Residential Property Market Outlook

January 2025

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KPMG Australia

Contents

Executive summary

As the new year commences, KPMG analysis shows that the performance of the housing market has been mostly in line with our previous forecasts. In the previous edition, KPMG forecast national house and unit prices to grow y/y by 5.3% and 4.5% respectively in 2024, with the actual growth being 5.1% for houses and 4.5% for units.

In this new report, KPMG forecasts that house prices will grow by 3.3% in 2025, and 6.0% in 2026.

KPMG anticipates unit prices will rise faster than houses over the next two years as they offer a more affordable entry point into the property market, amidst the affordability crisis, growing by 4.6% in 2025 and 5.5% in 2026.

- In a year of high interest rates, elevated inflation and subdued consumer sentiment, national house prices grew at a slower pace in 2024 than in 2023.
- Households seem to have coped well so far with the 4 percentage point increases in mortgage rates and the so-called fixed-rate mortgage 'cliff', with the job market remaining robust and the unemployment rate stabilising around the low 4.0% range.
- Rental price growth has moderated from its peak of 7.8% recorded in March 2024, to 6.7% in the September quarter 2024. Despite this deceleration, the strong rental price growth figures continue to reflect low vacancy rates and a tight rental market.
- We expect annual rent growth will be in the mid-3% to mid-4% over the next two years based on our projections for new dwelling completions and Commonwealth Treasury's population forecasts.
- As anticipated in our last publication, we are seeing that approvals are now starting to move in the right direction to meet the current supply shortages, which was driven largely by robust population growth. Construction costs are beginning to moderate. However, this still means only a limited translation of increased approvals into actual housing completions in 2025 and 2026 due to the time lag inherent in the construction process.
- Interest rates will continue to be the main influencing factor on house prices. Buyers have shown caution for most of 2024 due to uncertainty surrounding possible movement in the cash rate. While KPMG anticipates the much-anticipated rate cuts are likely to be delayed until Q2 2025, they are expected to serve as a morale boost to homebuyers for the second half of 2025 and will carry forward into 2026.
- Despite affordability issues and a delayed rate cut, limited dwelling supply, increased investor sentiment, and anticipated relaxed lending conditions will help support modest price growth. By 2026, improved housing supply and population growth returning to the pre-pandemic levels, along with rate cuts in 2025, will combine to produce more balanced prices growth.

Market overview

House prices in 2024 have been slightly weaker than 2023, influenced by the ongoing cost-of-living crisis, high interest rates and housing affordability issues.

National house prices increased by 5.1% and national unit prices by 4.5% according to Proptrack in the 12 months to the December quarter 2024.

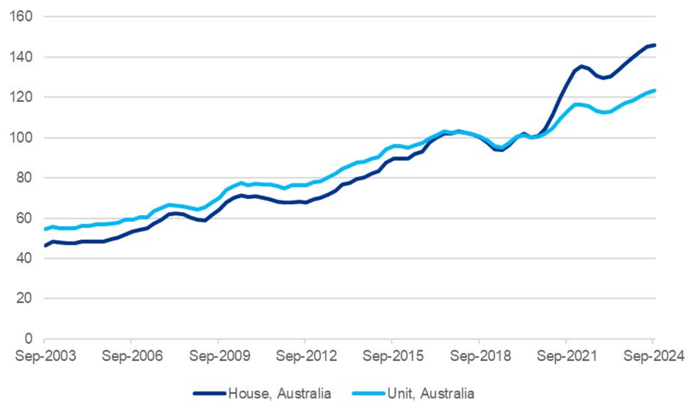
However, the market is slowing down. National growth in the December 2024 quarter was flat, marking the weakest quarterly outcome since March 2023. The deceleration in unit price growth is also apparent, with price growth in the December quarter being four times slower than the first three quarters of the year.

The recent slowdown happened against a backdrop of weakened economic conditions and uncertainty about the next cash rate decision.

Nevertheless, the mismatch between supply and demand helped maintain some of the momentum in the market as construction costs remain high. According to the ABS Building Activity data, it takes roughly 50% longer to build a house now than it did four years ago. Average construction times have blown out to 3.4 quarters currently compared to 2.2 quarters in the pre-COVID era.

The resilient labour market has also contributed to overall stability in the housing market, including helping mitigate the impact of the so-called ‘mortgage cliff’. That being said there has been a slight increase in mortgage distress and arrears, the average level remains low.

