhodes and Hurstville all proving popular. Although not serviced by rail, Zetland has also attracted strong offshore demand given its proximity to city amenities.

Figure 4

Residential Yield vs Bank Deposit Rate

Comparative yields (%)



Source: Knight Frank / RBA

Outlook

Although still somewhat inconsistent, new apartment demand continues to benefit from the growing acceptability of apartments as an alternative to houses, particularly as households embrace the cost benefit of apartments in popular locations. While the prospect of a recovery in the housing supply cycle may spread buyer demand over a larger number of projects, it is anticipated that this will be offset by improving demand in the year ahead. This is expected to stem from owner occupiers attracted to improving affordability metrics, local investors seeking to rotate cash holdings to higher risk/return alternatives and the continued demand from Asian buyers. The Hong Kong Government has recently placed a 15% buyers tax on off shore purchasers to assist in cooling the Hong Kong market. Consequently, Knight Frank expect a large increase in buyer activity in the Australian residential market going forward with buyers coming from China, Singapore, Malaysia, Indonesia and India.

Craig Moore
Joint Managing Director
NSW Project Marketing
+61 2 9036 6712
Craig.Moore@au.knightfrank.com

Andrew Drury
Joint Managing Director
NSW Project Marketing
+61 2 9036 6713
Andrew.Drury @au.knightfrank.com

Noel Lucas-Martinez
Joint Managing Director
NSW Project Marketing
+61 2 9036 6711
Noel.Lucas-Martinez@au.knightfrank.com

Knight Frank Research

www.knightfrank.com.au

Nick Hoskins
Associate Director, Research NSW
+61 2 9036 6766
Nick.Hoskins@au.knightfrank.com

Matt Whitby
National Director , Head of Research and Consultancy
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com