Intelligent Investment

Apartment vacancy and rent outlook

REPORT

Demand, supply, vacancy and rents for Australian apartment

CBRE RESEARCH
MARCH 2024

Apartment outlook

Rent outlook: CBRE expect median rents to grow by $155/week (+28%) between 2023-2028, across 53 precincts in Australian capital cities. A number of precincts are likely to see mid/high 30% rental growth.

We expect capital city vacancy will fall further to 0.8% by 2028, from 1.8% in 2023. These tight conditions will endure as vacancy stays at around 1/3rd of the previous decade average of 2.5%.

Demand to rent: Over the next 10 years, demand for housing is expected to benefit from the triple boost of rising population (+3.9m), rising jobs (+2.6m) and rising income (+$36k). We see c$860bn of additional income in the system to support mortgage, rents and other living expenses.

Monthly rents are 22% cheaper than alternate buy options at current prices. Mean-reversion of interest rates, to say 2-2.5% level, could see relative rental affordability retained as capital values rise.

Supply: CBRE forecast the future supply of apartments to range from a high of 70,000 (expected in 2026) to as low as ~60,000 in 2025 and 2027. Australia's forecast population growth requires apartment supply of ~75,000 pa to avoid further falls in vacancy.

- **Sydney:** Apartment delivery to average 14,500 pa over 2024-28, well below 30,000 pa demand for housing stock. Vacancy rate is set to fall from 2.2% to 0.7% and avg. rent growth of 5% pa to 2028.
- **Melbourne:** Apartment delivery to average 10,000 pa over 2024-28, nearly 40% below Sydney. Demand for housing stock (apartments and communities) is likely to average 37,000 pa over the next 5 years. This should continue to drive down city-wide vacancy from 1.7% to 1.0%.
- **Brisbane:** Apartment delivery to average 5,200 pa over 2024-28. Demand for housing stock (apartments and communities) is likely to average 18,000 pa which will drive down city-wide vacancy from 1.1% to 1.0%.

Construction and capital value: Historically, capital values have grown at 3x construction cost growth. This unlocks land and encourages supply. But in the past 3 years, construction costs (+37%) have out-stripped value growth. In our view, capital value for residential projects will accelerate significantly higher to ensure a healthy ecosystem for developers.

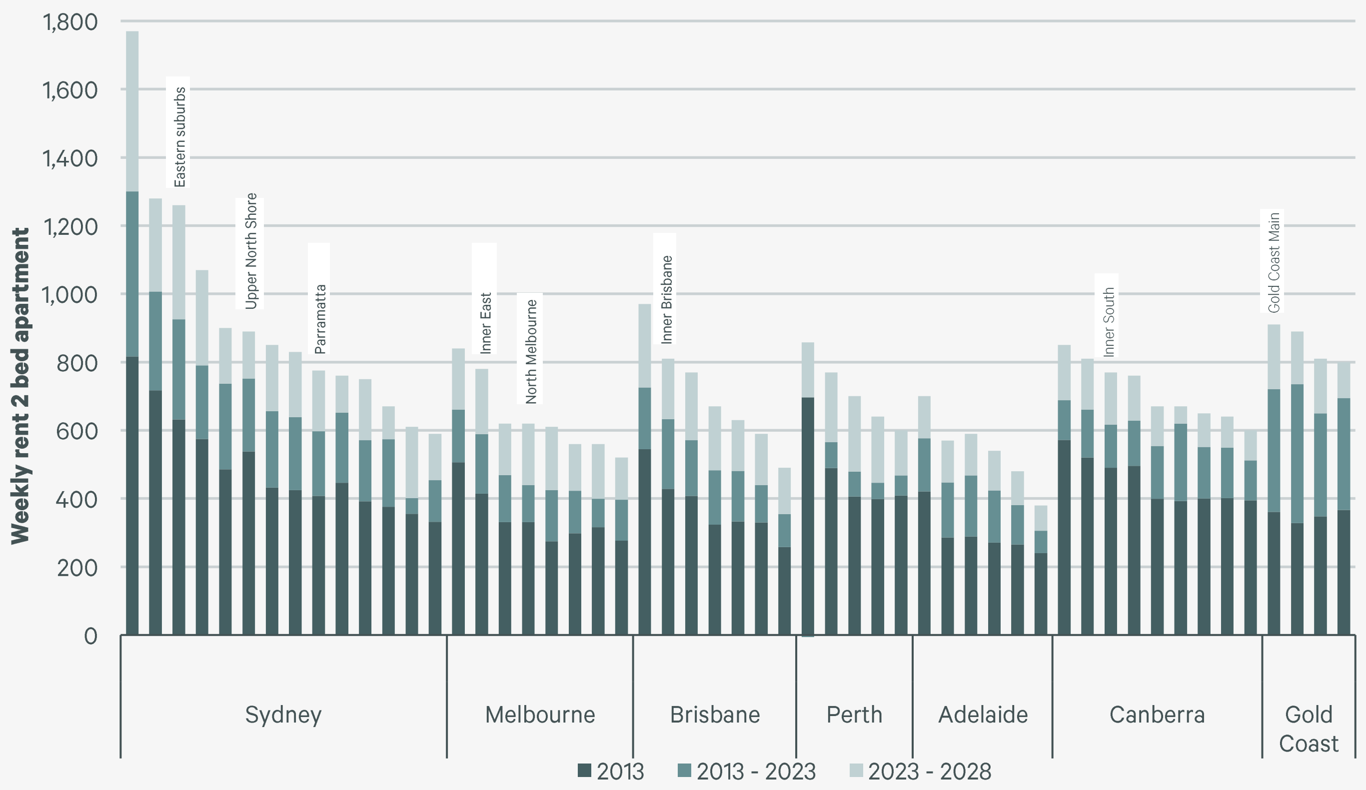
Rent outlook

CBRE expect median rents to grow by $155/week (+28%) between 2023-2028, across 53 precincts in Australian capital cities. We forecast growth will be nuanced:

