Brisbane CBD & Fringe Apartment Market – What Has Changed Over the Past 3 Years
Chesterton Corporate Property Advisors
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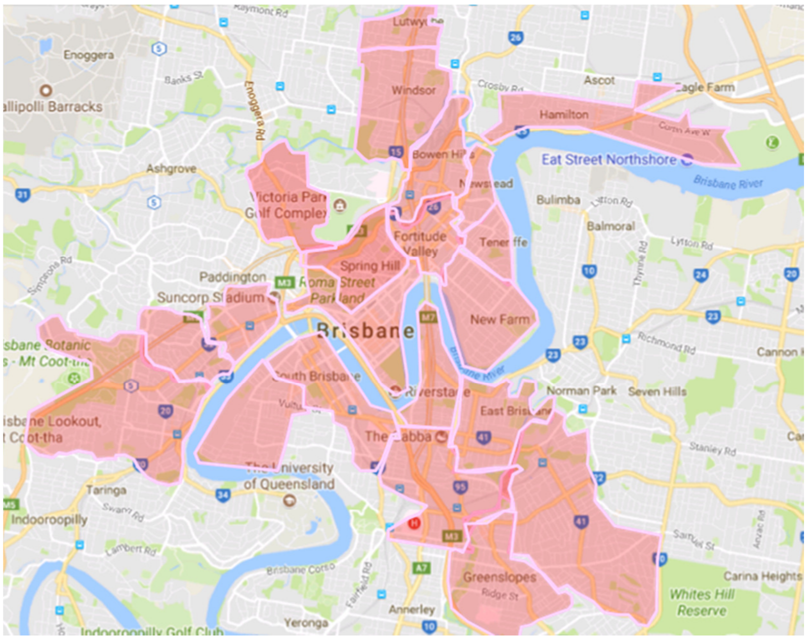
Summary of Conclusions

Research of the Brisbane CBD and Fringe Apartment Market has concluded that at present, the prudent person would not contemplate acquiring a vacant parcel of land for residential development in the Brisbane CBD or fringe areas. Whilst sites are still being acquired by prudent parties for redevelopment in the medium to long term, those properties have considerable existing improvements to provide holding income until the market is again ripe for redevelopment.

The extent of the stock in the pipeline is so great it is sufficient to satisfy both the current and next development cycle. The CCPA research incorporates 21 suburbs in the Brisbane CBD and fringe areas.



CCPA research concludes:

- There is supply for about 20 years if prevailing absorption rates are maintained.
- High Level changes to the market may have an impact on the absorption rate. Having a dampening affect on the market are changes in:
  - Australia Prudential Regulation Authority (APRA) policy on the banking industry;
  - Federal Taxation;
  - State Taxation; and
  - Foreign Policy.
- There is significantly less funding available both to the developer and the end purchasers.
- The market is continuing to self-regulate and returning to a more sustainable level of activity following the sharp and eventually unsustainable increase in supply in the years following the Global Financial Crisis.
- Heightened construction costs will continue to reduce the feasibility of high-density projects in the short term.
- Lenders have begun to blacklist certain CBD and fringe suburbs in the form of reduced loan-to-value ratios and increased loan margins amid fears of over-supply.

APRA Changes

Emerging pressures in the housing and residential development market have led to APRA intervening within the banking industry, introducing tighter lending regulations, which has subsequently resulted in banks reining in lending and in turn reducing demand for development sites.

In 2016, APRA introduced restrictions that have impacted lending for investment purposes. The banks have responded to APRA changes by changing serviceability requirements on investor loans, thus making it more difficult for investors to gain finance. Borrowing capacity has been downsized, interest rates have risen and the repayments on existing debt are assessed at a much higher rate.

APRA outlined steps to reduce residential mortgage lending risks in the form of paying closer attention to particular areas of concern including:

- Higher risk mortgage lending (high loan-to-valuation ratios, interest only loans);
- Portfolio growth to property investors below 10%;
- Loan affordability tests to new borrowers; and
- Increasing capital adequacy requirements for residential mortgage exposures by authorised deposit-taking institutions (ADIs).

More recently in March 2017 APRA stated that further to their earlier intervention in the banking industry aimed at reducing residential mortgage lending risks, there were still further risks that needed to be addressed. The impetus behind the imposition of these greater restrictions is on slowing down the overheating residential apartment market in cities such as Brisbane, where supply is far outweighing demand and increasing lender risk.

