Residential Property Market Outlook

June 2024

KPMG Australia

Contents

Executive summary

KPMG's outlook for dwelling prices remain largely unchanged on a national level relative to our previous publication.

KPMG forecasts national house prices to continue to rise 5.3% in 2024 and 5.6% in 2025.

Unit prices are forecast to rise 4.5% in 2024 and 5.6% in 2025.

- In a year of high interest rates, elevated inflation and subdued consumer sentiment, national house prices increased by 7.7% and national unit prices increased by 6.1% between March 2023 and March 2024.
- Households have seemed to cope well so far with the 4 percentage points increase in the mortgage rates and the fixed-rate mortgage cliff as the labour market remains robust and the unemployment rate remains relatively low.
- Rental prices have been on the rise as strong population growth and limited housing supply are exerting more pressure on the rental market. Rental prices rose 7.8% annually, the strongest rise since the March 2009 quarter. Rental price growth continues to reflect low vacancy rates and a tight rental market.
- We expect annual rent growth will be around 4–5% over the next two years based on our projections for new dwelling completions and the Treasury's population forecasts.
- We anticipate a reversal in the declining trend of housing approvals, driven by robust population growth and the resurgence in house prices. However, this means only a limited translation of increased approvals into actual housing completions within the forecasted period due to the time lag inherent in the process from approval to completion.
- We expect that price growth will be slower in 2024 than in 2023 as the prolonged contractionary interest rates will subsequently exert a cooling effect on the market and partly offset the gains as a result.
- Interest rates will be the main influencing factor to house prices in 2025. We expect the RBA to cut rates in the last quarter of 2024 which is anticipated to have a positive impact on house prices via the availability of credit and buyer's confidence.

Market overview

House prices went up in 2023 despite prolonged contractionary monetary policy and the cost-of-living crisis.

From March 2023 to March 2024, national house prices increased by 7.7% and national unit prices increased by 6.1% according to Proptrack.

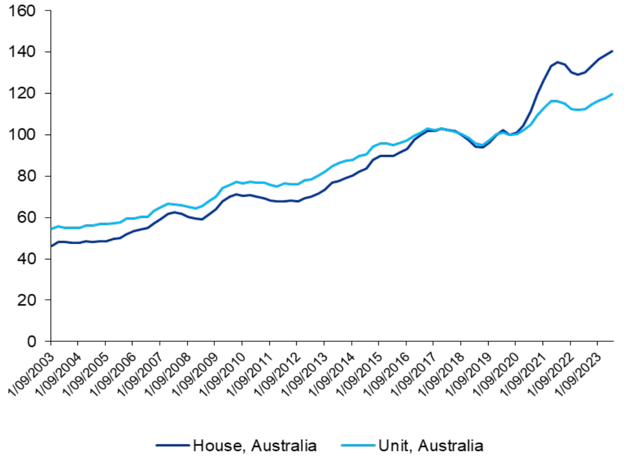
This growth persisted despite the backdrop of continued interest rate hikes, inflationary pressures, and subdued consumer sentiment.

Several factors contributed to the buoyancy of the market. Unprecedented population growth following the pandemic, coupled with low unemployment rates and a tight rental market maintained the seller's advantage throughout 2023. Additionally, a decline in construction activity exacerbated the mismatch in supply and demand, fuelling the upward trajectory of house prices.

Weak supply and the pullback in construction activity has also played a role in sustaining house prices. Although material costs and financing costs have started to stabilise after sustained increases, labour costs continue to increase in response to high demand for qualified tradespeople.

The much-discussed 'fixed-rate cliff' did not have the anticipated impact on the housing market. Contrary to initial predictions, the transition of mortgage holders from lower fixed-rate loans have not yet resulted in a significant increase in distressed listings or delinquency rates.

Chart 1 – National residential property price index (June 2020 = 100)