- 25 precincts could see +30% growth over the next five years, including Sydney's Eastern Suburbs, Parramatta, Melbourne Inner East and North, almost all precincts in Brisbane, and North-West and South-West Perth
- In contrast, rent growth could be at or below inflation (15% cumm. to 2028) across no precincts in the capital cities, on our forecasts.

In 2013, just four precincts in Australia had an average rent over $600/week. These included Sydney and Perth CBDs, Lower North Shore and Eastern Suburbs. In June 2023, this had grown to 20 precincts and by 2028, we expect 41 precincts or over 75% of Australian 2-bedroom apartments to have a rent exceeding $600/week.

Figure 1: Apartment rents (2 bed) across Australian city precincts



Source: CBRE Research

Vacancy outlook

CBRE forecast that Capital City vacancy will fall to 0.8% by 2028 from 1.8% in 2023. By late 2020s, we forecast apartment vacancy will be at 1/3rd of the previous decade average of 2.5%.

A balanced market for apartment rentals would typically see vacancy around 4-5%. For most markets, vacancy has remained below 4% during the previous decade, except for the 2020/21 lock-down periods.

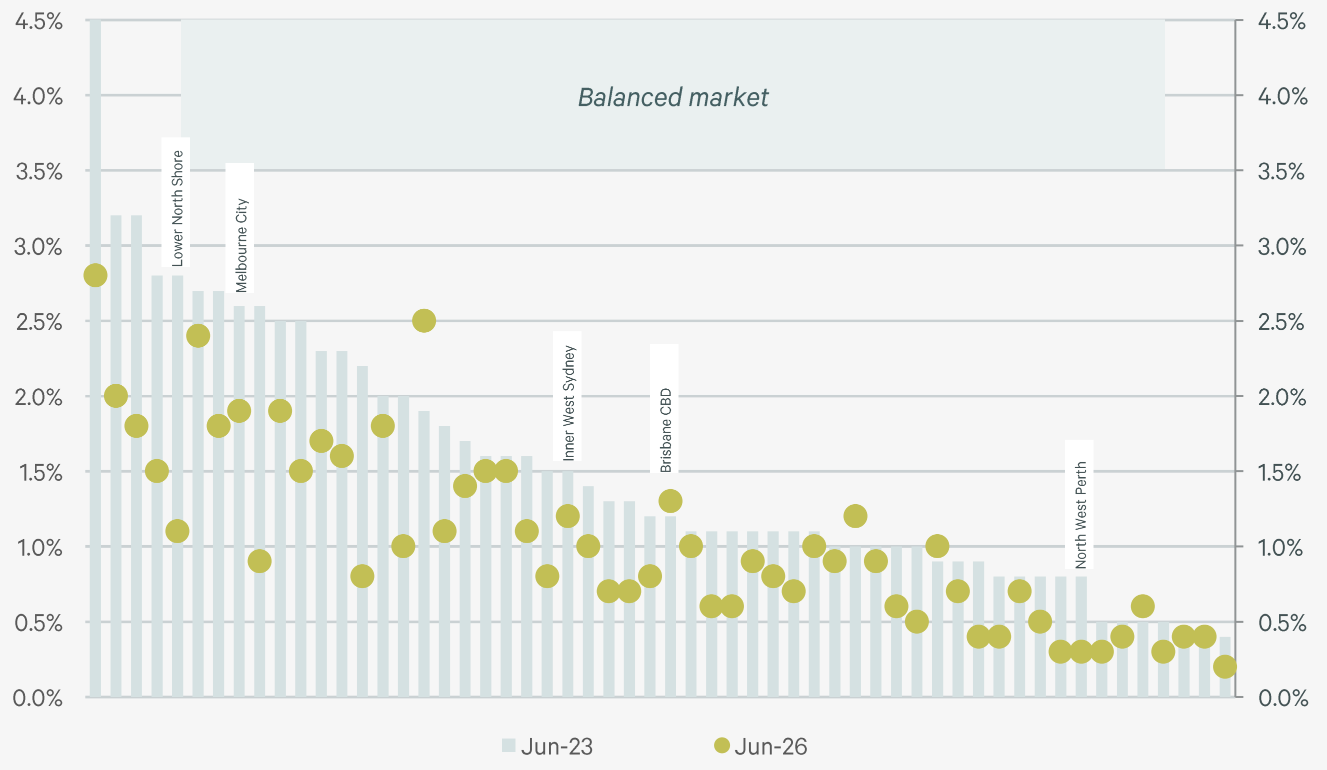
To balance the market, we estimate an incremental ~90,000 apartments are needed, over and above the current absorption rate. We forecast the annual absorption rate of house and apartments is c170k-200k pa.

Some of the markets where we expect to see the sharpest falls in vacancy include suburbs in:

- Close proximity to Eastern Suburbs, including Inner West and Lower North Shore
- Melbourne's Inner East and South East suburbs, including Bayside
- Brisbane's South East and North Gold Coast suburbs
- North Canberra

The vacancy situation is already extremely tight (sub 1%) in large parts of Adelaide, Melbourne and Perth. We expect this tightness to continue over the next five years.

