Australian Gold Fund Economic Commentary

Sydney Property Prices Decline – Longer, Deeper and More to Come… We Just Used the Wrong Figures

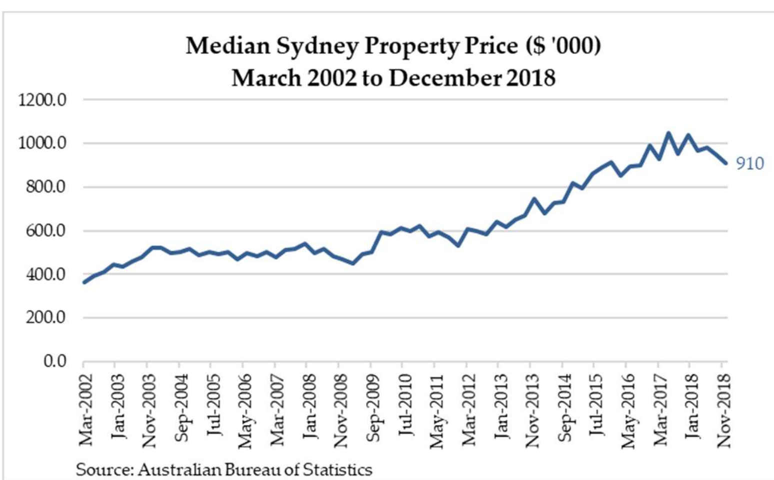
8th May 2019

Key Points

- Government, media and general public are being told regularly over the last year of falling property prices in Sydney and Melbourne, when prior to that the consensus was on rosy price forecasts. However, this change of narrative came too late because they have been dropping well before mid-2018.
- The use of aggregate property statistics caused smoothing of price movements. When price data is split by number of bedrooms, the price movement shows a bleaker picture.
- Hot suburbs such as Chatswood and Hurstville, previously driven by high demand from foreign Chinese buyers, are now witnessing substantial price drops. The trend shows that the drops began since as early as 2016.
- Those holding property who are anxious about their financial position should seek independent financial advice regarding how to finance their loans or to sell before it declines further.

Property Prices Decline Recognised… Albeit Too Late

After many years of hearing that property prices in Australia – Sydney and Melbourne in particular, are on the up, up and up, the narrative has changed abruptly since the middle of last year as industry experts and the media have begun to talk about how prices will be stagnant and will begin to drop. The price figures published from sources like CoreLogic, Domain and RealEstate.com.au have shown a turnaround in the increasing trend, although the levels are hardly raising an alarm. Below is the official price statistics of the median property price in Sydney according to the Australian Bureau of Statistics as at March 2019:



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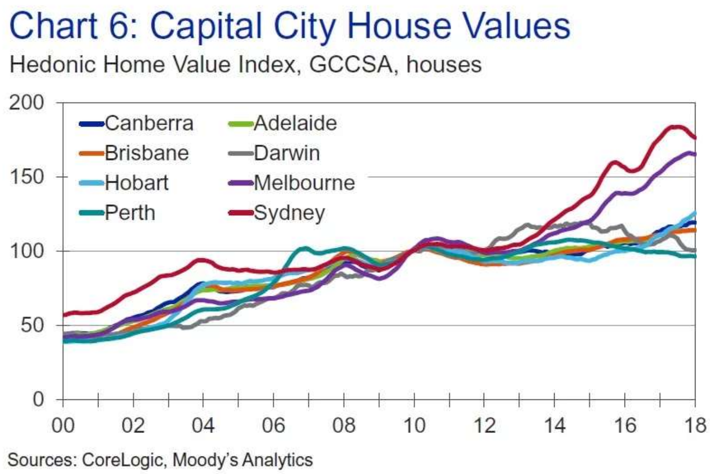
Currently, the median price in Sydney is $910 000, having peaked at around $1.05m in mid to late-2017. Using these levels, the decline of Sydney property price from its peak is 13.3%. This decline is over 18 months or so and may not translate to something requiring urgent attention. The CoreLogic data showing price indices shown below also echoes similarly a not-so-negative trend:

