SPOTLIGHT
Savills Research

Australia Residential

Demographic tailwinds benefitting residential

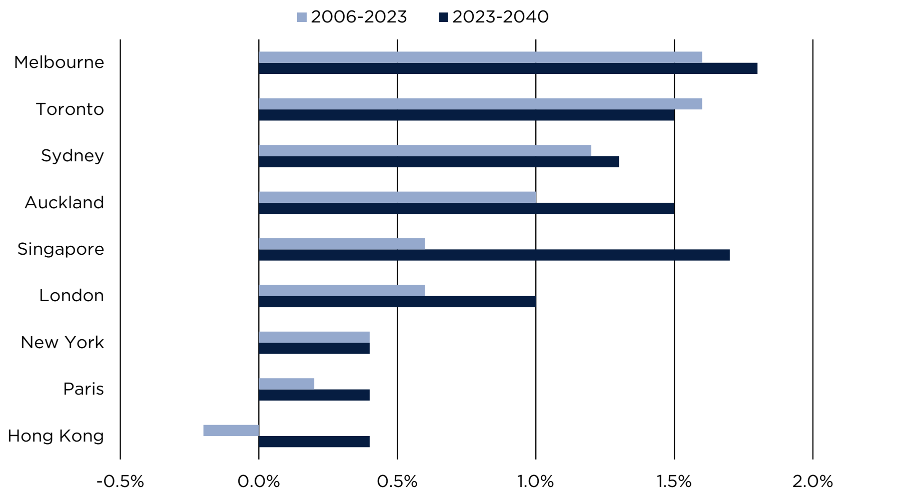
DEMAND-SUPPLY IMBALANCE TO FUEL PRICE GROWTH

Strong population growth, coupled with limited new housing supply, is driving a recovery in Australia's housing market despite the impact of higher interest rates still washing through the economy. This demand-supply imbalance is expected to fuel further growth in residential property prices. With the potential for apartment prices to outperform house prices, in contrast to recent historical experience, the residential sector will be an investor favourite in 2024.

POPULATION GROWTH DRIVING DEMAND

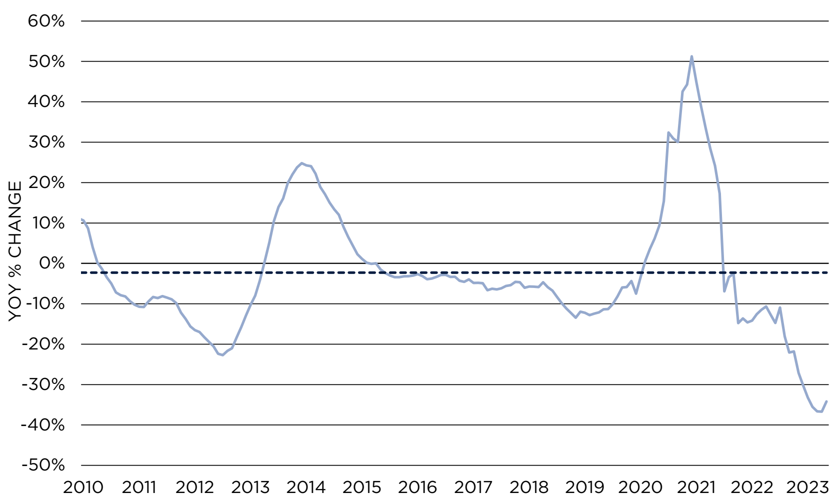
There has been a faster than expected recovery in Australia's population growth due to a rebound in net overseas migration predominantly to Australia's east coast cities: Sydney, Melbourne, and Brisbane. Net overseas migration increased by c.454,000 people over the year to Q1/2023, the highest annual rate ever recorded, and up from c.+128,000 a year earlier, and a pandemic low of c.-94,000 in the year to Q1/2021 when Australia's border was closed to overseas arrivals.