Figure 2: Vacancy outlook across Australian city precincts



Source: CBRE Research, SQM

Demand “triple boost”

The demand for housing is expected to benefit from the triple boost of rising population, rising jobs and rising income. Collectively, this wealth effect will add ~$860bn of income over the next decade, a significant portion is likely to be directed towards housing & living. The average Australian spends 13%-20% of income on either rent or mortgage servicing.

Population growth

Immigration is likely to contribute to two thirds of Australia’s population growth, from 26.5m in 2023 to 30.4m by 2033.

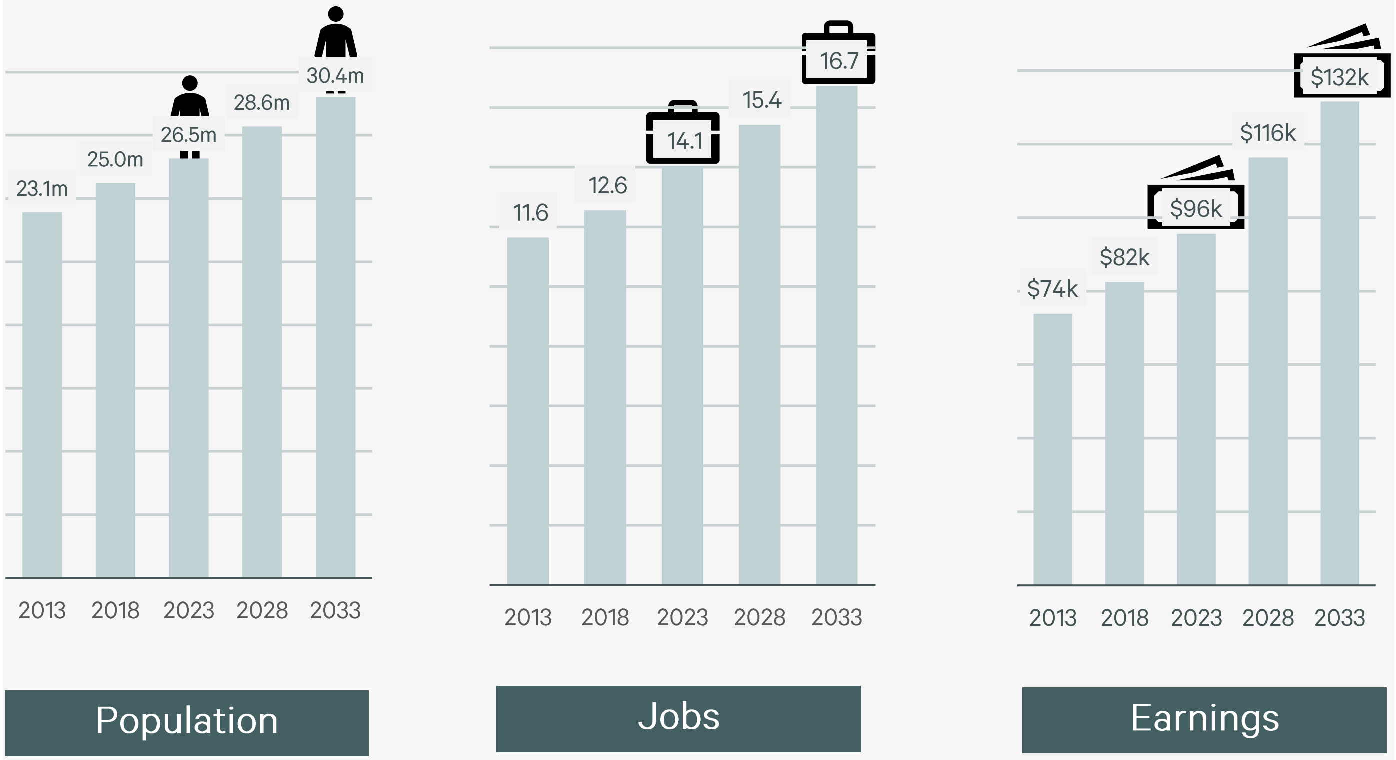
Jobs, jobs, jobs

The employment market has been particularly robust, adding 1.1m workers between Mar 2020 to Aug 2023. We see employment growing from 14.1m in 2023 to 16.7m in 2033.

Rising income & wealth

We see 2033 average annual income increasing from $96,000 currently to $132,000 pa by 2033. Wage growth had been circa 2.2% pa in 2018 but has accelerated more recently to 3.0% levels (2018-2023). Recent awards suggest a more bullish growth of +4.5% pa over the next few years before fading to 2.5% pa.