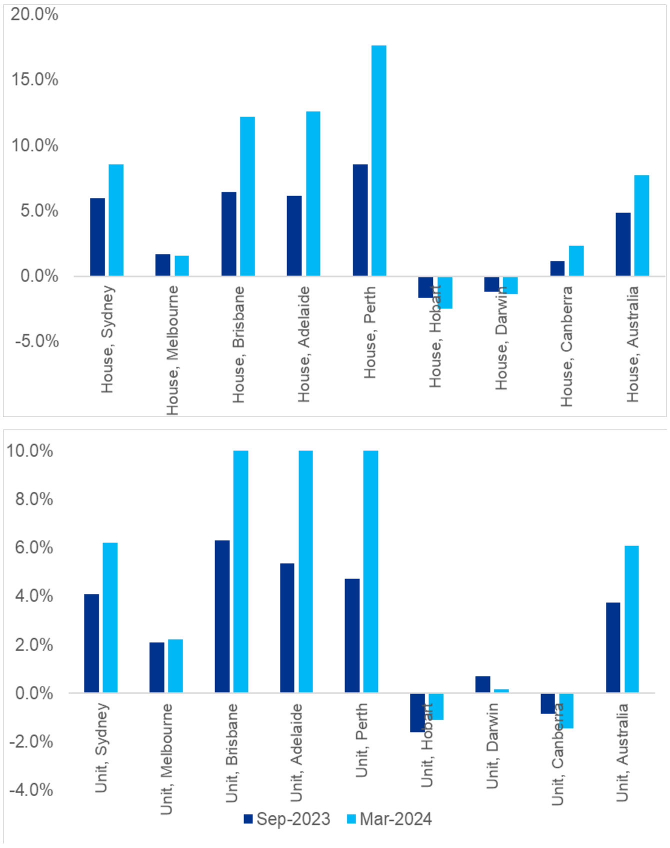


Source: ABS, Proptrack, KPMG

In the past 12 months, Perth houses have outperformed the other capital cities, with values sitting at 17.6% higher than at the end of March 2023 as seen in Chart 2. Sydney, Brisbane and Adelaide houses also recorded large increases, with values rising by 8.5%, 12.2% and 12.6% respectively.

Brisbane units recorded the largest rise in value across all capital cities in the past 12 months, with values increasing 12.8% since March 2023. Adelaide units and Perth units have also experienced large gains, with values rising by 11.1% and 12.0% respectively.

Chart 2 – Growth in house and unit prices since March 2023



Source: ABS, Proptrack, KPMG

Recent trends affecting property prices

Building approvals fell to a level well below Australia's underlying dwelling requirement, worsening housing affordability

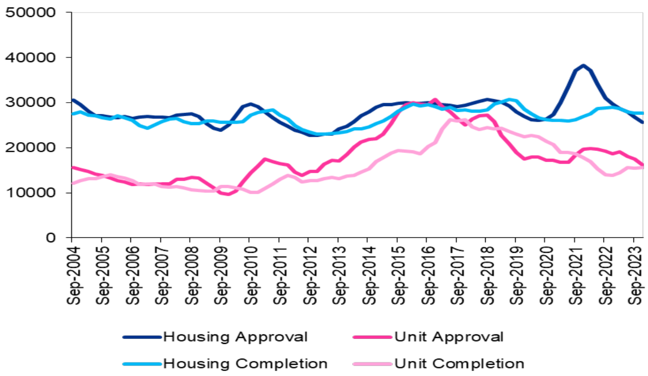
The latest ABS building approval figures for March 2024 reveal that the number of houses approved for construction remained at the lowest levels for more than a decade. The data shows that new house approvals have fallen in three of the past six months and have been on a declining trend since mid-2022 reflecting the effects of higher building costs, which have increased by more than 31% since the pandemic.

Recent data shows a stabilisation in construction costs. Over the past 12 months, input prices to house construction rose 2.4% in the December quarter 2023, following rises of 4.4% and 7.4% in the June and September quarter respectively. Reduced demand for new construction resulted in suppliers discounting products used during earlier stages of construction, such as structural steel products, partially offsetting rises. Increased capacity in sea freight is also contributing to easing prices for imported materials.

Wages growth in the construction sector has also fallen in line with national wages growth, noting that wages growth for the construction industry has risen by 7.8%, slightly higher than the national average wages growth of 7.6% for the period after the pandemic.

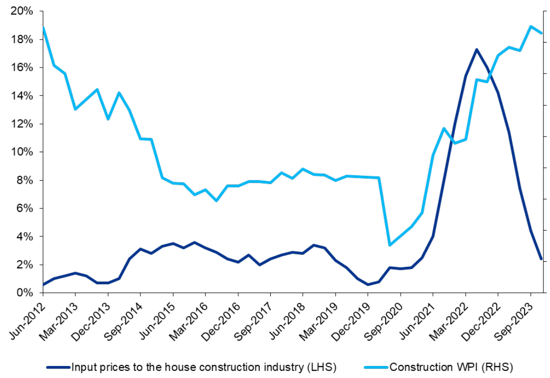
We expect building approvals are at a turning point because dwelling prices have recovered and the underlying demand for housing remains high as a consequence of the recent spike in population. Nevertheless, it still only means a limited translation of increased approvals into actual housing completions within the forecasted period due to the time lag inherent in the process from approval to completion.

Chart 3 – Building activity: number of approvals and completions (four-quarter moving average, number of dwellings)



Source: ABS, Haver, KPMG

Chart 4 – Growth in building costs (%, y/y)



Source: ABS, Haver, KPMG

Households look well-braced to withstand the fixed-rate cliff

The latest Housing Industry Australia–Commonwealth Bank Housing Affordability Index, which measures accessibility to home ownership for an average first home buyer, reveals that average first home buyers need to allocate approximately 56.9% of their income towards mortgage repayments in Q4 2023, a significant increase from 49.3% recorded in Q4 2022.

$350 billion worth of mortgages or half of all fixed rate credit, equivalent to around 880,000 loans, expired in 2023, with the peak of the roll-off passed in the June and September quarters. The remaining 38% of fixed rate credit, which includes about 450,000 loan facilities, will expire in 2024 and beyond.

So far the 'fixed-rate cliff' has not yet had the anticipated impact on the housing market, as households have coped with the 4 percentage points increase in the mortgage rates, helped by the fact that Australia's labour market remains robust and the unemployment rate remains relatively low.