GRAPH 1: Average Annual Population Growth Rates by Global Peers, 2006-2023 vs 2023-2040



Source Savills Research, Oxford Economics

GRAPH 2: Housing Transactions Across Australia, 12-month Moving Average, 2010 to 2023



Source Savills Research, Macrobond, Housing Industry Association

Among the states, Victoria's population is growing at its fastest rate since 2016 (+2.4%), while NSW is growing at its fastest rate in more than four decades (+1.9%) and Queensland, 16 years (+2.3%). Despite the east coast cities dominating annual trends in people moving to Australia, population growth in WA is outpacing the national average with its fastest growth rate in nine years (+2.8%) as the state benefits from interstate migration.

CONSTRAINED SUPPLY

In the face of strong population growth, housing supply remains constrained, leading to an acute housing shortage in both owner occupier and rental markets.

SHARP DECLINE IN MARKET LIQUIDITY

In the existing housing market, liquidity has declined sharply in recent years. According to the Housing Industry Association, housing transactions in Australia declined by 34% (in 12-month moving average terms) over the year to October 2023 to be well below average levels. This large decline in liquidity partly reflects reluctance on the part of owners to sell as the impact of higher interest rates weighed on housing prices in 2022. Mortgage holders who have locked in significantly lower fixed rate mortgages than the prevailing standard variable rate have also been disincentivised to sell.

Another factor driving low housing market liquidity has been the strength in household balance sheets, which has largely prevented forced sales in the housing market to date. While higher interest rates and inflation have increased mortgage payments and reduced household disposable income, households had large savings buffers built up during the pandemic to absorb these pressures (although this savings buffer has now been largely eroded). Ongoing tight labour market conditions have also supported household income.

LOWER SUPPLY PIPELINE

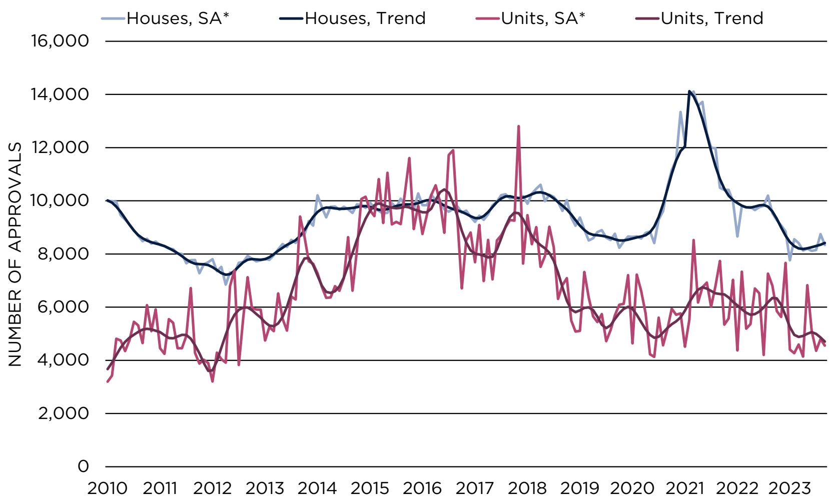
In addition to low liquidity in the existing housing market, there is also a shortage of new housing developments. Strict zoning laws and, in some cases, local government opposition to new housing developments, have limited residential construction in recent decades. Since the advent of the pandemic higher construction costs, particularly for materials and labour, have also played a role in limiting new development projects.

While the Government's Homebuilder scheme drove a significant increase in apartment building in 2020 and 2021, new completions are down 31% from their March 2021 peak. There remains a large pipeline of work yet to be done, and not yet commenced which is delaying new housing to the market. This is fuelling the undersupply of housing stock and contributing to rental growth across the country.

Forward looking indicators such as housing approvals suggest that housing supply constraints will not ease anytime soon. Building approvals for detached houses have declined sharply following a spike in 2020 and 2021, while unit approvals have been trending lower since 2016. In trend terms, approvals for detached houses are down 40% from their 2021 peak, while approvals for unit developments have fallen by 55% from their 2016 peak, back to around 2012 levels.

