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Eight reasons to be **positive** about Brisbane's apartment market

Summary

1. **Queensland's economy is bouncing back** – the post mining boom downturn is over and the economy is gaining momentum
2. **Increased infrastructure spending** – will support growth and directly assist soak up apartment supply
3. **Population growth is increasing** – which will see strong underlying housing demand growth
4. **Brisbane apartments remain affordable** relative to other markets
5. **Apartment supply is slowing sharply** due to tighter developer lending conditions
6. **Quality stock is still preforming strongly** – there is a divergence in performance of poor and high quality projects
7. **There is a structural change to higher density living** happening across Australia and Western economies
8. **The broader housing market across Brisbane is not oversupplied** so demand will transition from other parts of the market to apartments

Introduction

Brisbane's apartment market has experienced more challenging market conditions over the past 12-months as the market absorbs recent supply additions and tighter credit conditions take effect across the country. Nevertheless, we believe that the worst has already passed and that there are many reasons to be positive about the market over the short-medium term, particularly for quality, well designed and located stock. So below is our justification for being optimistic about the market outlook:

1. Queensland's economy is bouncing back and will be strong over the next few years

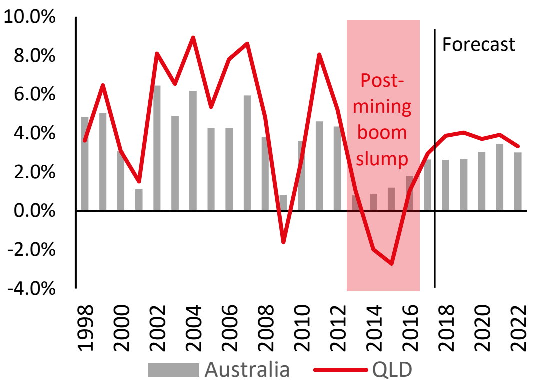
There is no doubt that Queensland has experienced one of its more challenging economic periods since the mining investment boom ended around 2013. The fall in mining investment had a direct negative impact on growth, but also had an indirect impact via the outflow of workers that had been drawn into the state from across the country and overseas during the boom. This all came at time when budgetary pressure meant the Queensland Government could not support growth through investment in infrastructure, creating a period of weak jobs growth and retail spending.

The good news is that the post-boom slump is over. Queensland has already bounced back and is likely to record growth of around 3.0% over 2017 in state final demand (SFD), a measure of the domestic economy. Deloitte Access Economics are forecasting a strong period of growth over the next five years, with Queensland's economy expected to grow at an average of 3.8% per annum. This is the strongest growth of all states and compares to the forecast national average growth of around 3.0% per annum over this period (See Figure 1).

A positive aspect of Queensland's growth moving forward is that it is expected to be very broad-based. Improved business and public sector investment is expected to contribute to growth, along with robust consumer spending and a strong contribution from exports.

Confidence is even returning to the resource sector and around $20 Billion of new projects across a wide range of commodities have emerged. We do not expect a boom like the last one, nor is that a desirable result, but the sector should return to being a boost rather than a drag on growth.

Figure 1: Economic Growth (State Final Demand)



Source: Deloitte Access Economics, JLL Research

2. **Increased infrastructure spending and other major investment in the city will support the economic recovery, boost the attractiveness of Brisbane and directly assist soak up surplus apartment stock**

Queensland's state debt levels have dented infrastructure investment over recent years. Nevertheless, improved state revenues from export royalties and property taxes, plus a less aggressive political focus on reducing debt levels quickly, have seen the infrastructure pipeline grow significantly. The recent state election has also cleared the way for several projects to get underway, including the long awaited $5.4 Billion Cross River Rail project.

Other significant projects for Brisbane include the $3.0 Billion redevelopment of the Queen's Wharf precinct to include an integrated resort and casino, which is under construction and due for completion in 2022. The second runway at the Brisbane Airport is also under construction and will be delivered in 2020. This project will give the Brisbane Airport the same capacity as the Singapore Airport, essentially future-proofing this infrastructure to encourage more visitors through Queensland.