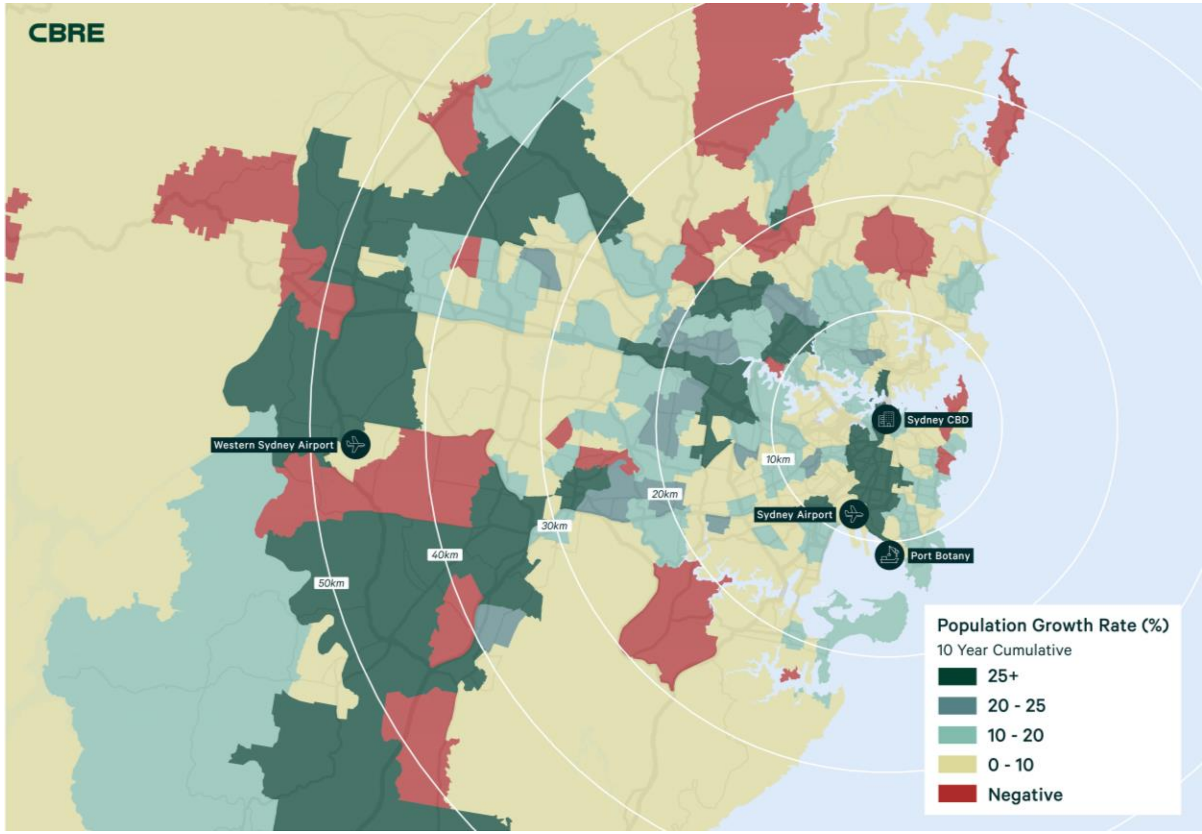
Figure 3: Triple boost of population, jobs and income



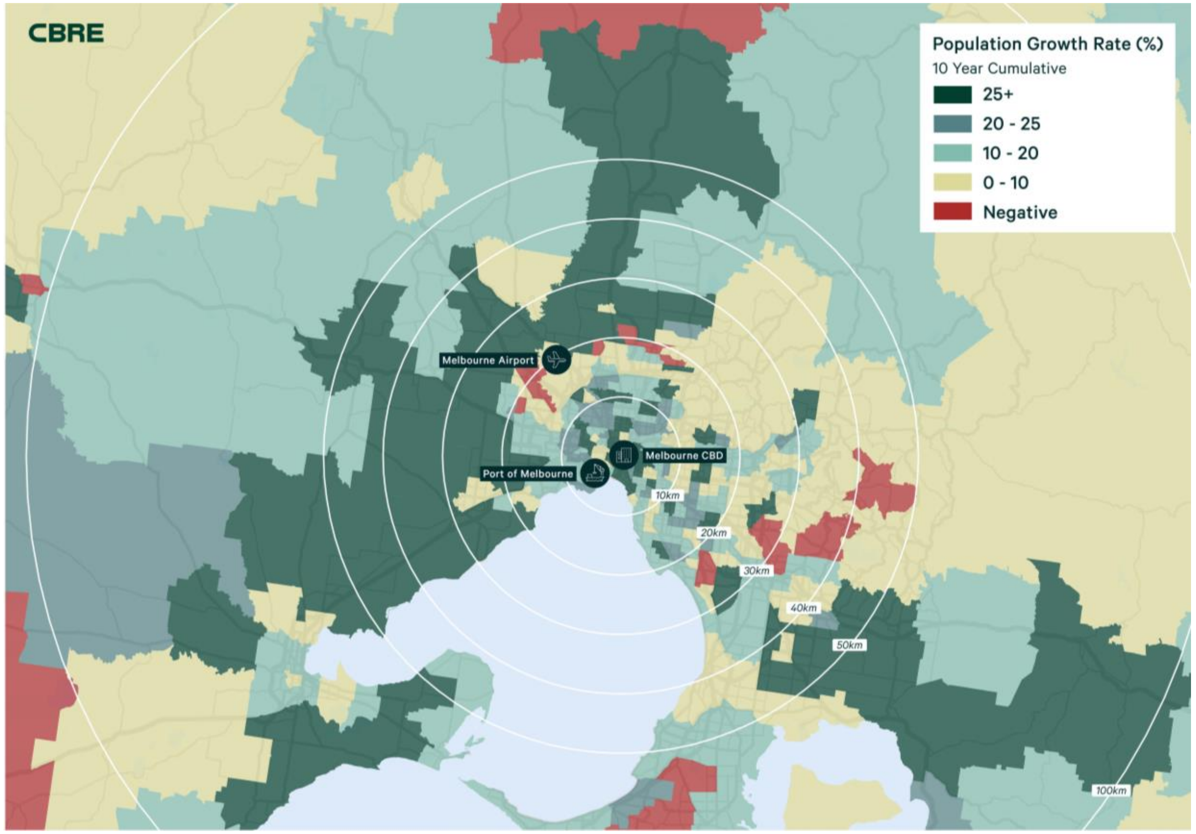
Source: ABS, 2023 Intergenerational report, CBRE Research