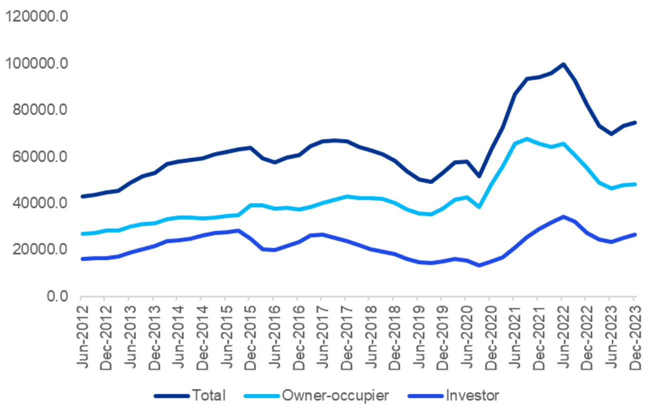
The latest data for May 2024 from SQM Research reveals that the number of distressed listings nationally decreased 2.5% over the month and down 8.5% annually. The trend for distressed property listings varies across states, with some experiencing large annual decreases (QLD, WA, SA) and others experiencing increases (NSW, VIC, ACT, TAS).

Uncertainty about borrowing capacities should be reduced as tightening cycle tops out

Buyers' uncertainty regarding borrowing capacities and mortgage servicing costs is alleviating as the Reserve Bank of Australia has completed its tightening cycle and we expect a rate cut in Q4 2024 or Q1 2025.

The overall value of new loan commitments for housing rose to approximately $80 billion in Q1 2024 after reaching a three-year low in Q1 2023. In y/y terms, new housing finance commitments for housing recorded its first positive growth for two consecutive quarters.

Chart 5 – The value of new loan commitments ($ billion)



Source: ABS, Haver, KPMG

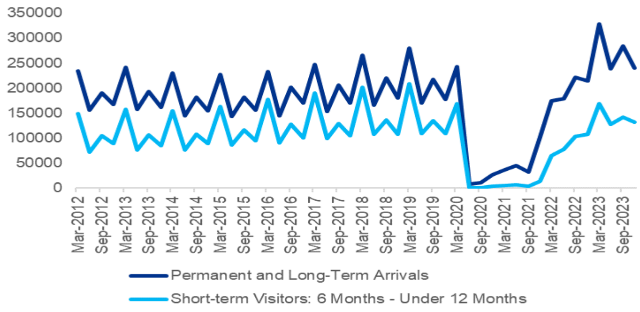
The government is dropping immigration back to 'normal' levels

High immigration rates have added significant pressure to the housing market. In FY23, net overseas migration was 518,100, much higher than the government's original estimate of 400,000. The Budget projected that overseas migration will further add a net gain of 316,000 and 261,000 to Australia's population in FY24 and FY25 respectively.

It's important to note that short-term visitors (which primarily consist of visitors who come to visit friends and relatives, and tourists) though not included in the Estimated Resident Population, make up a considerable portion, about half, of long-term and permanent visitors. These visitors significantly contribute to the demand for housing in Australia. The ABS Estimated Resident Population excludes short-term visitors who do not meet the Net Overseas Migration (NOM) '12/16 month rule'. The 12/16 month rule works on the basis 'that overseas travellers (whether Australian residents or overseas visitors) who are in Australia for a total of 12 months (defined as 365 days) or more during the 16 month period (defined as 486 days) following an overseas movement will be added to NOM estimates. Similarly, travellers who are overseas for 12 months or more out of the 16 month follow-up period will be subtracted from NOM estimates'.

Looking forward, the government is trying to balance between a natural increase versus migration by tightening the visa process for migration workers and international students. The government estimates that without these measures, migration levels would have remained higher for longer – at 440,000 and 305,000 in FY24 and FY25 respectively.

Chart 6 – Foreign immigration



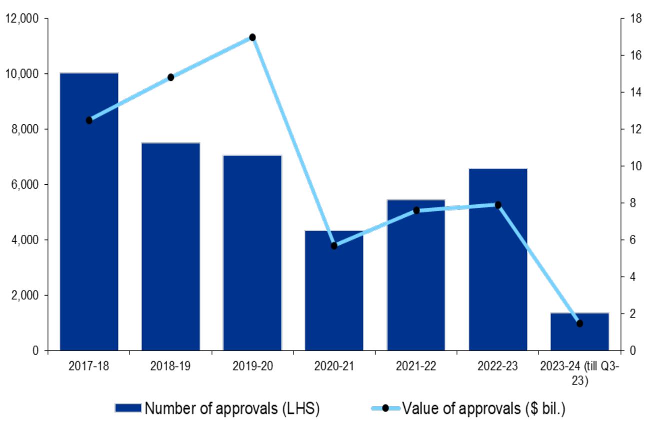
Source: ABS, Haver, KPMG

Foreign investment yet to rebound

Foreign investment further recovered in FY23 with 6,576 residential real estate approvals totalling $7.9 billion, following 5,433 approvals totalling $7.6 billion in FY22. In FY23, China remained the largest source country of investment for approved residential real estate proposals ($3.4 billion).