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

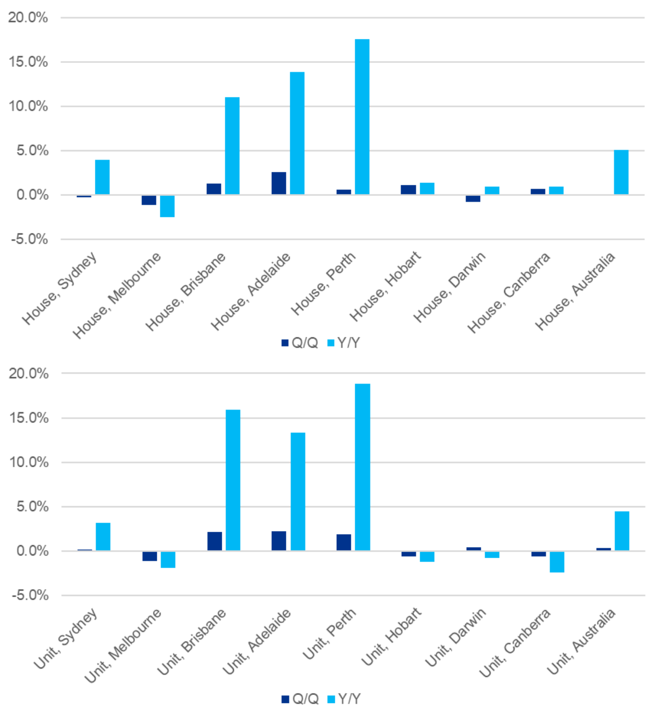


Source: ABS, Proptrack, KPMG

House price growth varied across different cities. Perth houses have continued to outperform the other capital cities since the beginning of 2024, with values sitting at 17.5% higher than at the beginning of 2024 as seen in Chart 2. Brisbane and Adelaide houses also recorded large increases, with values rising by 11.0% and 13.8% respectively. Sydney prices increased by approximately 4.0% this year but registered its first negative quarterly growth in the December quarter 2024 after experiencing nearly two years of positive growth. Melbourne property market continues to underperform, remaining 5.0% lower than their previous peak in 2022.

Perth units recorded the largest rise in value across all capital cities in 2024, with values increasing by 18.9%. Adelaide units and Brisbane units have also experienced large gains, with values rising by 15.9% and 13.3% respectively.

Chart 2 – Growth in house and unit prices in December 2024



Source: ABS, Proptrack, KPMG

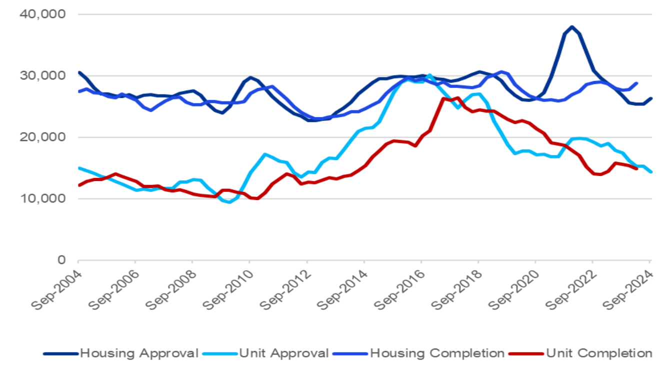
Recent trends in factors influencing property prices

Building approvals are heading in the right direction

ABS building approval figures for the September quarter 2024 indicate that the number of houses and units approved appears to have bottomed out in the March quarter. Since then, housing approval and unit approval have increased by 23% and 18% respectively.

We expect building approvals are at a turning point because dwelling prices have recovered and the underlying demand for housing remains high, driven largely as a result of the recent spike in population. Nevertheless, it still only means a limited translation of increased approvals into actual housing completions within the forecast 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)

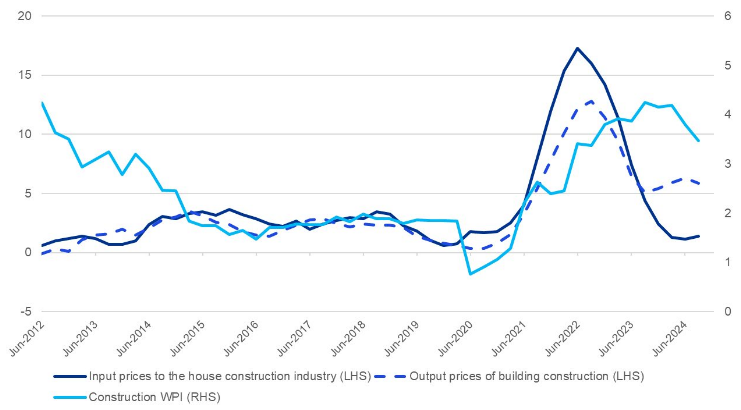


Source: ABS, Haver, KPMG

Recent data shows a stabilisation in construction material costs. Over the past 12 months, input prices to house construction rose 1.4% in the September quarter 2024, following rises of 1.3% and 1.1% in the March and June quarters 2024 respectively. Over the year, the main contributors were electrical equipment, ceramic products and metal products; and partially offset by the fall in plumbing products. Nevertheless, this still means that construction input prices for houses have increased approximately 35% since the outbreak of the COVID-19 pandemic.

However, as a result of persistent labour shortages, building construction prices increased by 5.9% over the year in the September quarter. Wages growth in the construction sector has slowed down, rising by 3.5% in the September quarter compared to 4.2% earlier this year. Despite this slowdown, the industry continues to face labour shortages for skilled tradespeople, with a particular demand for electrical services.

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



Source: ABS, Haver, KPMG

Households look well-braced to withstand the fixed-rate cliff but loan arrears are picking up

Financial conditions remain tight for households. The September quarter 2024 Housing Industry Australia–Commonwealth Bank Housing Affordability Index, which measures accessibility to home ownership for an average first home buyer, reveals that they needed to allocate approximately 54.4% of their income towards mortgage repayments in. This was little changed from the level recorded earlier in the year as the RBA concluded its monetary tightening cycle.

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 point increases in the mortgage rates, largely due to a resilient job market.

The latest data for November 2024 from SQM Research reveals that the number of distressed listings nationally decreased 0.4% annually. However, the trend for distressed property listings varied across states, with some experiencing large annual decreases (QLD and WA) and other experiencing large increases (ACT, VIC and TAS).