Zeroing in on demand

Sydney heatmap. Population growth 2021-2031

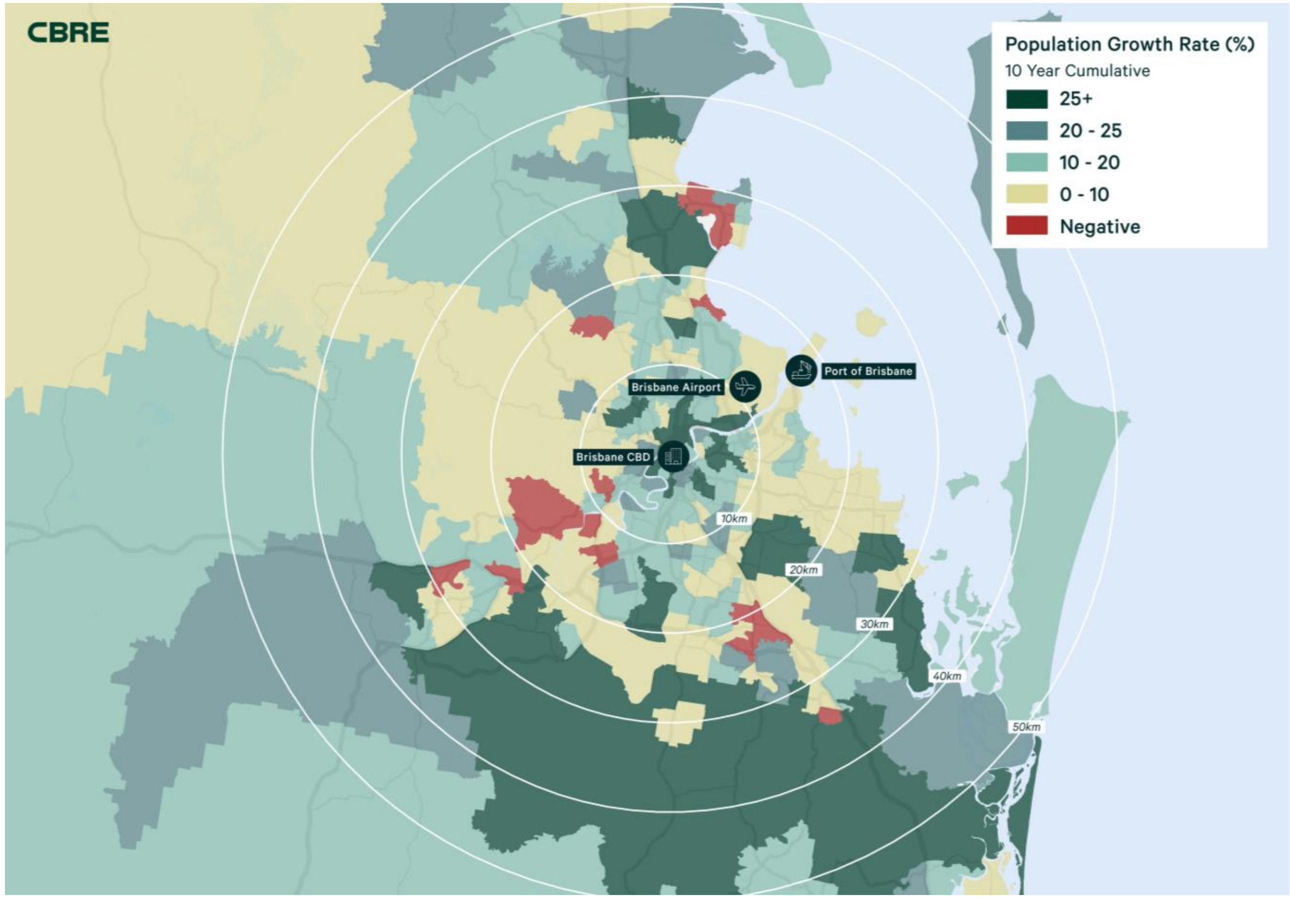


Melbourne heatmap. Population growth 2021-2031

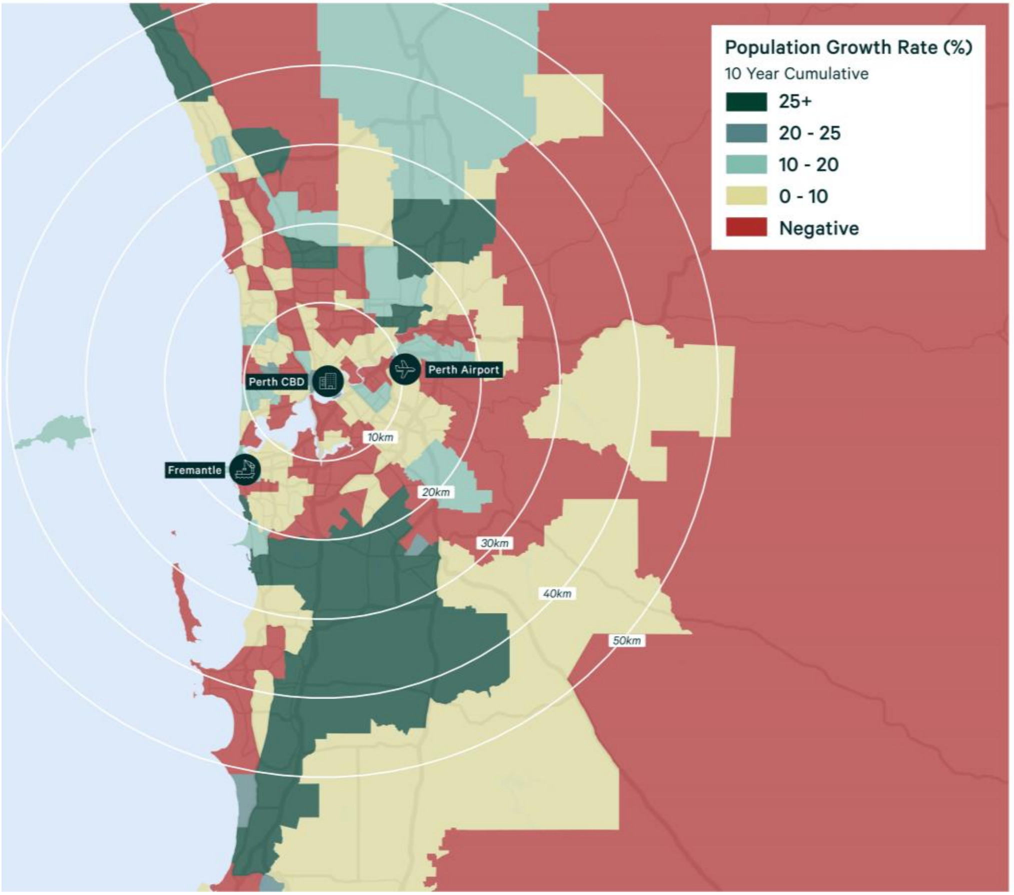


Zeroing in on demand

Brisbane heatmap. Population growth 2021-2031



Perth heatmap. Population growth 2021-2031



Demand: Rent vs Own

At present, monthly rent payments are 22% cheaper than alternate Buy options across most precincts in Australian capital cities. We