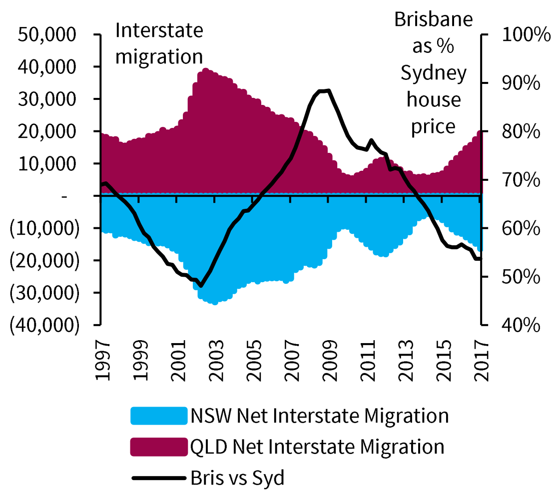
Other major infrastructure projects proposed or underway for South-East Queensland include Brisbane Metro, Herston Quarter health precinct, Brisbane Live entertainment precinct, Brisbane's Eagle Street Pier Precinct and Howard Smith Wharves. The pipeline for major infrastructure spending is worth almost $20 Billion. This investment will underpin job growth in South-East Queensland in both white collar and construction industries.

In addition, it is likely that some labour will be imported from interstate or overseas for the construction of some of these projects and this will have directly assist soak up recent inner-city apartment supply. For example, Queen's Wharf alone will require a construction workforce of around 8,000 workers and the long-tenure of the project is already luring contractors from other regions to seek opportunities on the project.

3. **Population growth is already picking up and will pick up further, driven by stronger economic momentum and *relative* housing affordability**

Population growth to Queensland has historically outperformed the national average. Over the past 35-years, Queensland's population has grown by 2.0% per annum, compared to 1.4% per annum nationally. However, growth slowed from around 2013 onwards as the mining boom ended and skilled labour began to leave. Annual population growth reached a trough of 1.3% in 2015, but has steadily recovered since to be 1.7% per annum at last measure in September 2017.

Figure 2: Net Interstate Migration & House Prices

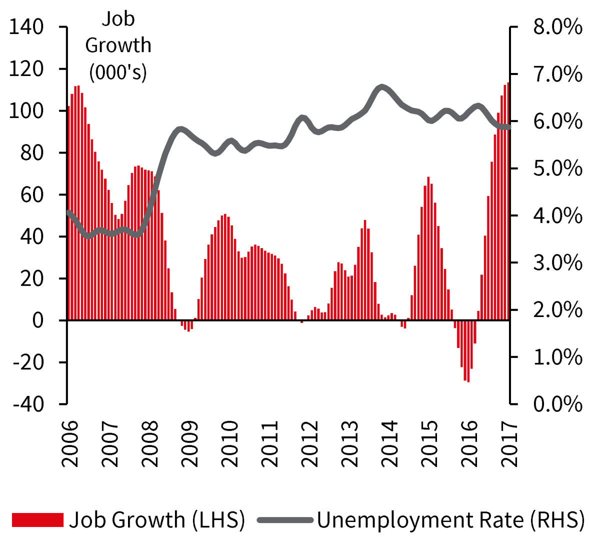


Source: ABS, Corelogic, JLL Research

One of the key drivers of this rebound is the affordability factor that Brisbane offers compared to the southern capitals, particularly Sydney. The median house price in Brisbane is currently 55% of the median in Sydney, which is driving migration to Queensland. A similar increase in interstate migration occurred in the early 2000's when the Brisbane houses were half the price of Sydney's (Figure 2). The latest ABS figures indicate that approximately 5,300 people migrated from other Australian states in 3Q17. If this increase in population from other states continues, almost 21,000 people will move interstate to Queensland in 2018.

The improved economy and job market is also likely driving an increase in both interstate and overseas migration to Queensland. Total employment in Queensland rose 4.7% over the 12-months to January 2018. The strong performance of the labour market is expected to underpin population growth in the state and subsequent increase in demand of the economy and residential sector.

Figure 3: Net Interstate Migration & House Prices



Source: ABS, JLL Research

4. Apartment prices are affordable relative to other markets – this limits any downside pricing risk and will also continue to attract both owner occupiers and investors

Brisbane missed the residential price boom that Sydney and Melbourne have enjoyed over the last 5-years. Apartment prices in Sydney have grown by around 50% over this period and Melbourne by just over 20%. In comparison, Brisbane apartment prices are only around 9% above the level of five years ago (CoreLogic). On a rate per square metre basis, investors can still acquire quality apartments in prime locations in and around the CBD for around $8,000 to $11,000 per sqm, while investors in Sydney are paying around twice that rate to acquire in secondary locations 15-20km from the Sydney CBD.