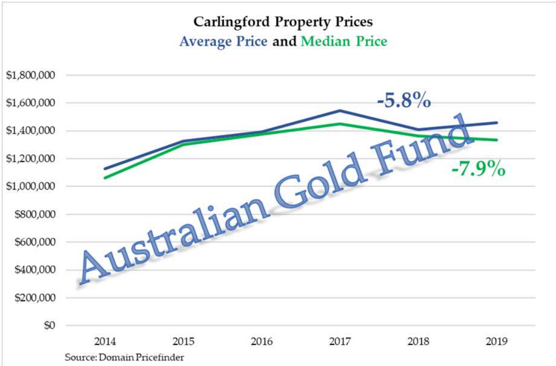


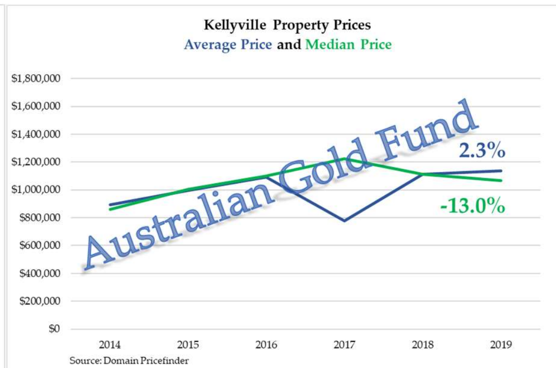
However, if one looks at the individual sellers and also the increase in the number of "For Sale" signs in frontyards, the story may be quite different. In fact, many people may claim that they have heard of a handful of stories of family, friends and acquaintances who have recently sold a property after a long wait, sometimes at steeper discounts that they claim they could have avoided if they had taken an earlier offer.

The disconnect between the official statistics and anecdotal evidence is wide. Usually, people conclude that official statistics are more trustworthy as they collect a larger pool of data and are analysed by experts. This fallacy of logic and misplaced trust come from a lack of understanding of how official statistics are measured and certain fundamental statistical principles are violated.

Aggregate Statistics Smooth Trends and Hide Vital Market Conditions

The median property price data being broadcasted to the public and used by government, corporations and experts considers the aggregate data, either including all sold properties or divided by houses and units by suburbs. This approach gives a smoothed average. Each month, a variety of houses and units are sold – the larger properties sell for a much higher price with studios and one-bedroom apartments being sold for a much lower price. The monthly price data can be distorted and/or vary widely depending on the mix of properties sold. To illustrate, consider the average and median prices over 2014-2019 for Carlingford, Chatswood, Hurstville, Kellyville, Leichhardt and Sutherland – suburbs that are in different parts of Sydney. The following figures show the price level declines from the peak to now over this time period:



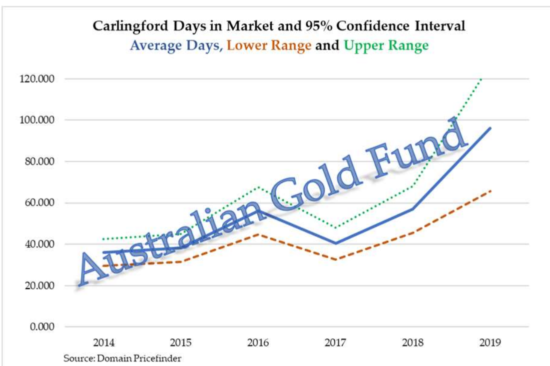


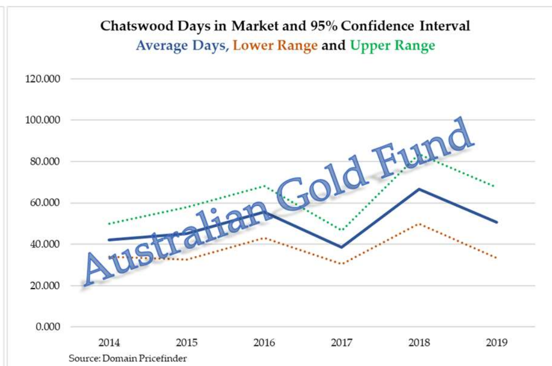
The median price declines for Chatswood, Hurstville and Leichhardt are substantial, although though this still does not show a more alarming trend in the underlying property prices, which is covered in the next section. The median price is subject to more volatility since the median is the 50th percentile of the properties ranked by price. Concentration of sales in the higher or lower ends of the market will move the median. On the other hand, the average price declines are usually more subdued because sales of properties in the top end of the suburb can do much to keep the average from deviating significantly.