looked at weekly average rent for apartments and compared it with mortgage repayments, assuming current capital values and 10% deposit.

Is this just because of the spike in mortgage rates? We don't think so. Looking back at 2018, monthly rental costs were ~30% lower than monthly mortgage repayments. The RBA's cash rate in December 2018 was 1.5% compared to 4.35% in December 2023.

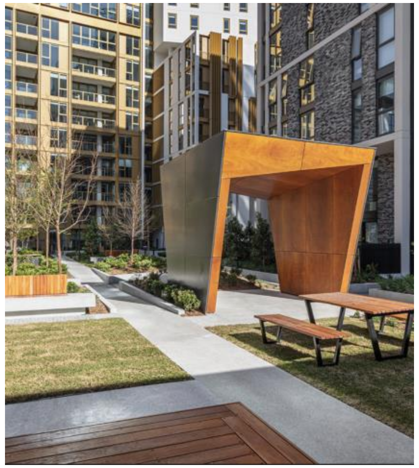
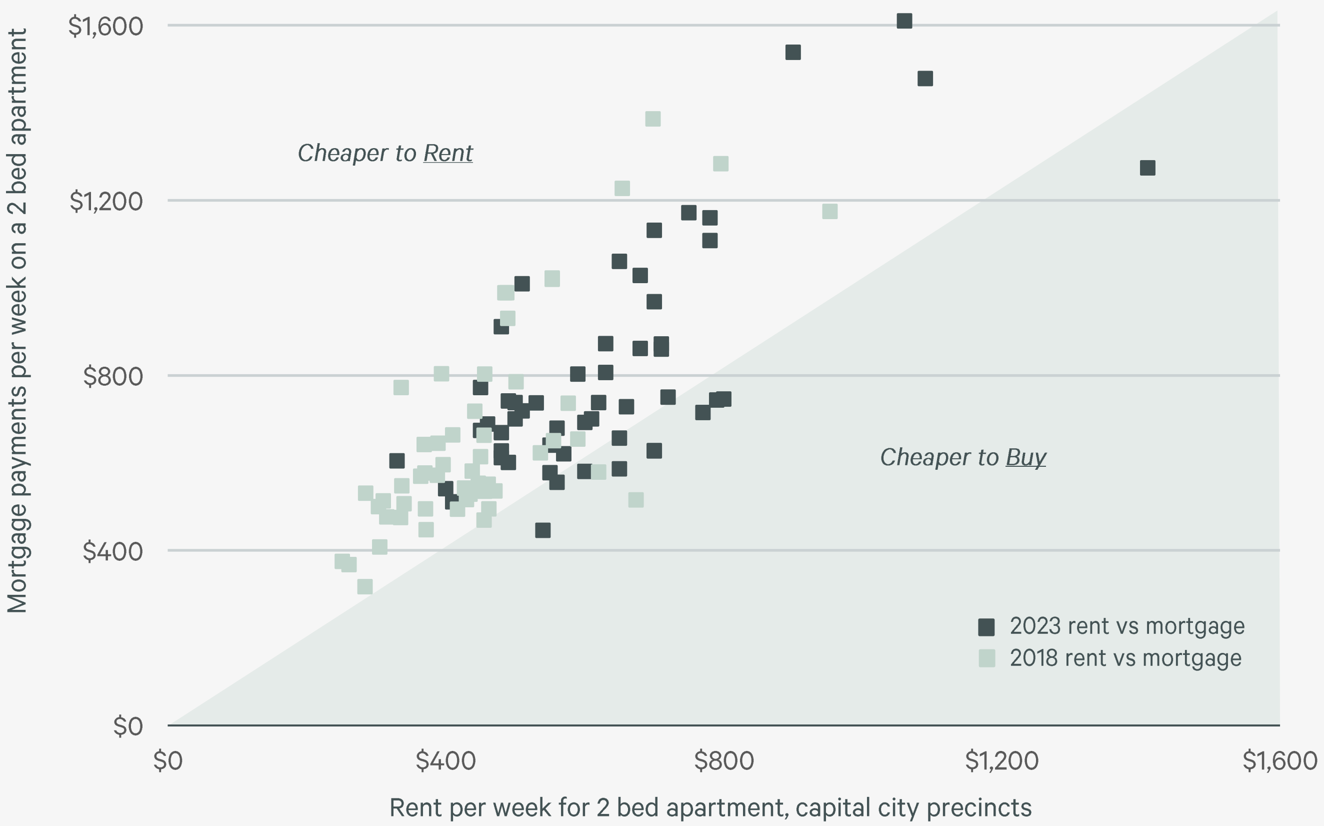