Although investors would have like this kind of capital growth over the period, the lower prices in Brisbane now help underpin our view optimistic view of the market by making pricing attractive to both investors and owner occupiers. While investor lending is currently constrained, investors (domestic and offshore) will be attracted by the lower entry prices, higher yields and potentially higher long-term capital growth prospects of Brisbane relative to Sydney and Melbourne. For owner occupiers, the attractive pricing re-enforces the case for stronger population growth set out above. For investors, although the average yield in Brisbane is approximately 4.80%, yields as high at 5.50% have been recorded for well-designed and located apartments. This compares to an average of 3.80% in Sydney and 3.96% in Melbourne, which makes it easier for Brisbane investors to cover the cost of their loan.

It is also likely that this attractiveness in pricing relative to Sydney and Melbourne will put a floor under pricing (which we appear to have reached, with strong evidence that existing apartment prices have stabilised over recent months). This means there is limited downside pricing risk for buyers in Brisbane than those entering the Sydney and Melbourne market after stronger run-ups in pricing.

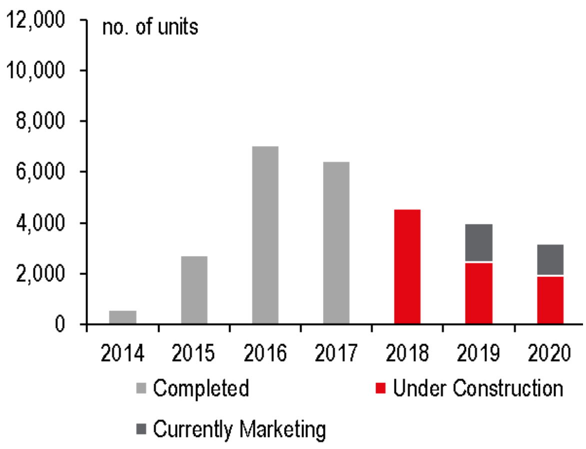
5. Apartment supply is slowing sharply due to tight developer lending conditions

A lot has been written about recent Inner Brisbane apartment supply levels, but the fact is that the supply pipeline has already peaked and construction is already falling and will fall sharply over the next few years. This slowing is directly the result of the regulatory actions taken by APRA to slow the housing market nationally. In addition, major banks and other lenders have responded to regulation by tightening lending criteria for developers, including requiring higher levels of pre-sales.

The combined impact of slower investor sales rates and higher pre-sales hurdles has been that very few projects have progressed from planning and marketing stages into construction over the past

12-months. Consequently, supply peaked in 2016 at just over 7,000 apartments and fell around 9% in 2017. Construction will fall by around 30% to around 4,500 apartments in 2018 and we expect a similar decline in 2019 with the flow of projects moving into construction remaining at a near stand-still at present (Figure 3). This self-regulation in the supply pipeline will help the market move quickly back into balance, or even into under-supply, over the next few years.

Figure 4: Inner Brisbane apartment supply



Source: JLL Research

6. **Quality stock is still performing strongly – there is significant discrepancies between the performance of quality product and lower-quality stock**

Those buyers that thoroughly do their research on the market, sub-locations and on developers can rest assured that quality well-located stock is still performing strongly in the current market in spite of the recent headwinds the market has faced.

It is important to recognise that a significant portion of the recent apartment construction boom has been secondary-located and lower quality stock aimed specifically at meeting a low-price point investor market. This is typically one and smaller two-bedroom configurations and have lower quality finishes to keep prices low. At the peak of the supply cycle this investor product was selling fast, but not now that APRA have clamped down.