Foreign demand for Australian residential real estate is tipped to face some uncertainty this year as foreign investment faces increased fees and stricter compliance. Fees for investments in established dwellings will rise significantly, but lower fees will be introduced for 'build to rent' projects. This will reduce foreign demand for established dwellings, while helping increase the housing stock which will look to reduce the rental crisis.

Chart 7 – Foreign investment activity



Source: ABS, KPMG

High rental costs may make it more appealing to own a home

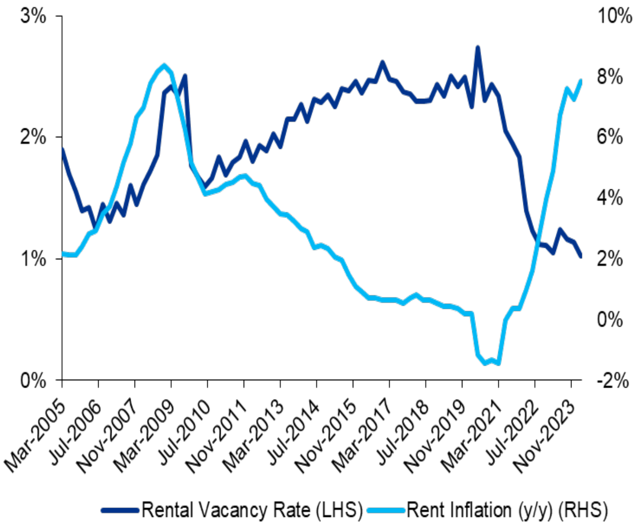
The balance between rental costs and the financial benefits of owning a property can impact the overall housing market dynamics. When the cost of renting is comparable to the cost of buying and owning a similar property, households may opt for home ownership, potentially driving up house prices. Conversely, if renting is more affordable, it can exert downward pressure on housing prices.

The rental market is tight, where the SQM national rental vacancy rate index is 1.03% in Q1 2024, the lowest historical level. In contrast, the vacancy rate averaged at around 2.4% in the five years before the pandemic.

Rent inflation has increased by approximately 7.8% over the year in Q1 2024, after increasing 7.3% in Q4 2023 and remains one of the key contributors to the consumer price index in the March quarter 2024.

The rate of quarterly and annual growth in rents this quarter was moderated in Q1 2024 by increases in Commonwealth Rent Assistance (CRA). Excluding these changes to CRA, rents would have increased by 9.5% over the 12 months to the March 2024 quarter.

Chart 8 – Rent vacancy rate and rent inflation



Source: ABS, Haver, KPMG

Rental costs not expected to ease

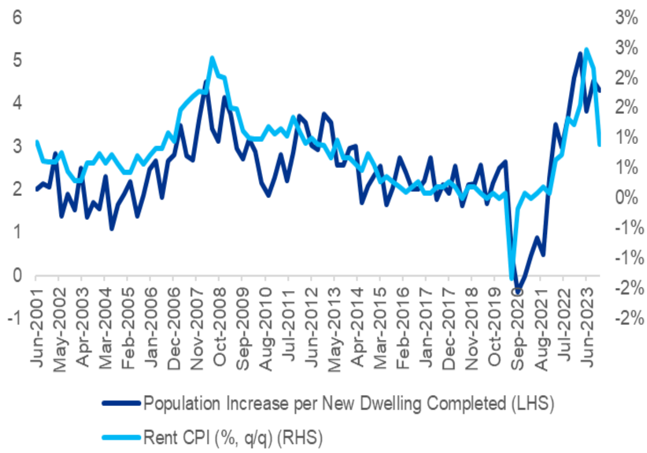
Robust population growth and limited housing supply are poised to exert more pressure on the rental market. The population increase per new dwelling completed currently exceeds the levels observed during the immigration boom of 2008.

Our analysis indicates that the population increase per new dwelling ratio is a strong predictor of rent inflation. That is, KPMG's analysis shows that nominal rents tend to rise 0.3% each quarter when population growth matches growth in dwellings. Our analysis finds this relationship between quarterly population growth and quarterly growth in dwellings can account for up to 75% of variations in rent inflation, with the remaining factors potentially explained by changes in dwelling formation. Furthermore, during immigration booms, nominal rents tend to rise even faster, increasing by 0.5% each quarter when population growth matches dwelling growth.

Based on our projections for new dwelling completions and the Treasury's population forecasts, we anticipate that the Rents subgroup of the CPI will likely exceed the 10-year pre-Covid average quarterly growth rate by an additional 0.4 percentage point each quarter until the end of 2025. These numbers are downgraded from our earlier forecast last year as we anticipate a slight upward moderation in housing completions. This also means annual rent growth will be 4–5% over 2024 and 2025, which is 1–2 percentage points higher than the long-term average of 3.0%.

Furthermore, KPMG estimates new dwelling completions need to be around 45% higher than current dwelling completion forecasts in order for this above-trend rental growth to be pulled back to normal levels while still allowing for the expected population growth over the next few years.

Chart 9 – Population increase per new dwelling completed and rent inflation



Source: FIRB, KPMG

Dwelling prices forecasts

KPMG Economics' dwelling price forecasts utilise an error-correction model (ECM) framework. This framework was chosen as our analysis found that, over time, house prices tend to revert back to the equilibrium suggested by the long run relationship between population and housing stock, but that in the short run factors like interest rates, employment and housing completions can influence prices around the long run equilibrium.