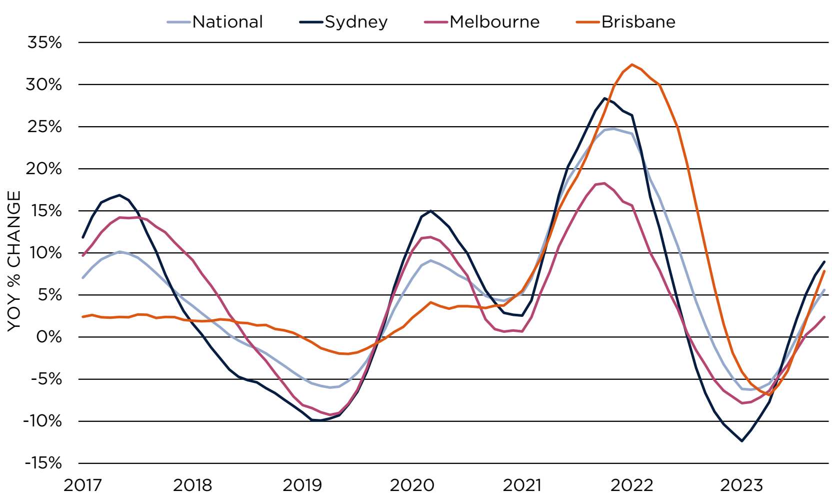
In contrast to recent historical experience, price growth for units could potentially outperform houses in the coming years, as the discount for units coupled with strong rental growth and the ongoing demand-supply imbalance for apartments drives stronger capital growth.

GRAPH 3: Housing Approvals, 2010 to 2023



Source Savills Research, Macrobond, ABS
*SA = Seasonally adjusted

GRAPH 4: Change in Dwelling Prices, 2017 to 2023



Source Savills Research, Macrobond, CoreLogic

The large fall in unit approvals in recent years has unsurprisingly been driven predominantly by the larger East Coast states. Unit approvals in NSW have declined by 64% in trend terms since the peak in July 2016, while approvals in Queensland have fallen by 71% from the peak in December 2015. While trending lower in recent years, unit approvals in Victoria have declined to a lesser extent (-45% since its peak), helped by a sizeable rebound over the past six months.

STRONG DEMAND AND LIMITED SUPPLY DRIVING MARKET REBOUND

The combination of strong population growth induced demand and limited supply are acting to offset the impact of higher interest rates and driving a rebound in housing prices. Nationally, housing prices have increased by 7.6% since January 2023, after having declined by 7.5% between April 2022 (the month before the first RBA cash rate increase) and January 2023.

The major East Coast markets have seen more pronounced cycles – particularly in Sydney – where housing prices are up 11.6% since January 2023, after a 12.4% peak to trough fall from January 2022 to January 2023.

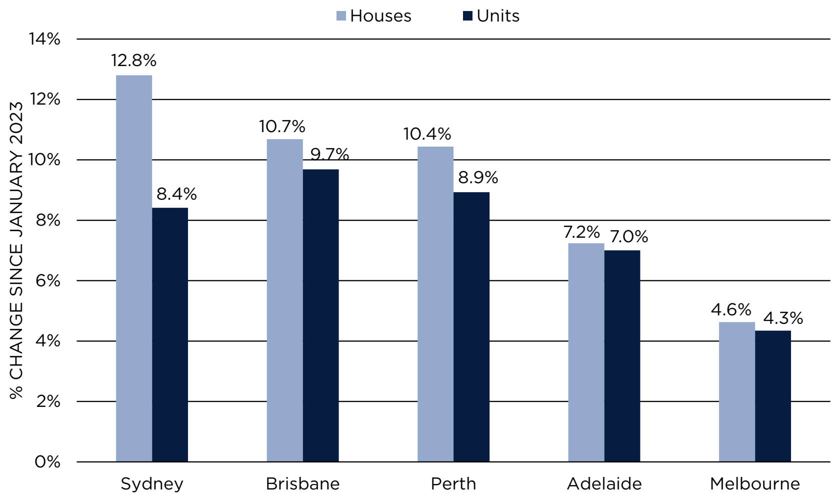
House prices have led the recovery since the trough in national housing prices in January 2023. This is particularly true in Sydney where house prices have increased by 12.8%, compared to an 8.4% rise for unit prices. In other major markets such as Melbourne and Brisbane, price growth for houses and units has been more even.