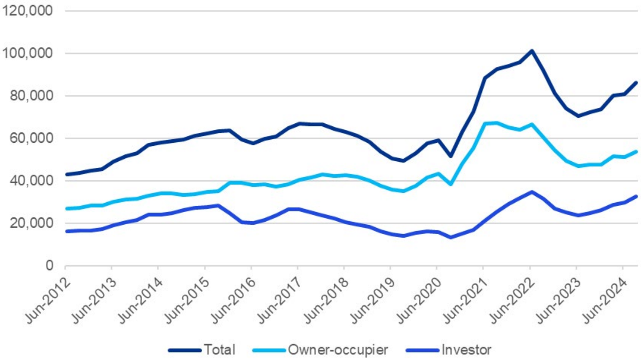
Data from APRA reveals that housing loan arrears rates have been steadily increasing from low levels since late 2022. The share of owner-occupier borrowers who are 90 days or more n arrears has risen from 0.5% to 0.8%. This trend is not likely to peak yet due to rising household budget pressures from higher inflation and interest rates. However, the RBA's assessment indicates that financial stability risks remain should contained. This is because highly leveraged borrowers – the group of households most at risk – comprise a relatively small share of total housing lending, and very few loans are estimated to be in negative equity.

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

Buyers' uncertainty regarding borrowing capacities and mortgage servicing costs is diminishing as the Reserve Bank of Australia has completed its tightening cycle and we expect a series of rate cuts in 2025 and 2026.

The overall value of new loan commitments for housing continues to rise, increasing to approximately $90 billion in Q3 2024 after reaching a three-year low in Q1 2023. This latest increase means the value of new housing finance commitments for housing has now recorded positive growth for the past four consecutive quarters.

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



Source: ABS, Haver, KPMG

Immigration levels continued to exceed the government's estimates

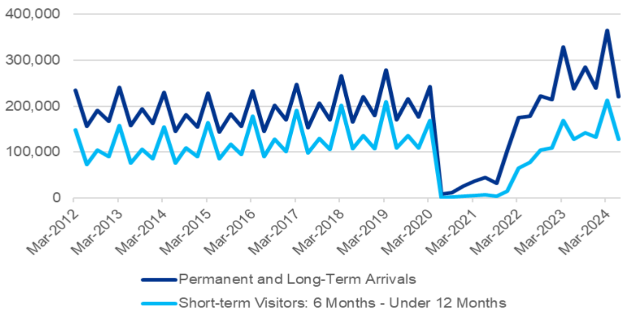
High immigration rates have added significant pressure to the housing market. In FY23, net overseas migration (NOM) was 518,100, much higher than the original government estimate of 400,000. The Budget in FY24 projected Nom to be 397,500; however, this forecast has nearly been reached with NOM of 387,000 by the third quarter of the financial year.

It's important to note that short-term visitors, primarily consisting of those visiting friends and relatives, as well as tourists, are not included in the Estimated Resident Population, representing about half that of permanent visitors. These visitors also significantly contribute to the demand for housing in Australia.

The ABS Estimated Resident Population excludes short-term visitors who do not meet the 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 temper increases in migration by tightening the visa process for migration workers and international students. As a result of these measures, the government is forecasting a sharp decline in NOM in this year's Budget, with NOM being expected to decrease to 261,500 in FY25 and 255,700 in FY26.

Chart 6 – Foreign immigration



Source: ABS, Haver, KPMG

Foreign investment remained much lower than pre-pandemic levels, with buyers from China leading the slowdown

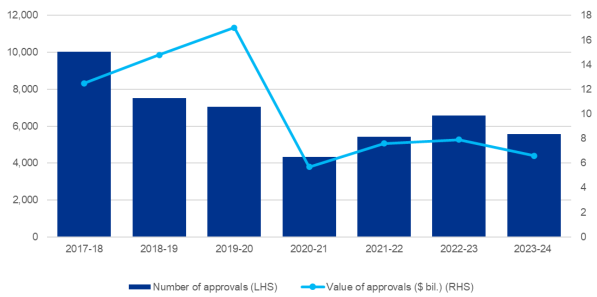
Foreign investment in residential real estate fell in FY24; with the number of residential real estate investment proposals approved was 5,581 with a total value of $6.6 billion, down from 6,576 approvals with a total value of $7.9 billion in FY23.

The main driver of this decline was the pull back of investors from China, with the number of FIRB approvals dropping by 23% between FY23 and FY24, from 2,601 to 1,998.

Nevertheless, China remains the largest source for approved residential real estate investment proposals by value in FY24 ($2.6 billion), followed by Hong Kong ($0.4 billion), Taiwan ($0.4 billion), Vietnam ($0.4 billion), and India ($0.4 billion).

Foreign demand for Australian residential real estate is tipped to experience further uncertainty this year as foreign buyers face increased fees and stricter compliance. Fees for investments in established dwellings will rise, but lower fees will be introduced for 'build to rent' projects. This is anticipated to reduce foreign demand for established dwellings, while helping increase housing stock.