Long run property prices

Real house prices in the long run are heavily conditioned by two key factors: population (demand) and housing stock (supply).

Population

We adopt the population projections in this year's Budget paper. Population growth is now expected to be 2.0% in FY23,1.7% in FY24 and 1.5% in FY25.

Strong population growth in the near term reflects the catch-up of net overseas arrivals after the pandemic. However, the strength in population growth is expected to be temporary, with migration patterns expected to return to normal in FY25.

Housing stock

Australia's stock of dwellings changes over time as our population changes and demographic factors, including family composition and age, influence the type of dwellings in demand.

For this study, we have constructed our own quarterly estimate of housing stock for each capital city due to the limitations in the data provided by the Census and the ABS. We note that the Census of Population and Housing only provides a count of housing stock every five years. In addition, while recently the ABS provides some quarterly housing stock data, it only covers a limited time span from the June quarter 2016 to the June quarter 2022 and the ABS does not plan to update the data regularly.

We construct the housing stock by adding housing completions and subtracting housing demolitions, which appears to have some relationship with housing approvals (in terms of completion rate and the time lag between the receipt of a building approval and the actual demolition) to the initial Census housing stock numbers. Our estimates are reliable as they align well with the official ABS housing stock numbers that are available from 2016 to 2022.

Short run property prices

Real property prices in the short run are also influenced by a range of factors that push and pull real property prices away from the long run levels.

KPMG's analysis identifies a range of short run factors that influence real dwelling prices, including:

- momentum being growth in real dwelling prices in the previous period
- the magnitude of the gap between the actual price and the estimated long run equilibrium price
- interest rates
- new housing completions
- interconnected markets.

We also consider several other short run factors such as the share of dwellings purchased by investors, the strength of the labour market as captured by the number of people employed, and the cost of renting versus mortgage repayment for a similar property (the renting-buying gap). However, these factors rarely display a strong forecasting power on prices growth.

In the context of this modelling analysis, only prices growth momentum and the long run gap are determined within the model. In contrast, projections for interest rates, inflation, and new housing completions are developed independently outside the model. In particular:

- interest rates peak at 4.35% and will start to fall gradually from the end of Q4 2024 to 3.1% by the end of 2025
- inflation follows the forecasts prepared by KPMG Economics as per the March 2024 edition of the KPMG Quarterly Economic Outlook
- housing completion forecasts involve analysing the lagged relationship between housing approvals and completions. This is done first by considering the influence of forecasted population and residential prices on housing approvals.

Chart 10 – Forecasts of interest rate and inflation

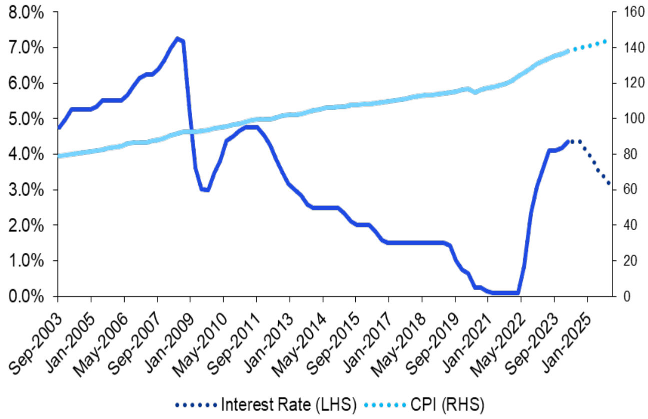
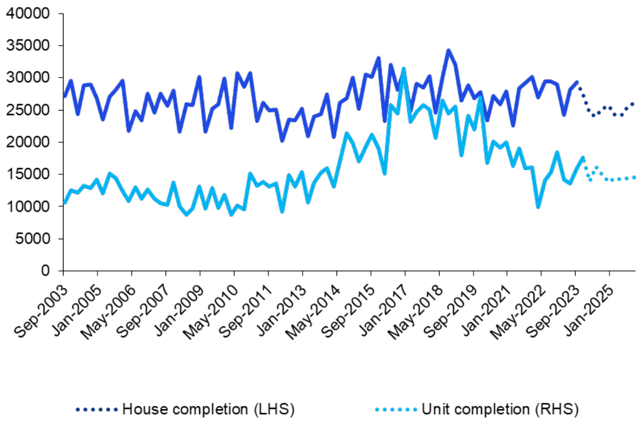


Chart 11 – Forecasts of housing completions (number of dwellings)



Our findings

We expect that price growth will be slower in 2024 than in 2023

The key findings of KPMG's analysis for the national dwelling market is summarised on this page, while the charts presented show historic and forecast dwelling prices by property type and market.

House prices growth is expected to decelerate in 2024 compared to the rapid expansion witnessed in 2023, primarily due to a cooling-down market. KPMG forecast national house and unit prices to continue to rise by 5.3% and 4.5% in 2024. The previous year saw a surge in demand fuelled by strong population growth and constrained housing supply. However, as the market adjusts and we expect more balanced population growth in 2024, these factors will result in a more tempered growth trajectory for dwelling prices.