Figure 4: Weekly payments for rent vs buy options across Australian precincts



Source: CoreLogic, SQM, CBRE Research

National apartment supply – **where?**

CBRE forecast the future supply of apartments is likely to range from a high of 70,000 (expected in 2026) to as low as ~60,000 in 2025 and 2027. During low points of delivery, supply will be 40% below the previous peak in 2017 and near decade lows.

Current population growth forecasts demand apartment supply of ~75,000 pa to avoid further falls in vacancy.

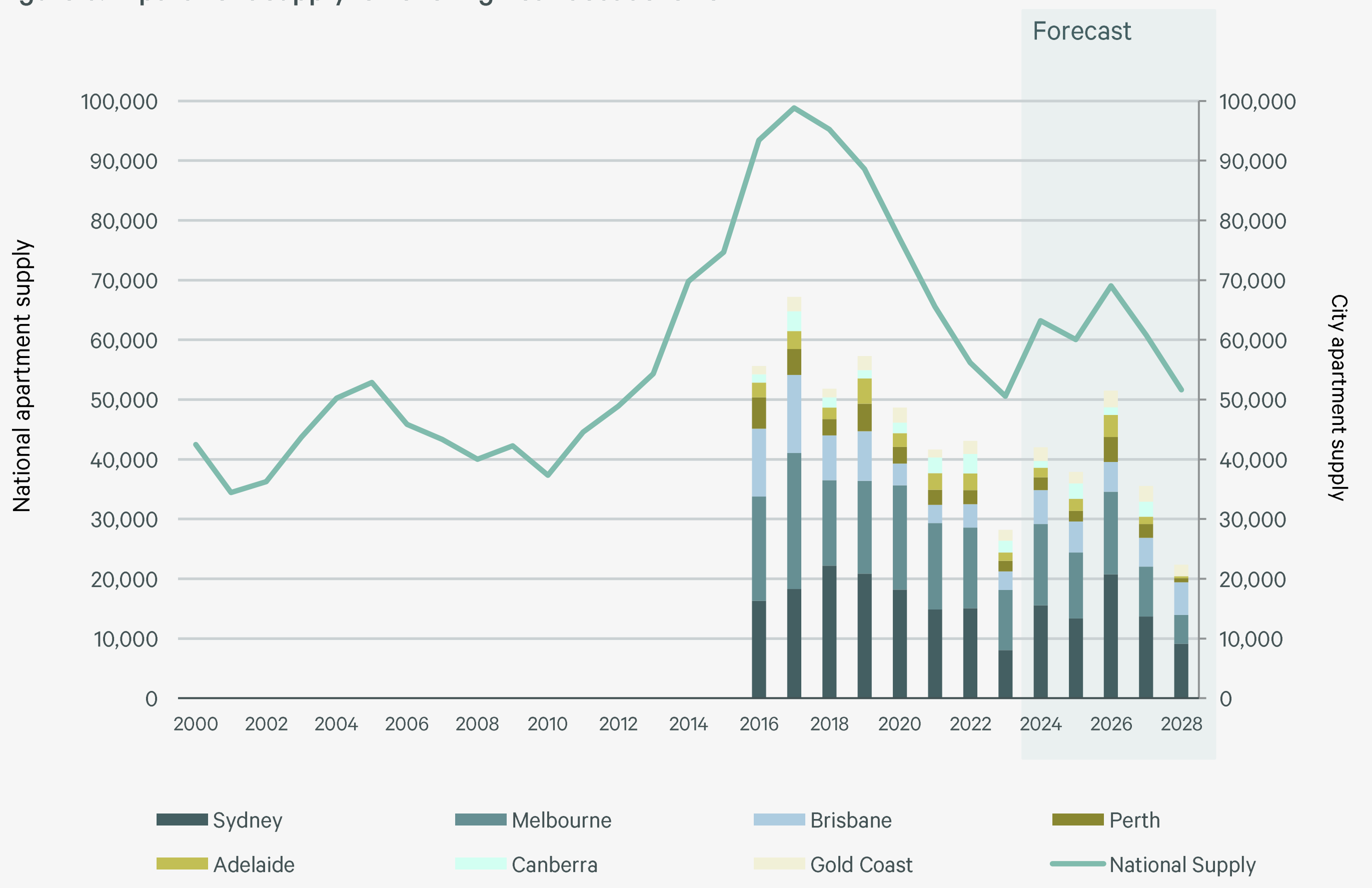
One of the key regions where supply is likely to be elevated will be The Hills and Western precincts and suburbs surrounding the Sydney Metro line. Compared to the past, we see a dearth of new supply in Brisbane and Melbourne over the next 5 years.