Chart 7 – Foreign investment activity



Source: Commonwealth Treasury, KPMG

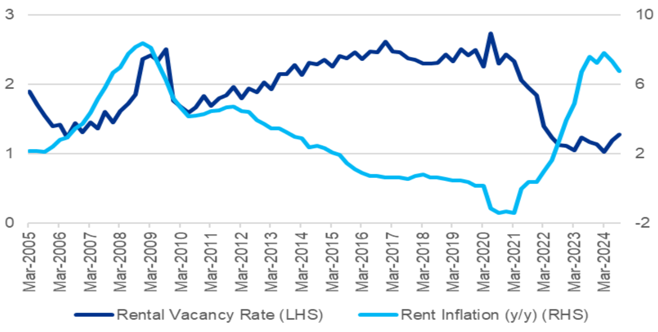
High rental costs may make it more appealing to own a home

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.

While the rental market remains tight, it has eased somewhat relative to the levels recorded earlier this year, with the SQM national rental vacancy rate index rising to 1.6% in Q3 2024 from 1.1% in Q1 2024 – still well below the pre-pandemic vacancy rate of 2.4%.

Headline rent inflation remains high in Q3 2024 but was moderated by the Commonwealth Rent Assistance (CRA). Rent inflation fell to 6.7% in Q3 2024 after appearing to having peaked at 7.8% in Q1 2024. Despite that, rent inflation remains one of the key contributors to aggregate inflation. The maximum rate available for CRA rose by 10.0% in Q3 2024, in addition to the annual CPI indexation and the 15.0% increase in assistance last year in Q3 2023. Excluding these changes to CRA, rents would have increased by 8.5% over the 12 months to the March 2024 quarter.

Chart 8 – Rent vacancy rate and rent inflation



Source: ABS, Haver, KPMG

Rental costs expected to ease

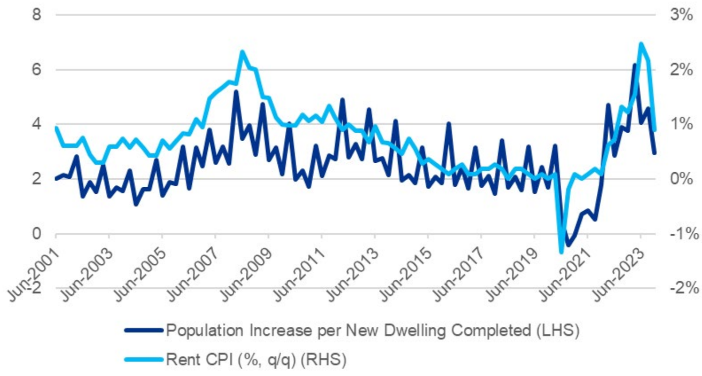
Robust population growth and limited housing supply have been the key contributor to the tight rental market. The population increase per new dwelling completed currently exceeds the levels observed during the immigration boom of 2008.

Our analysis indicates that the ratio of population increase per new dwelling 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 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 0.13 percentage point each quarter until the end of 2026. These numbers are downgraded from our earlier forecast last year as we anticipate a slight uptick in housing completions and a slowdown in population growth. These adjustments suggest to KPMG that annual rent growth will around mid-3% to mid-4% over 2025 and 2026.

Furthermore, KPMG estimates new dwelling completions need to be around 17% higher than current 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 versus rent inflation



Source: KPMG's calculation, ABS

The imbalance between housing demand and housing supply

The imbalance between housing demand and housing supply is the key driver of worsening housing affordability. We assess this imbalance by comparing our net housing supply forecast (completions minus demolitions) with the underlying demand forecast from Housing Australia.

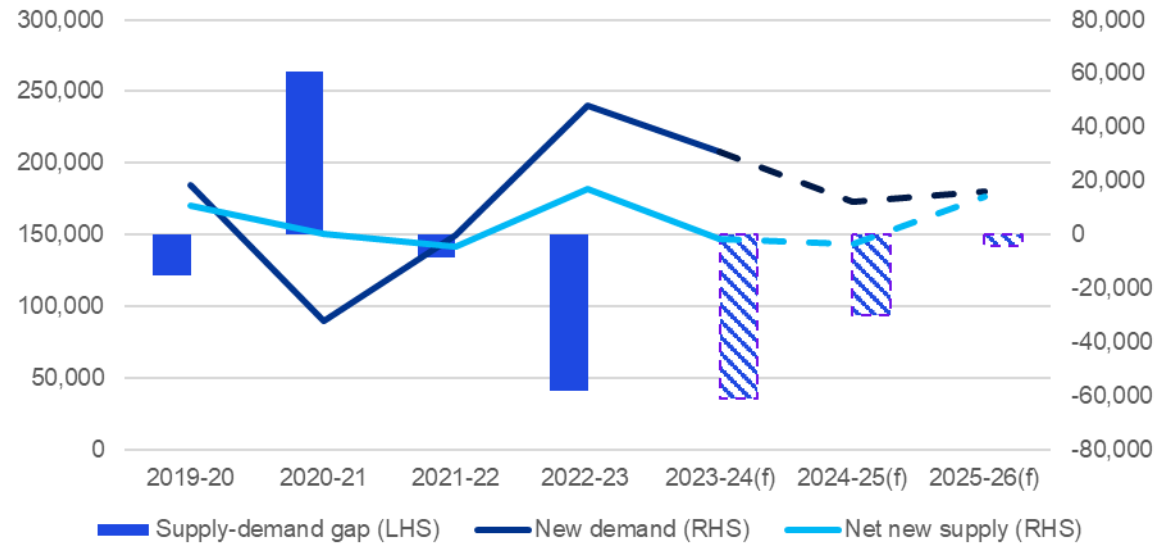
Housing Australia estimated underlying demand from the number of occupied dwellings needed to accommodate future population growth and household formation (based on the projections from the ABS). Demand for housing was forecast in 2023–24 to be 208,000 households. This strong number reflects extraordinary population growth but is nevertheless based on the 2023 Population Statement and could well be on the lower side, given the stronger-than-expected population growth in 2023–24. From 2024–25, underlying demand is forecast to stabilise at around 174,000 new households formed per year.