Anticipated rate cuts are predicted to drive accelerated growth in house and unit prices in 2025

House prices and unit prices are projected to accelerate further in FY25 as dwelling supply continues to be limited throughout the forecasting period, coupled with the anticipated rate cuts. Positive market dynamics, increased investor sentiment, and potentially relaxed lending conditions driven by anticipated rate cuts will all contribute to heightened demand and fuel price growth. In FY25, national house prices and unit prices are forecast to rise by 5.6%.

Table 1 – Forecasts of house prices and unit prices (% y/y)

	House		Unit	
	Dec-24	Dec-25	Dec-24	Dec-25
Sydney	4.9%	5.3%	3.8%	5.6%
Melbourne	2.8%	6.5%	3.3%	6.5%
Brisbane	7.8%	5.1%	5.7%	2.5%
Adelaide	7.9%	5.9%	6.9%	4.6%
Perth	10.2%	5.2%	8.6%	8.0%
Hobart	1.4%	5.7%	2.2%	5.3%
Darwin	1.4%	5.8%	1.7%	4.0%
Canberra	4.2%	6.0%	1.3%	4.1%

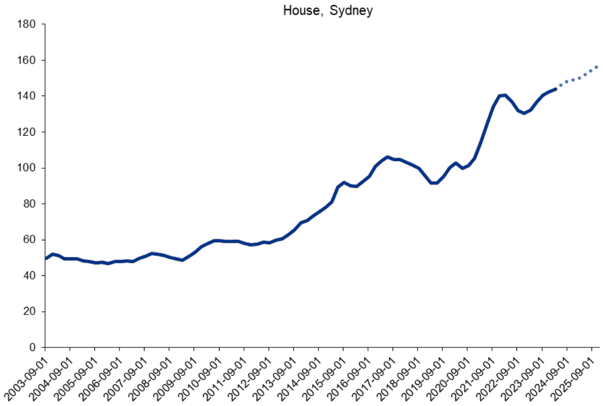
Complex market dynamics across cities and property types

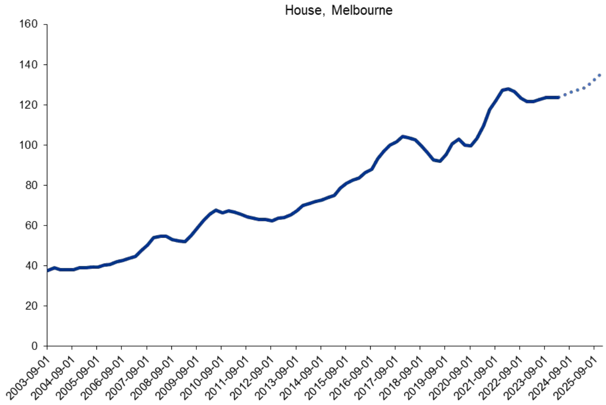
In 2024, houses prices are expected to grow moderately in all cities except for Hobart and Darwin.

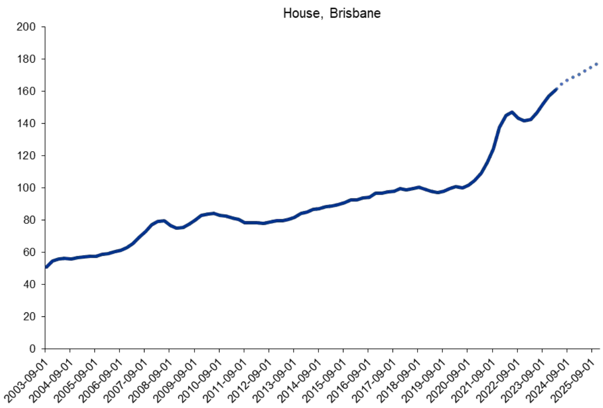
House prices growth in Perth is expected to be strongest, with house prices rising by approximately 10.2% by the end of 2024. Brisbane and Adelaide are also poised to record strong price growth in 2024.

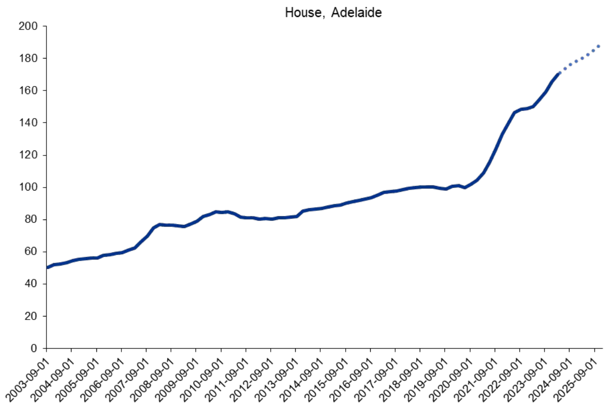
Notably, we revise our forecast for Hobart downward compared to our previous publication due to recent weak growth data observed in the region. This slowdown in growth is expected to impact the momentum of economic expansion in Hobart. Additionally, we have noted weak growth trends in Melbourne, which serves as a significant indicator for growth in Hobart. Given the interconnected nature of these two markets, the sluggish performance in Melbourne is likely to have a ripple effect on Hobart's economic prospects.