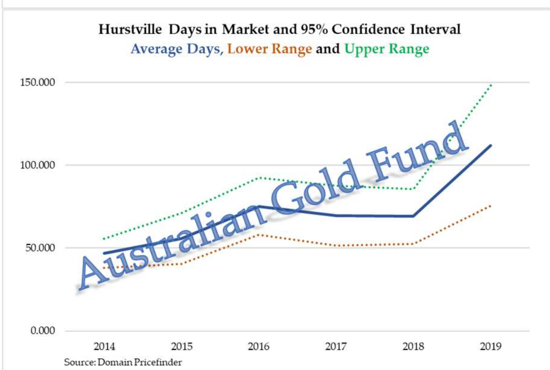
Extending from the above point, sales in the property market are not uniform over different stages of the market. In a normal market, the sales may cover a diverse range of properties as there is healthy demand. However, as the market demand slows down, the more desirable properties may be sold first as they are better quality. More desirable properties may be those that sell at a higher price, since the buyers are willing to pay a high price for it and the sellers are satisfied with the offer. Those of lower quality or owned by sellers who are holding out for higher prices may have to wait longer before they are able to sell. As the market slows down further, these sellers may be more financially constrained and they may be taking any price offered to them, even at a deep discount to what they had initially refused.

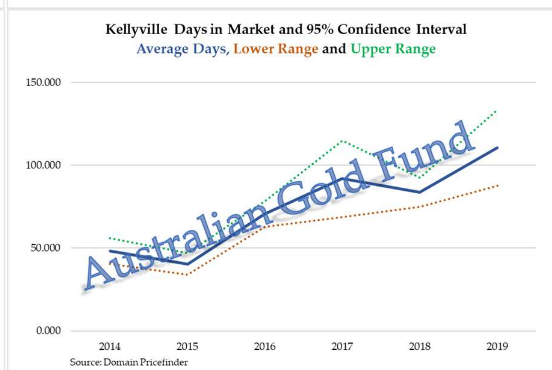
The trend in the market becomes what is popularly known as a "two-speed market" – a more buoyant higher quality property market and the stagnant lower quality market. However, the price data aggregates the two. The result is an apparently smoothed out price trend, but it hides a more unstable market underneath.

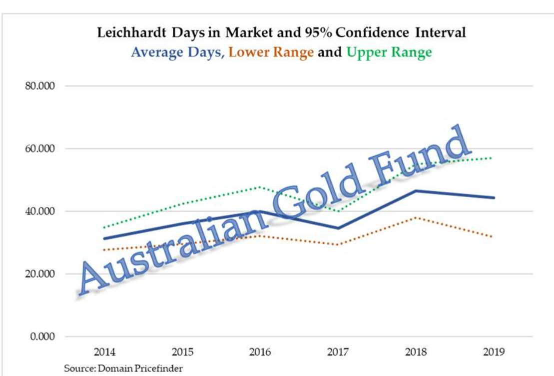
However, what cannot be hidden from the price data is the longer wait that sellers face before they are able to find a buyer to make an offer they cannot refuse. While sales volumes have declined in an accelerating pace in 2018, the time between listing the property for sale and an offer is accepted has accelerated at a more alarming rate. The figures below show the number of days that properties in selected suburbs in Sydney spent on the market between 2014-2019:

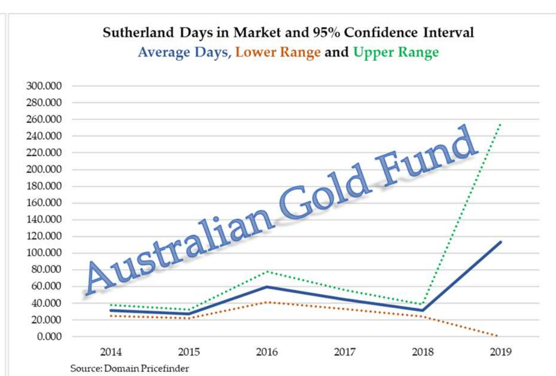












What can be seen in the above figures is that properties have faced a sudden cliff in demand, with many suburbs where sellers are now waiting on average for double the time than those who managed to sell their properties in the previous four years. Even after considering the fact that the data is based on the first 4 months, and hence there is substantial margin of error, the sales volume is so low in some of these suburbs that may suggest that the market could turn for the worse as the year unfolds. In fact, even these figures do not disclose the sellers who have waited for over six months to find an offer they are willing to accept. Some properties are actually now still pending an offer, having waited for as much as a year. These properties may not have a sign in their front yard anymore, but may be advertised sporadically with the real estate agent. This is to avoid giving prospective buyers the impression that it is on the shelf for too long.