Partially offsetting housing demand from strong population growth was a temporary rise in household size as the cost-of-living crisis incentivised households, where they could, to increase the occupancy density of dwellings by taking on additional ‘flatmates’.

This recent experience is unlikely to indicate a permanent reversal in the long-term trend of declining average household size. From the 1980s to 2024, the average number of people per household decreased from around 2.8 to approximately 2.5. This long-term decline can be attributed to an ageing population, a post-pandemic preference for more personal space, and the rising trend of remote work. While the cost-of-living crisis has temporarily altered household formation patterns, KPMG expects the broader trend towards smaller households.

Between 2023 and 2026, net new market housing supply is expected to total 467,000 dwellings. New demand is expected to total 562,000 households. This creates a shortfall of approximately 95,000 dwellings relative to new demand. Due to this imbalance between supply and demand, housing affordability is expected to continue to remain strained over the next two years; however this imbalance is expected to start correcting by 2027. Nonetheless, it will take several more years for supply to address and clear the accumulated imbalances of the past few years.

Chart 10 – Housing supply–demand imbalance



Source: KPMG’s Calculation, Housing Australia

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 FY24, 1.5% in FY25, 1.4% in FY26 and 1.3% in FY27.

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

Housing stock

Australia's stock of dwellings change 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. 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 2022 quarter and the ABS does not plan to update the data regularly.

We construct the housing stock by adding housing completions and subtracting housing demolitions 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; and
- 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, the cost of renting versus mortgage repayment for a similar property (the renting-buying gap). However, these factors rarely display 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 have already peaked at 4.35% and will start to fall gradually from the end of Q1 2025 to 3.6% by the end of 2026
- inflation follows the forecasts prepared by KPMG Economics as per the December 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 11 – Forecasts of interest rate and inflation

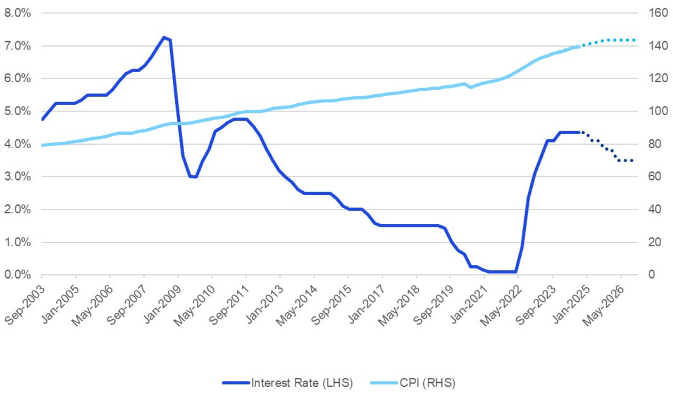
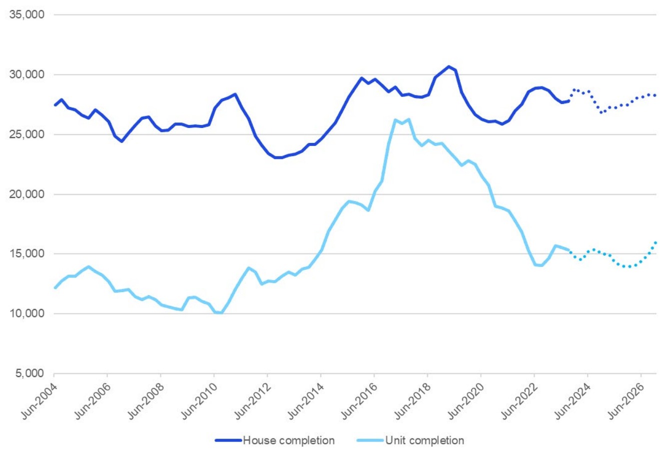


Chart 12 – Forecasts of housing completions (number of dwellings)



Our findings

The likely delay to the first cash rate cut, together with affordability issues will keep prices growth at modest levels in 2025

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

National house price growth is expected to be modest in 2025, recording increases at a slightly lower level than in 2024. KPMG forecasts national house prices to rise by 3.3% in 2025 and 6.0% in 2026. House price growth will be more pronounced in the second half of 2025, which aligns with the anticipated series of rate cuts.

While affordability issues are keeping buyers away and the beginning of the rate-cutting cycle has been delayed, there are still several factors supporting price growth. Dwelling supply continues to be limited throughout the forecasting period, which is a significant factor in sustaining price levels.

Additionally, increased investor sentiment, as measured by the Melbourne Institute–Westpac *Time to buy a Dwelling* Index, is edging closer to the favourable range and was at the highest levels in the December quarter 2024 since the March quarter 2022. The recovery of sentiment reflects the anticipation of rate cuts next year and will look to contribute positively to market dynamics. Moreover, potentially relaxed lending conditions driven by the awaited rate cuts could lead to heightened demand, offsetting the challenges associated with affordability and supporting modest price growth.

