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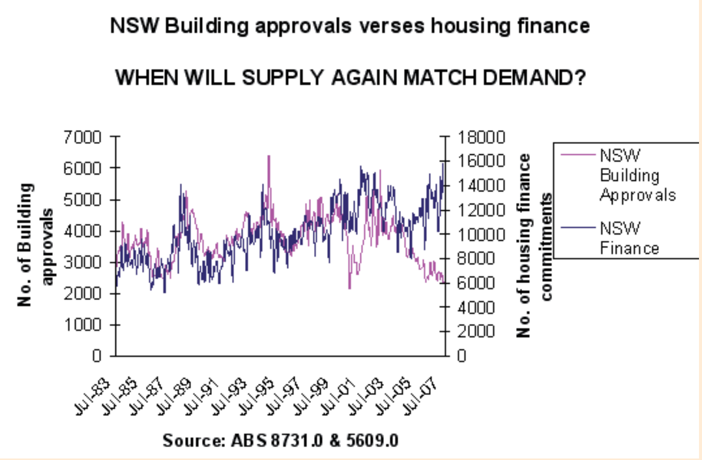
How to profit from a property upturn, without owning any property

If you want to take advantage of a possible recovery in the NSW housing market, yet the thought of taking out a crippling housing investment loan has been stopping you, there just might be another way forward worth considering.

ASX listed property developers are increasingly becoming a rare breed with many transforming their businesses into property trusts and fund managers. Very few remain that focus exclusively on property development.

Lets consider the current fundamentals with a focus on NSW, as it has by all accounts been the hardest hit with the residential property downturn of 2004 to 2006.

NSW housing finance approvals and building approvals are illustrated in the chart below.



As the chart shows, both measurements are recognised as being strong leading indicators of demand and supply.

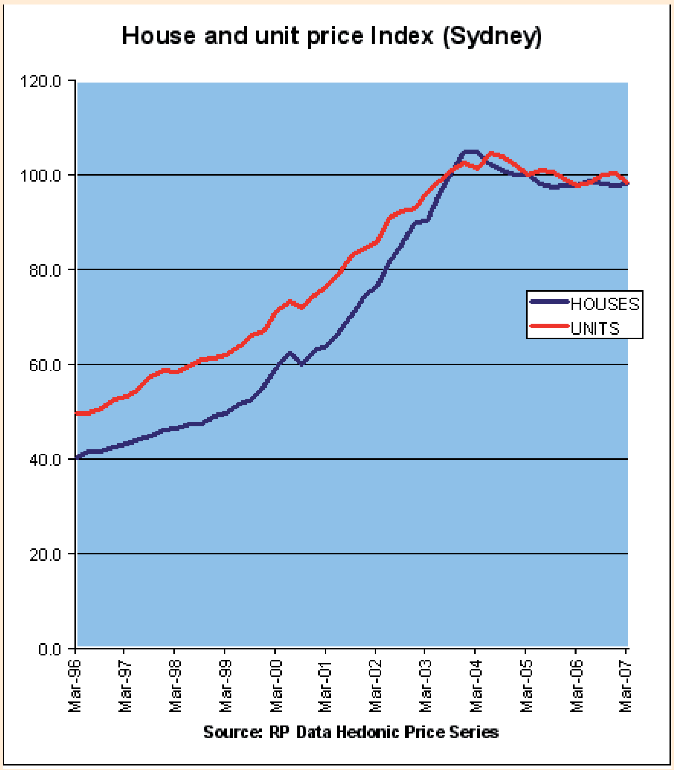
Interestingly, both indicators are positively correlated, with NSW housing finance leading building approvals by approximately three to four months historically, which is a relatively short time lag.

This trend makes sense. Developers rarely seek development approval from council unless they have a certain percentage of the planned development pre-committed by investors.

Yet, as the chart shows, while NSW building approvals are at an all time low, NSW housing finance is now at an all time high and rising.

How is it possible that there is rising housing demand yet falling supply? Will this last?

The answer may lie in unit and land prices, in that while demand has risen in recent times, dwelling prices haven't yet risen beyond the last price peak. Developers require their product, being new housing stock, to be able to be sold at a certain price in order to generate a profit from the development.



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It is interesting to note that according to RPData, housing prices are still lower today than where they were back in late 2003 – the point at which building approvals last peaked. Many developers land banked during the peak and past the peak of the last boom in expectation that the housing market would roll on and prices would continually rise. Therefore it is very possible that housing prices are not yet at the point where developers can make a certain profit on the development. And that's why developers are slow this cycle to meet demand.

But this can only go so long. Developers will return to the market place, and based on recent upward movements in housing prices for the June quarter as reported by APM, I believe developers will be responding very shortly to the improved conditions.

Given the historical relation between demand and supply, it is actually possible that building development for NSW will snap up back to the 5,000 dwelling units a month level (from the 2,500 per month now). Potentially it could go even higher.

If the this occurs, it means absolute boom times for developers that have a significant weighting towards NSW who have been struggling over the past three years to make a positive profit margin.

For an investor, this means taking a good look at listed property developers and builders that have a greater than average weighting towards the NSW housing market.

AVJennings is one such developer that has ridden the fortunes of the NSW and Victorian housing market over the past 10 years. Out of the total land lots in AVJ's inventory, NSW represents 32% of held lots and Victoria 39%. AVJ also has inventory in Queensland and South Australia however this is a relatively small percentage compared to NSW and Victoria.

What it means is that keeping all things equal, AVJennings and other developers that have a good weighting towards NSW may do very well over the next 12 to 24 months if there is indeed a building recovery.

Of course, any additional benefits from the Federal government will be an additional fillip to the mix and so far the signs are encouraging with efforts in resolving the so-called 'housing affordability crisis' aimed squarely at reducing the breakeven points for builders and developers.

It is important to do thorough company research before buying into shares of any types. Not only do the market conditions need to be right, so does the company's management, product corporate governance etc. It is also important to recognise that the building industry is very cyclical as illustrated previously and therefore not for the fainthearted or for those who prefer to buy shares and forget about them.

AV Jennings 5 Year Price Chart

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