Given that aggregate data does not reflect the state of the property market, alternatives are worth considering. One obvious approach to evaluating the property markets is to stratify the properties in each suburb by the number of bedrooms. While this is not a perfect approach, there is general acceptance that a house with more bedrooms should be larger and more likely to fetch a higher price, all other factors equal (which one should acknowledge is also not a robust assumption!)

So, how do price trends look in the selected suburbs after subdividing the data to consider the number of bedrooms?

Key Sydney Suburbs Have Fallen… Longer and Deeper Than Thought

The analysis considers the number of bedrooms in houses sold in the six selected suburbs. Not all properties have their vital statistics recorded, so the data is more sparse and subject to error. Nonetheless, the price trends tell a grim tale that cannot be ignored – prices of houses in Sydney may well have fallen for longer and more deeply than we are led to believe.

Below are figures showing some of the price declines from the peak levels across the different suburbs. Taking into account the data variability, the focus is on categories for which there are adequate sales volume for 2019:

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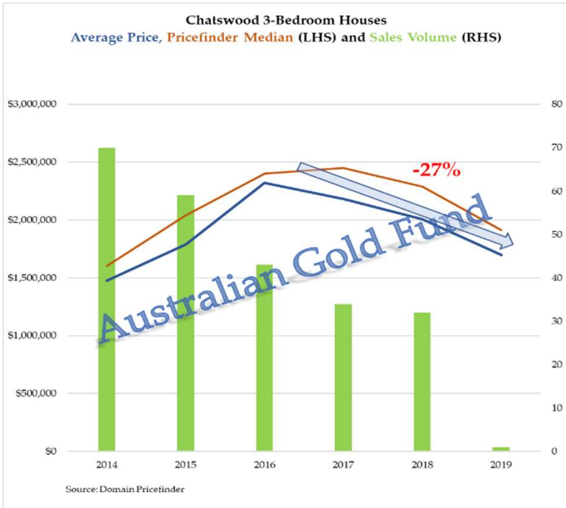
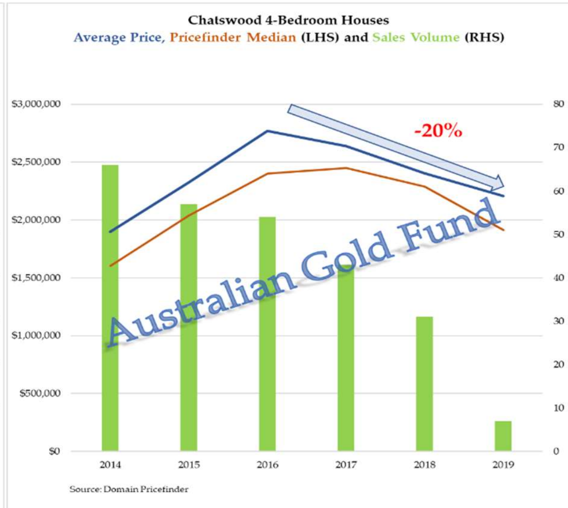
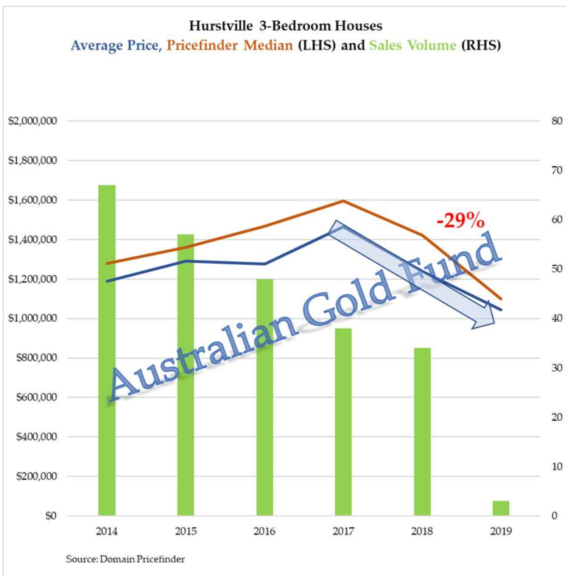
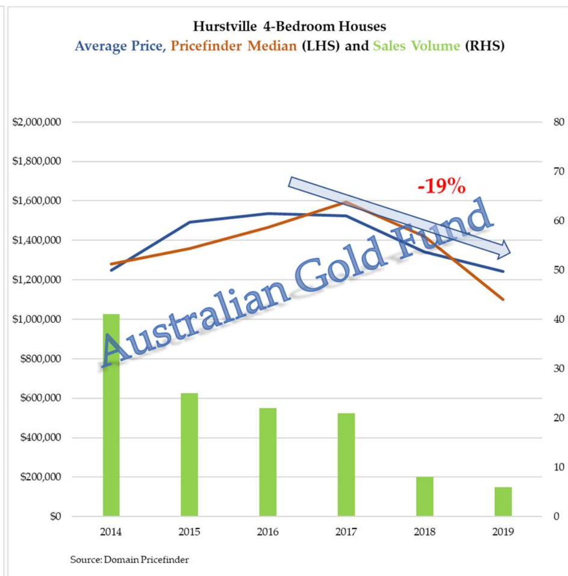
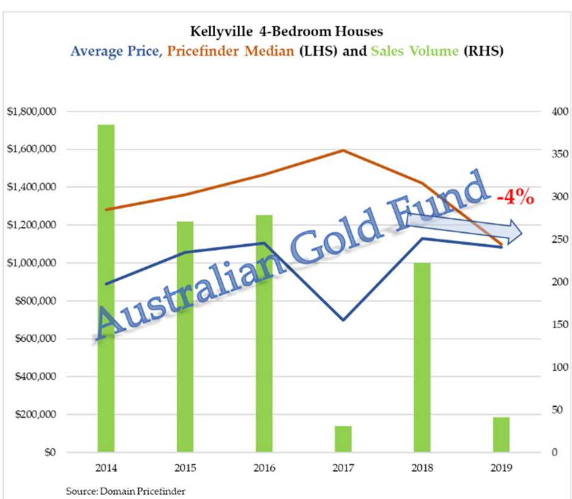
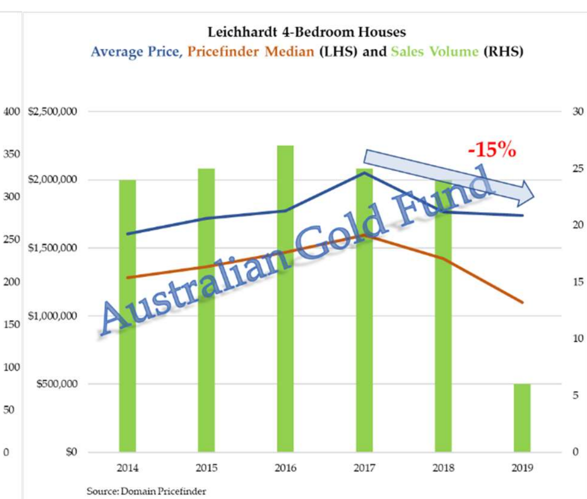

Chatswood 3-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
80
70
60
50
40
30
20
10
0
2014
2015
2016
2017
2018
2019
-27%
Australian Gold Fund
Source: Domain Pricefinder

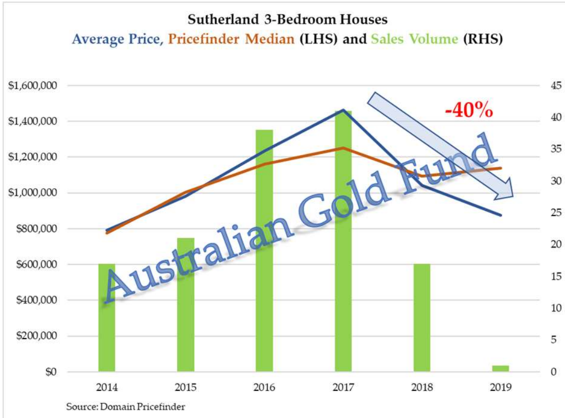

Chatswood 4-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
80
70
60
50
40
30
20
10
0
2014
2015
2016
2017
2018
2019
-20%
Australian Gold Fund
Source: Domain Pricefinder