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

	House		Unit	
	Dec-25	Dec-26	Dec-25	Dec-26
Sydney	3.3%	7.8%	5.0%	6.1%
Melbourne	3.5%	6.0%	4.7%	7.1%
Brisbane	3.1%	5.6%	4.1%	3.3%
Adelaide	2.0%	3.6%	4.6%	3.1%
Perth	4.0%	4.6%	5.0%	5.0%
Hobart	1.8%	2.7%	4.0%	4.2%
Darwin	1.2%	2.5%	3.8%	2.7%
Canberra	3.5%	3.5%	4.0%	3.9%

More balanced growth in 2026

Looking ahead, as we look at 2026, several factors are expected to contribute to a more balanced and sustainable rate of price growth that are more aligned with long-term averages. The lower rates established by the end of 2025 will continue to support improved sentiment among buyers and investors, maintaining market confidence. In addition, improved housing supply, together with expected 'normal' population growth anticipated in 2026 will help to balance prices growth.

Complex market dynamics across cities

We are anticipating a mixed performance across capital cities. House prices are expected to grow moderately in some but will be weaker in others.

House prices growth in Perth is expected to continue to be the strongest, with steady mining sector performance forecast over the next two years and robust government capital expenditure being the key contributing factors.

Despite the affordability issues, Brisbane is also poised to record modest price growth over the next two years, driven primarily by a positive investor sentiment, partly fuelled by the prospect of the 2032 Olympics.

Adelaide is projected to have more balanced price growth over the next two years. This is attributed to an anticipated pick up in completions, a reversal of positive interstate migration, along with the affordability challenges common to all cities.

High costs in Sydney has made it the least affordable housing market nationally, which is contributing to a cooling of the market. On average, 68% of household income is required to service a new mortgage in Sydney, significantly higher than the national average of 50%. Despite this, Sydney's real estate market is anticipated to demonstrate resilience because of its status as a major job hub and also of the lack of housing supply to meet demand.

Melbourne is currently experiencing a minor downturn in house prices, However we expect Melbourne house prices to recover in 2025. While recent changes to the Victorian land tax and the current downward momentum may hinder growth, these negative factors are expected to offset by positive demand. Melbourne's house prices are relatively more affordable compared to another capital cities which will likely attract both interstate and overseas buyers.

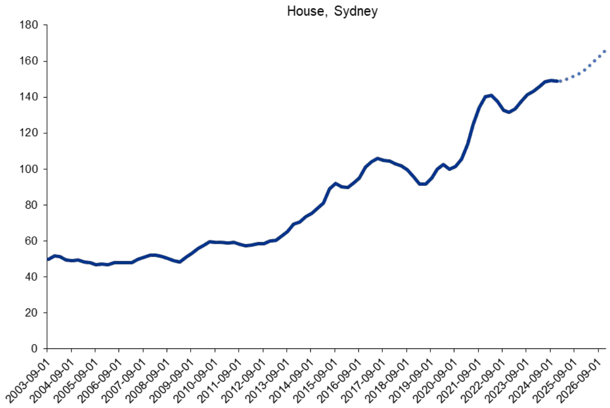
We anticipate modest prices growth in other capitals. Notably, Darwin has been recording weak growth in recent years. With strong government spending in the city relative to the size of the state economy, we expect this will help turn around Darwin's performance although it will take some time for this to appear.

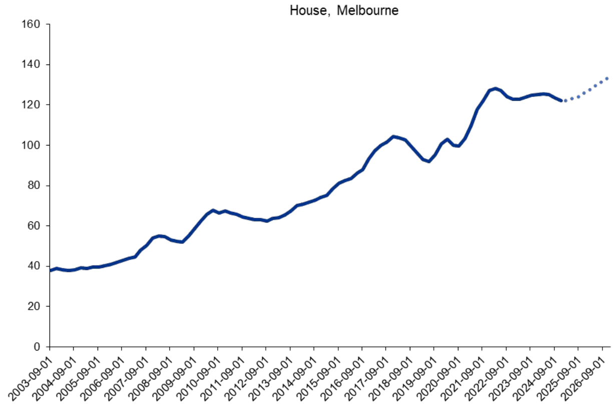
Affordability issues likely to drive buyers from houses to units

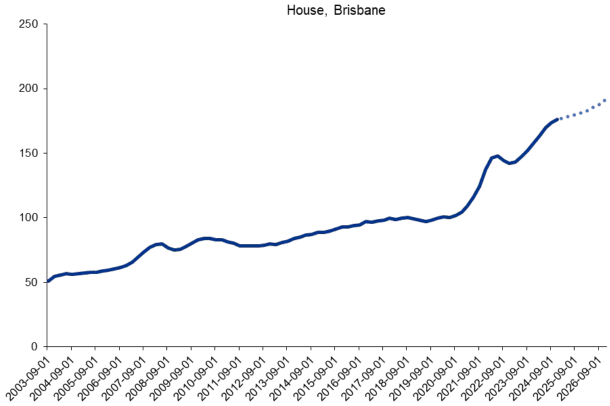
One of the key trends emerging in the housing market is unit prices are expected to outpace house prices, with apartment prices growing by 4.6% and 5.5% in 2025 and 2026 respectively.