Historically, the liberal approach to lending has bolstered Australia's residential market growth and arguably been a significant contributor to soaring housing prices in cities such as Sydney. APRA's recent attempts therefore aim to quell the threat of the growing residential bubble and make it tougher for developers and investors to freely introduce new stock into the market. This has in turn reduced the demand for development sites in Brisbane and created a significant disparity in the number of apartments approved for development and the number currently under construction.

In 2017 APRA introduced supervisory measures requiring ADIs to:

- Limit the flow of new interest-only lending to 30% of new residential mortgage lending, and within that:
  - Place strict internal limits on the volume of interest-only lending at loan-to-valuation ratios (LVRs) above 80%; and
  - Ensure there is strong scrutiny and justification of any instances of interest-only lending at an LVR above 90%;
- Manage lending to investors in such a manner so as to comfortably remain below the previously advised benchmark of 10%;
- Review and ensure that serviceability metrics, including interest rate and net income buffers, are set at appropriate levels for current conditions; and
- Continue to restrain lending growth in higher risk segments of the portfolio (e.g. high loan-to-income loans, high LVR loans and loans for very long terms).

Federal and State Taxes

New federal and state taxes on foreign buyers under the 2017/18 Federal Budget have created negative sentiment and significantly reduced the number of property investors. More specifically, the Budget will:

- Remove the capital gains tax exemption for the main residence of foreign investors;
- Restrict foreign owners in new developments to 50%; and
- Introduce a minimum annual charge of $5,000 on foreign owners of residential property, where the property is not occupied or available for rent for at least six months per year.

The Federal Budget has also provisioned APRA with $2.6 million worth of funding to allow the regulator to exercise new powers over the provision of credit by lenders that are outside the traditional banking sector.

The Queensland state budget introduced:

- An additional 3% transfer duty surcharge on foreign buyers of Queensland residential property, effective 1 October 2016; and
- An additional 1.5% absentee land tax surcharge on foreign buyers of Queensland residential property, effective 30 June 2017.

Foreign Policy

Capital outflow controls implemented by the Chinese government have also added to the slowdown of the residential market. In January 2017 the Chinese government announced that the annual USD $50,000 cap on foreign currency exchange would remain in place, in addition to introducing:

- A mandatory signed pledge stating that the foreign currency will not be invested in overseas property;
- A disclosure statement detailing the type and timing of the use of funds; and
- Stricter penalties for those that violate the controls.

Impact of the Changes

The effects of the additional macro prudential measures implemented by APRA can be further seen in the slowing of sales in the Brisbane inner-city apartment market. JLL research has indicated that sales volumes of units have reduced by 29.9% over the year to the 3rd quarter 2016. Stating that:

> "The Stricter lending criteria for investor loans for both foreign and domestic buyers has been a major contributor to the slowdown in sales rates" (JLL Residential Commentary Brisbane Apartment Market January 2017).

Residential developers are facing the full force of these further restrictions as credit lenders are urged to exercise greater levels of caution in the current economic climate. A number of non-traditional sources of capital such as private equity groups and opportunistic funds have emerged as an alternative source of funding. However these lenders make up a small proportion of total lending, and are generally either unable or risk averse to funding large high-density projects.

Among the current concerns for APRA is this use of mezzanine, debt and quasi equity from third parties, which in turn reduces the amount of bank capital needed from developers for a project. Such funds, in conjunction with a reliance on increases in land valuations essentially reduce the hard equity needed to proceed with a residential development.

Impact of the Changes (Cont'd)

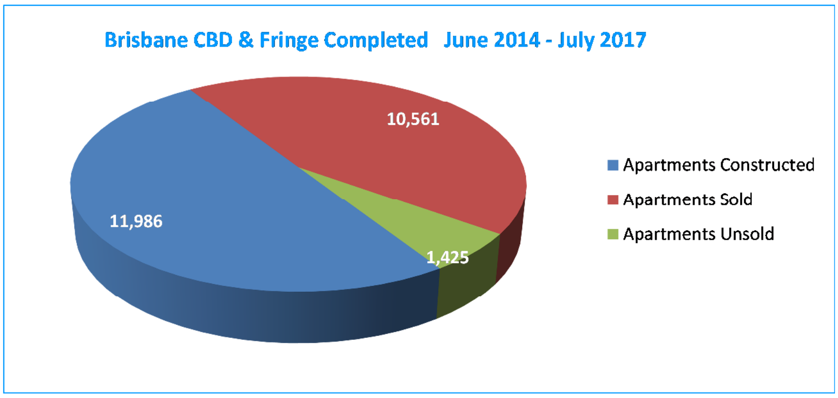
APRA further noted that banks now generally require the amount of presales in a project to be equivalent to at least 100% of debt. The increasing volume of apartment construction in Brisbane which is exceeding demand and resulting in a slower uptake of stock is making this a difficult requirement to satisfy for many residential developers.