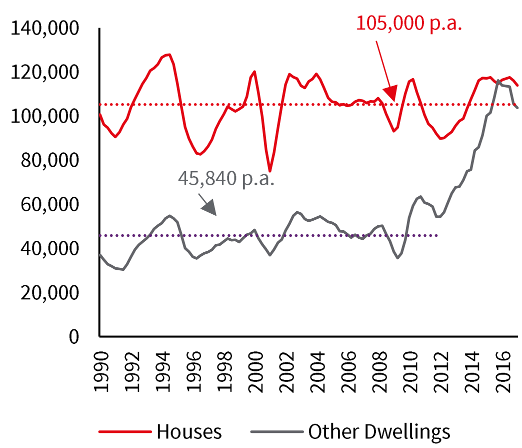
Our analysis of re-sales of apartment completed over the past three years clearly illustrates that it is this lower-end stock that has borne the brunt of the market slowdown. Nevertheless, around 64% of apartments re-sold in 2017 were sold above their initial purchase price and some quality projects achieved quite strong uplift of over 20%. Also, it was clear that larger apartments in prime areas and with quality amenity, performed much stronger than smaller apartments and the evidence strongly supported the proposition that the discrepancy between performance of low and high quality stock is significant.

7. **There is a structural change to higher-density living that is happening across Australia and most Western economies and it is here to stay**

Historically in Australia there has been 2.3 detached houses built for every attached dwelling (apartment and townhouse) built. However, that changed dramatically in the current cycle and in 2016 the number of apartments built annually surpassed the number of detached dwellings (Figure 4).

While part of this trend was cyclical, a large part of it was also undoubtedly a structural shift to higher density living. This structural trend is also far from just a local trend and a similar pattern has emerged across most developed economies. Large cities have become dominate economic drivers and where people want to live. This combined with affordability pressures and changing attitudes among younger generations that are rejecting the proposition of living on the urban fringe like their parents, has led to acceleration of these densification trends.

Figure 5: Building commencements by type of dwelling



Source: ABS, JLL Research

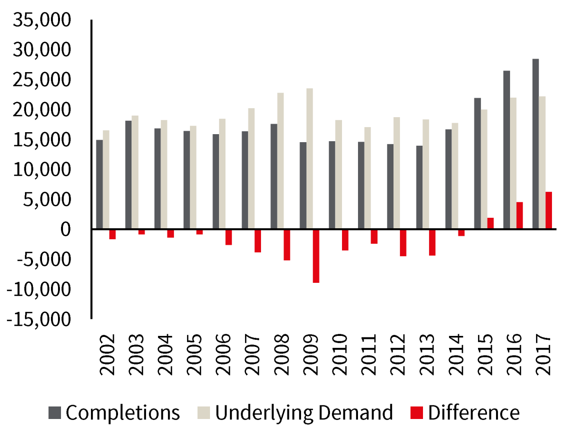
For Brisbane, this trend is starting from a low base. At the 2016 Census, just 12.6% of occupied dwellings in Greater Brisbane were apartments, which compares to 28.1% of Greater Sydney dwellings. As such, the recent level of apartment construction did add significant stock in a relatively short period. Longer-term, the structural shift to greater density supports this greater level of apartment development.

8. The broader housing market across Brisbane is not over-supplied, so demand will steadily transition from other parts of the market to the apartment market

With reference to the previous point regarding the shift of demand from other housing product to apartments, it makes sense to look across the broader Greater Brisbane housing market to see what overall dwelling supply looks like relative to demand. Our assessment of this equation, is that the overall market (including houses, townhouses and apartments is not over-supplied).

In Figure 5, we have shown total dwelling completions across greater Brisbane relative to our estimate of underlying demand (based on a household formation rate of 2.5 people per dwelling and making provisions for replacement of stock and vacant dwellings). It shows that supply probably has slightly exceeded underlying demand for the past three years, but in total this over-provision only amounts to about eight months' demand and it also follows an extended period of under provision.

Figure 6: Greater Brisbane Housing Market Balance*



Source: ABS, JLL Research

* Assumes household formation rate of 2.5 persons per dwelling and allows for demolition and vacant properties

As a result, it is our opinion that the overall market is not grossly out of balance. Further, with underlying demand likely to pick up over the next few years with greater population growth and with supply continuing to fall swiftly, conditions will quickly move back to an under-supply of dwellings.

Conclusion

The headwinds that the Brisbane apartment market has faced are very quickly fading. There is a strong local macroeconomic story and an improving Queensland economy and regional population growth will drive stronger underlying demand growth. At the same time, supply levels are falling, particularly apartment construction levels. As such, we expect Brisbane to move quite quickly over the next few years into a position of under-supply. As such, we believe that the outlook for apartments is positive, and particularly well-located and higher-quality product with usable and differentiated amenity.

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