Hurstville 3-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$2,000,000
$1,800,000
$1,600,000
$1,400,000
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$0
80
70
60
50
40
30
20
10
0
2014
2015
2016
2017
2018
2019
-29%
Australian Gold Fund
Source: Domain Pricefinder


Hurstville 4-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$2,000,000
$1,800,000
$1,600,000
$1,400,000
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$0
80
70
60
50
40
30
20
10
0
2014
2015
2016
2017
2018
2019
-19%
Australian Gold Fund
Source: Domain Pricefinder


Kellyville 4-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$1,800,000
$1,600,000
$1,400,000
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$0
400
350
300
250
200
150
100
50
0
2014
2015
2016
2017
2018
2019
-4%
Australian Gold Fund
Source: Domain Pricefinder


Leichhardt 4-Bedroom Houses
Average Price, Pricefinder Median (LHS) and Sales Volume (RHS)
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
30
25
20
15
10
5
0
2014
2015
2016
2017
2018
2019
-15%
Australian Gold Fund
Source: Domain Pricefinder



With the exception of Kellyville, which is a suburb with growing demand as many middle-income young families have purchased properties as they move further away from the CBD, the price declines observed are substantial. In Carlingford, Hurstville and Sutherland, prices began declining in 2017 and accelerated, resulting in drops of 20% or more. Of substantial interest is Chatswood, once a darling suburb and still widely touted as a growth area for investors, the truth may be far from expectations. Prices peaked in 2016 and since then, houses have been selling at increasingly steeper discounts. While the suburb still remains largely out of reach of even upper-middle class households since average prices are still above $1.5m for three-bedroom houses, the declines have been steady. This may change in the coming months as demand continues to slow and more sellers become anxious for a transaction, even at a lower price to what they hope for now.

The sparseness of the data aside, when suburb sales are divided into number of bedrooms, this gives a better reflection of the state of the property market. What is seen is not only unflattering, but downright startling in some cases. However, the question is "do we conceal the reality because we may not like what we see?"

Perhaps one may want to catch a sobering breath as the reality of our property market is allowed to sink in. And, if you are a homeowner or investor, the question at the tip of your tongue may be "what should I do now in light of this?"

Hold On or Cut Losses?

In a declining market, there is a well-known statement of "return OF capital, not return ON capital". One may do well to consider this statement and see how it applies to you. Rather than providing answers in this article, here are some questions for you to consider with your family as well as your financial advisor:

1. **Is the quest to secure your property causing you to stay awake at night as you struggle to work out how to make ends meet?** Many households are tied down by a substantial loan with hefty periodic repayments that are made, all the while causing additional stress on top of one's family life, work commitments and the ups and downs of life.
2. **Are you equipped to weather the storm if it gets worse?** Investments are supposed to yield returns but comes with risk that it will amount to losses in an unfavourable market.

If your lender raises interest rates or you lose your job or there are unforeseen bills to pay, do you have enough without sinking further into debt? Do not leave things to chance as complacency can lead to despair when you least expect it.

3. **Do you want cash in the bank or a story to tell of how you let a big one get away?** Funnily enough, we like to boast about our investment prowess with stories that are similar to fishermen reminiscing the "big one that got away". Be pragmatic, no one ever went bankrupt taking smaller profits off the table. Rather than sharing a story over a beer, you may be celebrating a win that you secured.
4. **Are you holding out for the next bull market even as this one is starting to turn into a roaring bear?** Investors often think that a bear market always leads to a bull market very soon, only to wait with bated breath as their capital is whittling away. In a declining market, there is no reward for loyalty.
5. **Are you worried about selling your own home and having to move frequently when you become a renter?** Many homeowners bought thinking that they would be living an unstable nomadic life by renting, as the property market at its halcyon days saw many transactions. However, in the current market, rental properties are facing rising vacancies and landlords are sometimes more anxious to secure long-term tenants, even at a discounted price. After all, they want the cashflow to keep their loans afloat if they do not own the property outright.

With the insights in this article, may your perspectives be shaped and you take what you are told about the rosy outlook of the Australian property market with caution. Test the narrative with what you observe and hear from your family, friends and acquaintances. If they speak from personal experience, they are part of the statistic that the official sources include but do not see in detail!

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