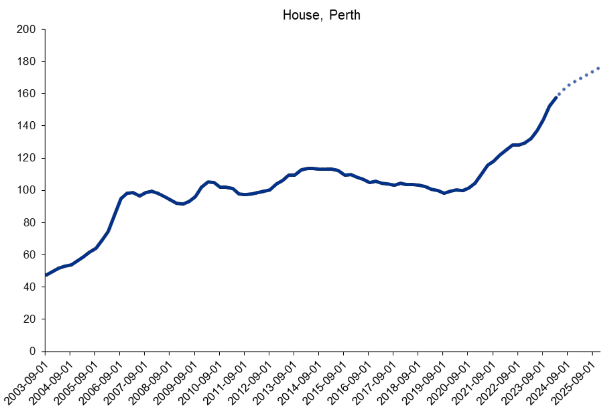
House prices forecasts (June 2020 = 100)

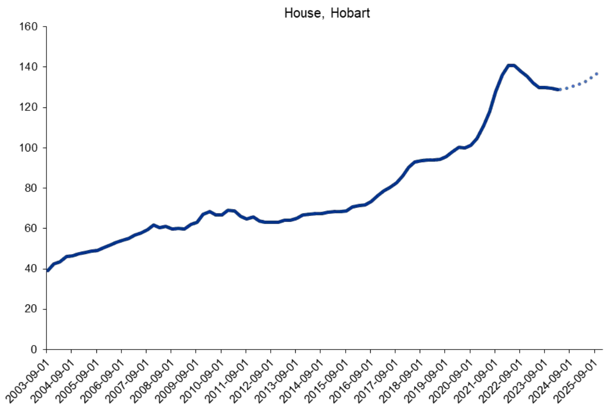


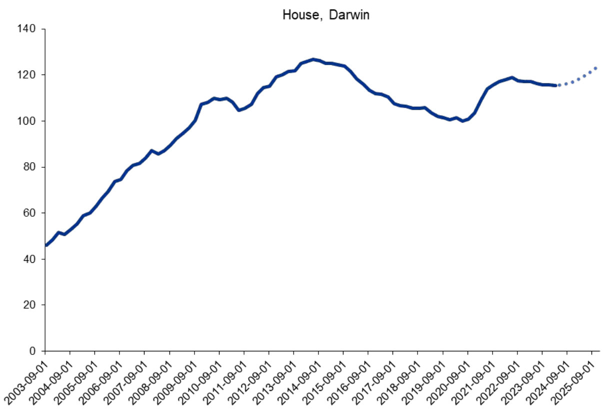


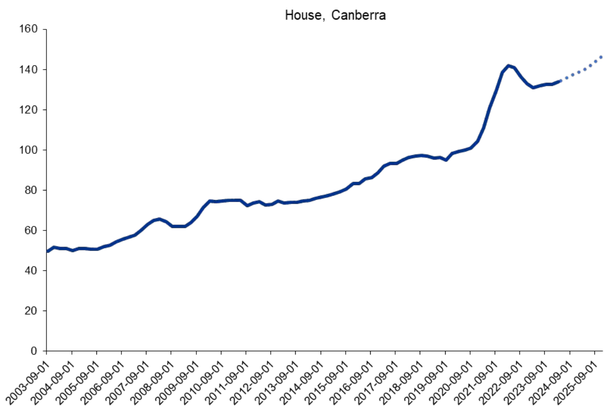






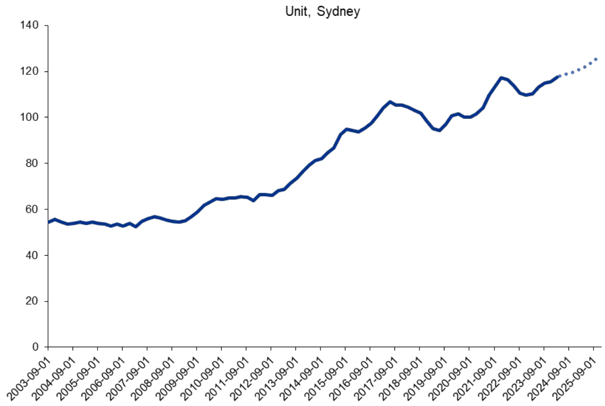


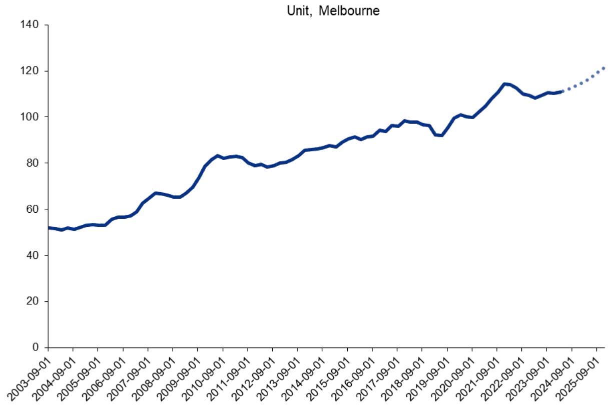


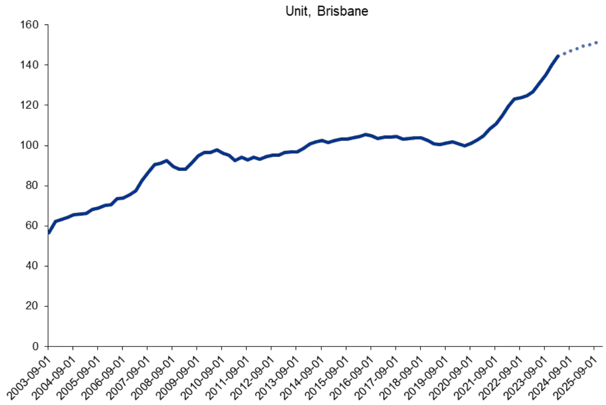