It is therefore the culmination of government policy concerns and action through increasing restrictions on foreign investment, in conjunction with the role of APRA in aggressively tightening lending requirements that is resulting in a significant decline in demand for residential development sites in Brisbane. Attaining development finance continues to be the biggest hurdle for developers and traditional lending institutions remain largely averse to lending for high-density residential projects.

Historic Absorption 1 July 2014 to 30 June 2017

The Supply and Demand statistics reflect the Brisbane Development Mapping.

- 11,986 apartments in 120 projects were completed;
- Of these 10,561 have been sold with 1,425 remaining unsold;
- The annual consumption is therefore 3,520 apartments over the past 3 years; and
- 8% of the projects completed had more than the APRA imposed threshold of 50% of foreign purchasers. In total of the 10,561 units sold approximately 27% were to foreign purchasers.



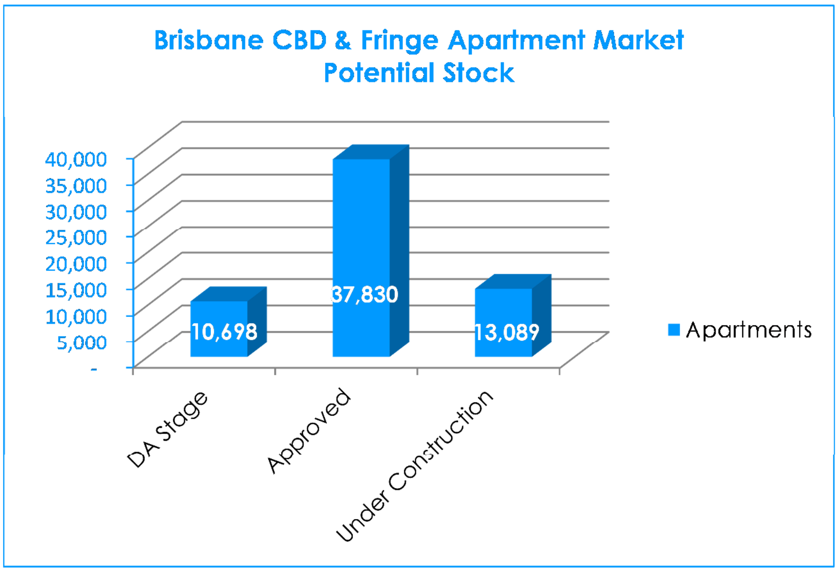
Source: CCPA Research

Upcoming Supply

- There are 13,089 apartments currently under construction.
- JLL research identifies 76% of presales in a similar but geographically smaller study area with projects due to be complete by 4Q19.
- Extrapolating the percentage to the CCPA study area approximately 9,948 units have presold in developments to be completed over the next few years.
- There are 61,617 units in the pipeline including:
  - 10,698 where a Development Application has been lodged but are not yet approved; and
  - 37,830 are approved but construction has not yet commenced.
- Adding the currently unsold completed apartments and those under construction, but unsold, the increase in available stock will be approximately 4,566 apartments when these developments are completed.

Upcoming Supply (Cont'd)

- Whilst there are presales of a number of projects, many of these projects are being abandoned/deferred by the developer before the construction phase.
- A majority of projects currently in the development approved or application stages are therefore unlikely to proceed further this cycle.



Source: CCPA Research

Suburb by Suburb Analysis

	DA Stage	Approved	Under Construction
Brisbane CBD	2,784	9,130	2,090
Spring Hill	1,282	502	0
Fortitude Valley	219	6,301	1,000
Bowen Hills	-	1,461	-
Windsor	-	558	87
Lutwyche	245	356	95
Hamilton	-	2,234	503
Newstead	616	1,556	2,267
Teneriffe	164	570	73
New Farm	88	84	14
Kangaroo Point	605	1,610	534
East Brisbane	518	31	127
Woolloongabba	1,034	5,469	758
Greenslopes	154	677	74
Coorparoo	109	154	384
South Brisbane	346	2,719	2,522
West End	1,372	2,553	2,127
Kelvin Grove	20	-	-
Milton & Auchenflower	612	1,005	-
Toowong	530	860	434
Total	**10,698**	**37,830**	**13,089**

Source: CCPA Research