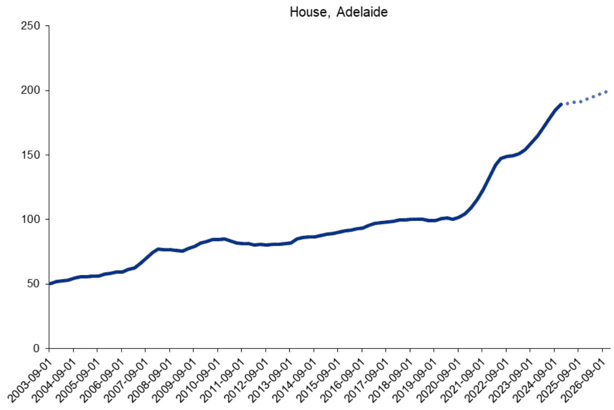
The shift is largely driven by ongoing affordability constraints, particularly in capital cities where the escalating prices of detached houses have left a large portion of the population priced out of that sub-market. As a result, there is growing demand for more affordable housing options, particularly apartments and townhouses. Attached dwellings offer relatively lower entry points compared to houses, making them more viable options for a larger pool of buyers.

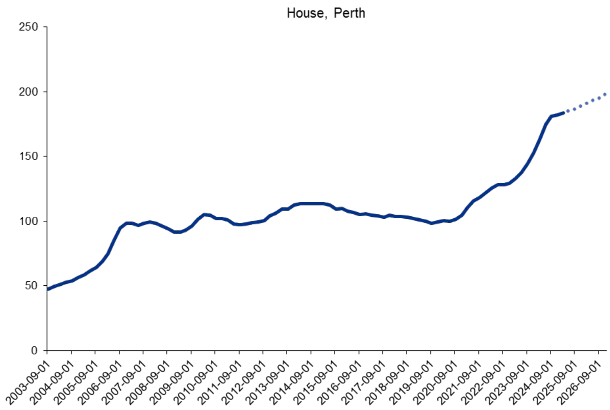
House prices forecasts (June 2020 = 100)