APARTMENTS TO OUTPERFORM?

The mismatch between demand and supply of units in the rental market is putting significant upward pressure on rental growth rates. Median asking rents have risen sharply in major markets like Sydney and Melbourne since 2022 as pandemic restrictions eased, facilitating a rebound in international arrivals.

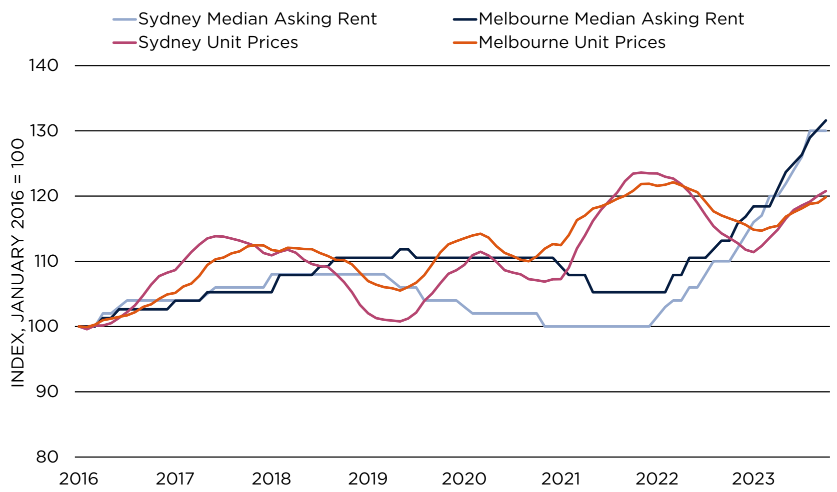
Indeed, rents have grown by 30% and 25% in Sydney and Melbourne respectively since the end of 2021, significantly outpacing

GRAPH 5: House and Unit Prices, January 2023 to October 2023



Source Savills Research, Macrobond, CoreLogic

GRAPH 6: Median Asking Rent and Unit Prices Indices, 2016 to 2023



Source Savills Research, Macrobond, CoreLogic

unit capital value growth after a period of underperformance, particularly at the onset of the pandemic.

The rapid rise in rental growth, combined with the discount for units compared to houses is expected to increase the appeal of apartments, both for investors and owner-occupiers. Historically, house price growth has exceeded unit price growth. Nationally, house prices have risen by 166% over the past 20 years (5.0% per annum) compared to the 106% increase in unit prices (3.7% per annum). In contrast to this recent historical experience, price growth for units could potentially outperform houses in the coming years, as the discount for units coupled with strong rental growth and the ongoing demand-supply imbalance for apartments drives stronger capital growth.

BRIGHT OUTLOOK FOR RESIDENTIAL BUT INTEREST RATE UNCERTAINTY REMAINS

While the outlook for residential markets is supported by medium-to-long-term tailwinds, higher interest rates have the potential to weigh on the housing market in the short-term. The impact of the sharp rise in interest rates since mid-2022 is still washing through the economy, and low consumer confidence, higher mortgage rates, and tighter access to credit can be expected to temper housing market conditions in the short-term.

There is also the potential for further rate increases, with financial markets partially pricing in one more 25-basis point increase in early 2024. Despite this, the monetary tightening cycle looks to be nearing its peak, with market economists generally expecting several interest rate cuts by the end of 2024, which will reduce the pressure on the housing market.

Beyond the immediate pressure from higher interest rates, the housing market will continue to be boosted by strong population growth and housing supply shortages.

For more information about this report, please contact us

Savills Australia

Paul Craig
CEO
+61 2 8215 8888
pcraig@savills.com.au

Savills Research

Katy Dean
Head of Research & Consultancy, Australia
+61 2 8215 6079
kadean@savills.com.au

Chris Naughtin
National Director, Capital Markets - Research, Australia
+61 2 8215 8832
chris.naughtin@savills.com.au

Simon Smith
Regional Head of Research & Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.asia