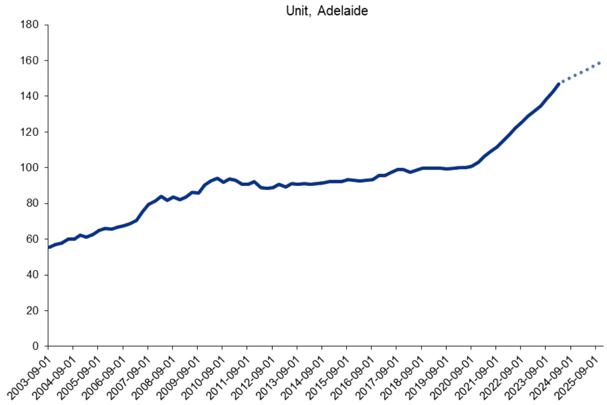
Source: ABS, Proptrack, KPMG

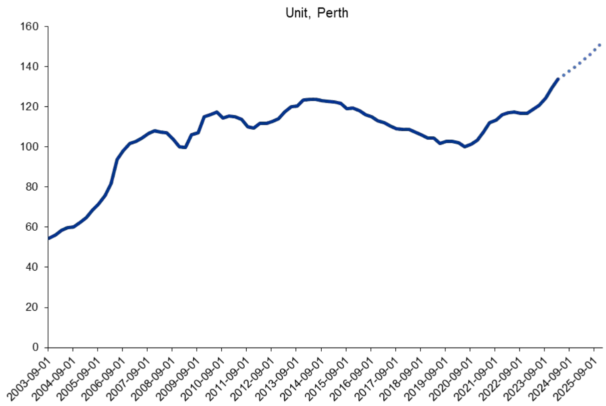
Unit prices forecasts (June 2020 = 100)

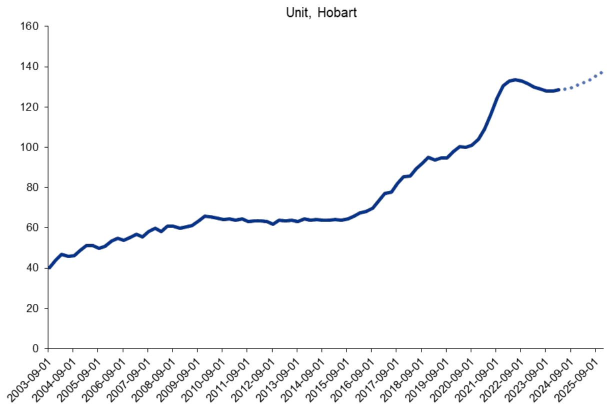


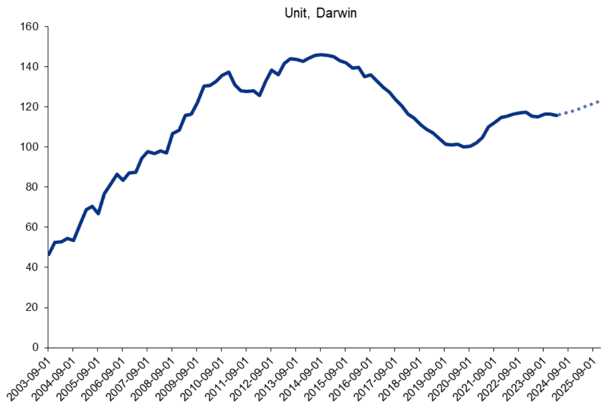


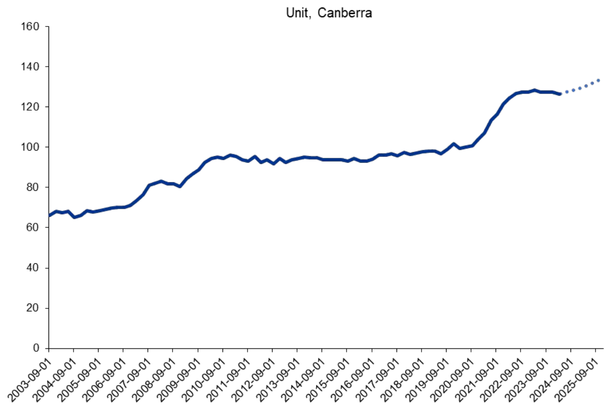












Source: ABS, Proptrack, KPMG

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