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MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA


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# That River In Egypt

Littlewood's Law holds that an individual can expect to experience a “miracle”—defined as an event with a one-in-a-million chance of happening - about once every month. Formulated by Cambridge mathematician John Edensor Littlewood, it illustrates that extreme coincidences are actually normal because we live through millions of tiny events.

Over the years I’ve made many predictions. Thanks to confirmation bias, most people only remember the correct guesses and forget the hundreds of wrong ones. I like to work on the Law of Truly Large Numbers whereby with enough guesses random coincidences become statistically certain. Sadly, but perhaps accurately, the managing director says I can’t predict things at all and have little foresight but that I am a gifted BS artist. For those Seinfeld fans out there just remember, it’s not a lie if you believe it.

Back to the topic at hand. Most recently I contemplated the May Federal Budget and made some wild and crazy observations regarding possible impacts on the property market. Turns out we are experiencing a one-in-a-million event. I was mostly right and I’m not going to let the chance to say so pass by.

Based on what we are seeing right now the nation has a problem. The Treasurer is in that river in Egypt, and the market is somewhere else entirely. A remarkable example emerged last week when Dr Jim stated that mid-point rents will only increase by $2 a week. In his own electorate, where 36 percent of households rent, those costs are already rising way faster and higher, driven by landlords needing to compensate for rising interest rates, rising land tax, rising holding costs and impending changes to CGT guidelines. Meanwhile, our friends at Ray White and NAB are predicting a 25 percent to 30 percent increase in rents over the next two years in some major cities.

At the same time, property developers are reporting a tangible slowdown in demand for off-the-plan sales, particularly units, driven primarily by SMSFs no longer being able to borrow for residential investment. This comes on top of changes to negative gearing and CGT rules that are disincentivising investors from purchasing existing stock. The net result will almost certainly be less investment stock coming to market, resulting in demand exceeding supply.

Our Treasurer’s policy simply doesn’t account for supply-side economics, and it would seem the government didn’t see this coming. It beggars belief, really.

Meanwhile, research by the Cotality Group suggests the total number of rental listings nationally is around 18 percent below the five-year average. Sydney and Melbourne are even worse.

As with so much that our federal government attempts, it seems blind to the unintended consequences of policy decisions. In this case a desire to help first-home buyers and young families into the market looks to have spectacularly backfired. It also seems that in punishing working Australians our leaders have forgotten that circa 60 percent of families actively assist kids to get into the property market. Be it living at home rent-free, gifting a deposit, going guarantor or co-buying, the Bank of Mum and Dad has demonstrated a willingness to help. I suspect government strategies that undermine the property values of the very people trying to assist first-home buyers are unlikely to inspire those very people. There is no doubt the property market is in a downturn, but new buyers are hardly rushing in. Major lenders like CBA and Westpac are reporting 15 to 20 percent falls in mortgage applications which correlate with real estate industry data regarding auction clearance rates and softening demand.

Of course, just as a rising tide raises all boats, so a falling market can sink them. If you happen to be a first-home buyer who got into the market through the government-guaranteed 5 percent deposit scheme and the market falls, you are heading for negative-equity territory. For a policy designed to help people into home ownership, that must be an uncomfortable possibility.

Assistant Minister for Immigration and Assistant Minister for Foreign Affairs and Trade Matt Thistlethwaite recently appeared to confuse negative equity with mortgage default on national television.

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He claimed that 99 percent of first-home buyers participating in a government deposit scheme could not experience negative equity because they were meeting their repayments. But meeting repayments does not prevent a property's value from falling below the outstanding loan balance. Negative equity and mortgage default are two very different things.

As the MD often tells me - usually after I've explained all the reasons why I should buy a new motorbike - better to be thought a fool than to open your mouth and remove all doubt.

On the ground, the off-the-plan management rights (OTP) sector makes for interesting observations. We are in the process of acquiring a large off-the-plan townhouse MLR in an emerging south-east Queensland suburb. The first stage is 95 units, and we expected to get circa 70 in the letting pool. As of today, it looks like all 95 will be investors. This is a development that should have appealed to first-home buyers and particularly young families. The area is well served by childcare, education, health and sporting hubs. Trouble is that grandfathered rules around negative gearing and CGT make off-plan very appealing to investors. These buyers typically have more financial firepower than first-home buyers and we see this with investors pricing others out of the market. In other words, the exact opposite of what the geniuses in Treasury were planning.

On the flip side, another recent OTP experience played very differently. 135-unit high-rise apartment project in a desirable beachside suburb. 70-plus units expected in the letting pool. The end result was a struggle getting to 50-plus units with clear and present owner-occupier demand impacting letting pool numbers. A very different project to the example above with superior living amenity and much higher prices which, combined with lower ROI, is disincentivising investors. In the end not a viable proposition for some buyers.

If I can end this missive on a positive note, it is this. I am seeing signs of stabilisation in letting pools that might otherwise be threatened by owner occupation. I'm also bullish about OTP permanent management rights but with a caveat. Properties with semi-luxury amenity in highly appealing locations and higher unit price points are going to continue to present owner occupation risk, both at initial settlement and over the life of the property. These projects will be less appealing to investors due to higher price entry points and lower return on investment. That investor appeal will further reduce once the units are no longer classified as a new build and get caught by the revised tax rules.

OTP management rights opportunities of scale in the 'burbs and preferably with no real estate to buy are the absolute sweet spot, albeit a rarity to some degree. We can thank our government for these outcomes as they continue to swim happily against the current in that river in Egypt.

I'll leave you with a couple of thoughts. The economist Henry Hazlitt famously stated that every action has unexpected consequences. I prefer the economic parable of the cobra effect. A government offers a bounty for every dead cobra to lower the deadly snake population. Citizens soon realise that breeding cobras is far easier than hunting them in the wild. Snake farming becomes a profitable venture. The government finds out what's going on and cancels the scheme. The snake breeders release their now useless snakes into the wild. The cobra population ends up higher than when the scheme started.

A tale of snakes, scams and unintended consequences. Ring any bells?

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No AI or ChatGPT has been used in the writing of this article.