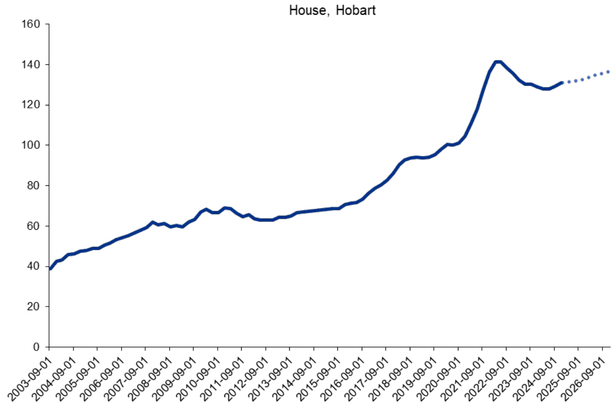


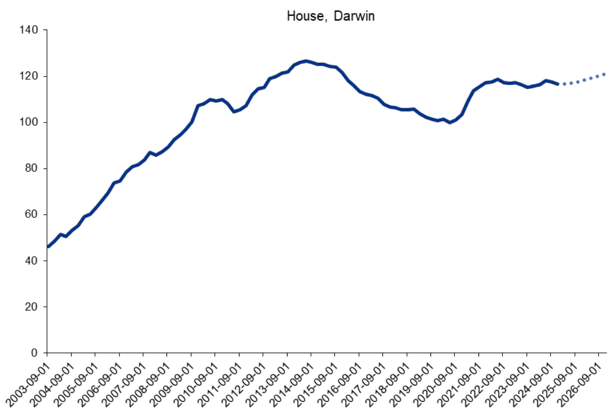


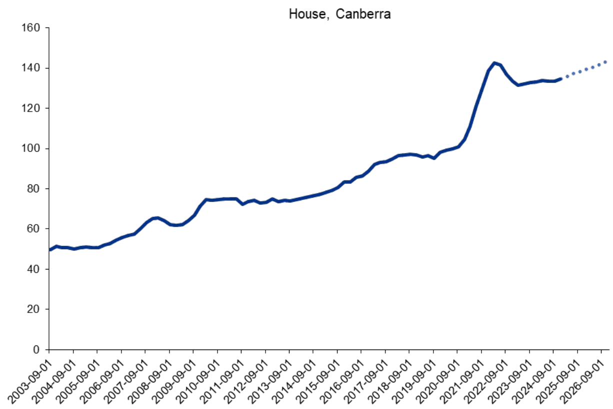




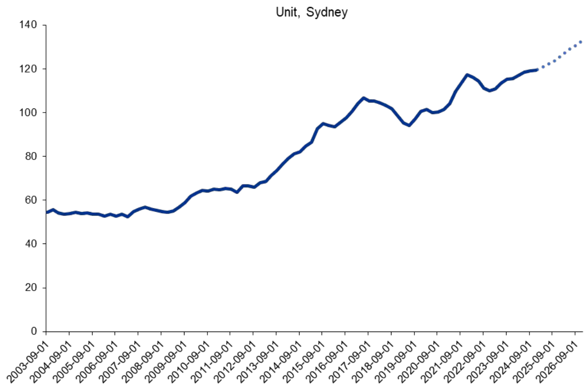


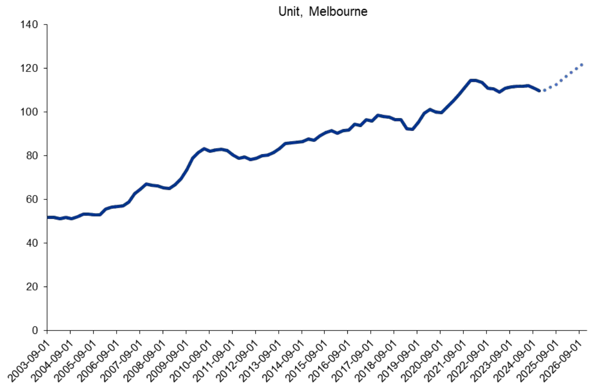


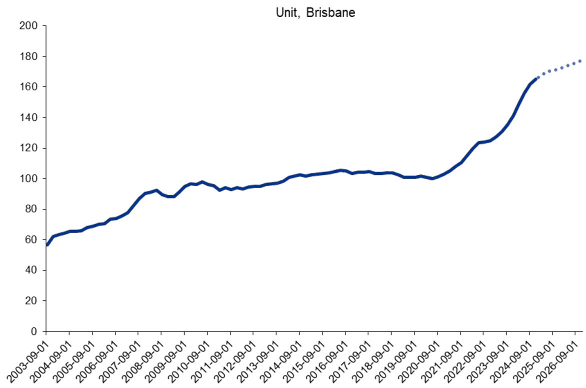


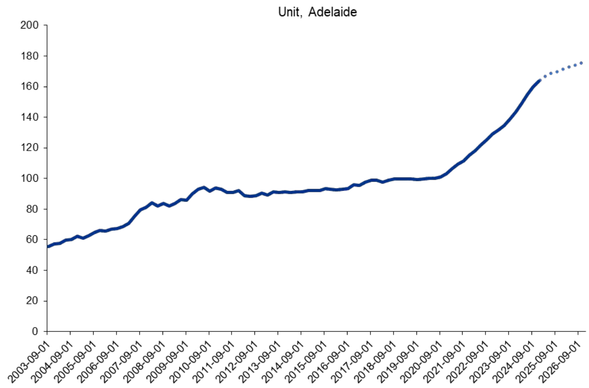


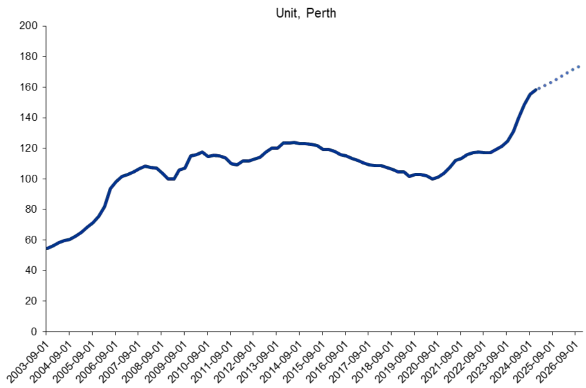
Unit prices forecasts (June 2020 = 100)

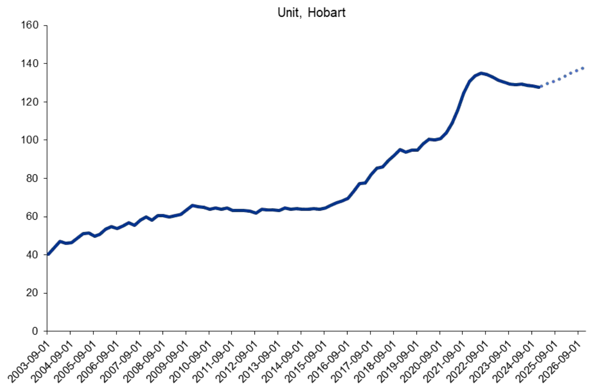


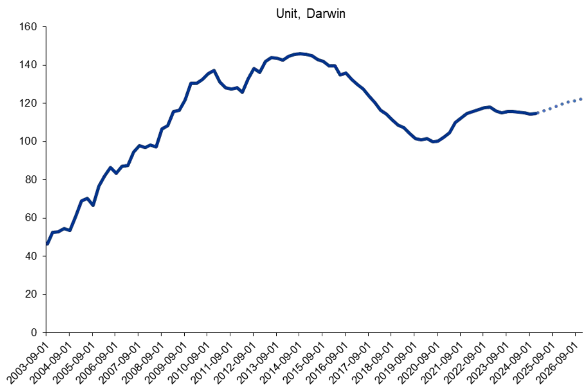


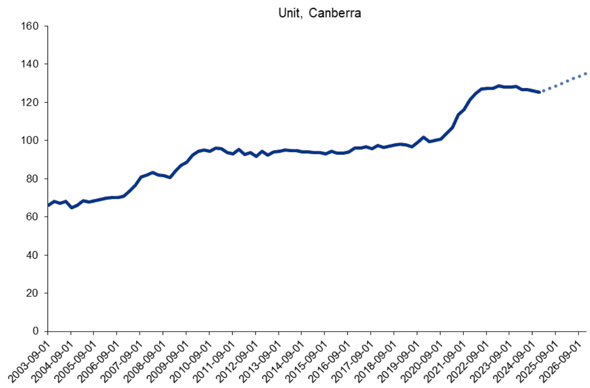












Source: ABS, Proptrack, KPMG

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