Tight credit conditions and prospect for capital value growth are likely to be key features of the future pipeline. Looking back at the GFC, tight credit conditions had lowered supply by 10% in 2010, before a recovery, partly led by ~20% capital value growth over the same period.

Our apartment supply forecasts are probability adjusted to take into account project timelines and potential of reaching completion. Increased capital flows from the Housing Australia Future Fund and BTR could increase our long-range forecasts. But this is unlikely to be a material driver of supply over the next 3-5 years.

Current population growth forecasts demand apartment supply of ~75,000 pa to avoid further falls in vacancy.

Figure 5: Apartment supply is hovering near decade lows



Source: ABS, Cordell's, HIA, CBRE Research

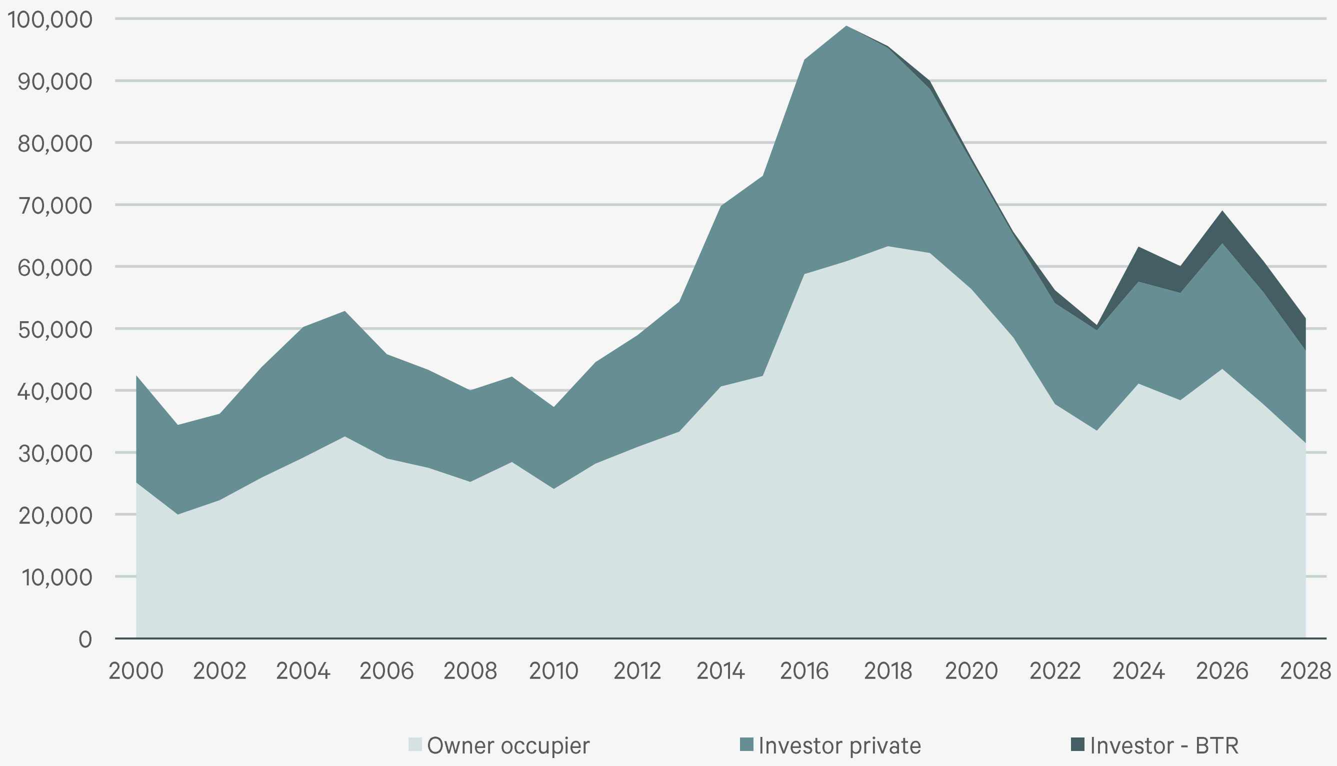
National apartment supply – **who?**

Over the previous 25 years, owner occupiers have comprised 64% of purchasers of new apartment stock. Owner occupiers have been more prevalent purchasers post APRA's (financial regulator) intervention in the home lending market during 2017.

Our long-term forecasts assume that owner occupiers will comprise 60% of new supply purchase. Of the investor market, we see a growing share moving across to institutional build-to-rent (BTR) sector.

By 2028, we see institutional BTR comprising ~9% of new apartment supply, equating to about 5,000 apartments per annum. There is scope to grow this share further by 2028, if there is more ready access to sites and construction labour.

Figure 6: Owner occupier range between 58%-74% of buyers. BTR supply meaningful in late 2020s



Source: ABS, CBRE Research

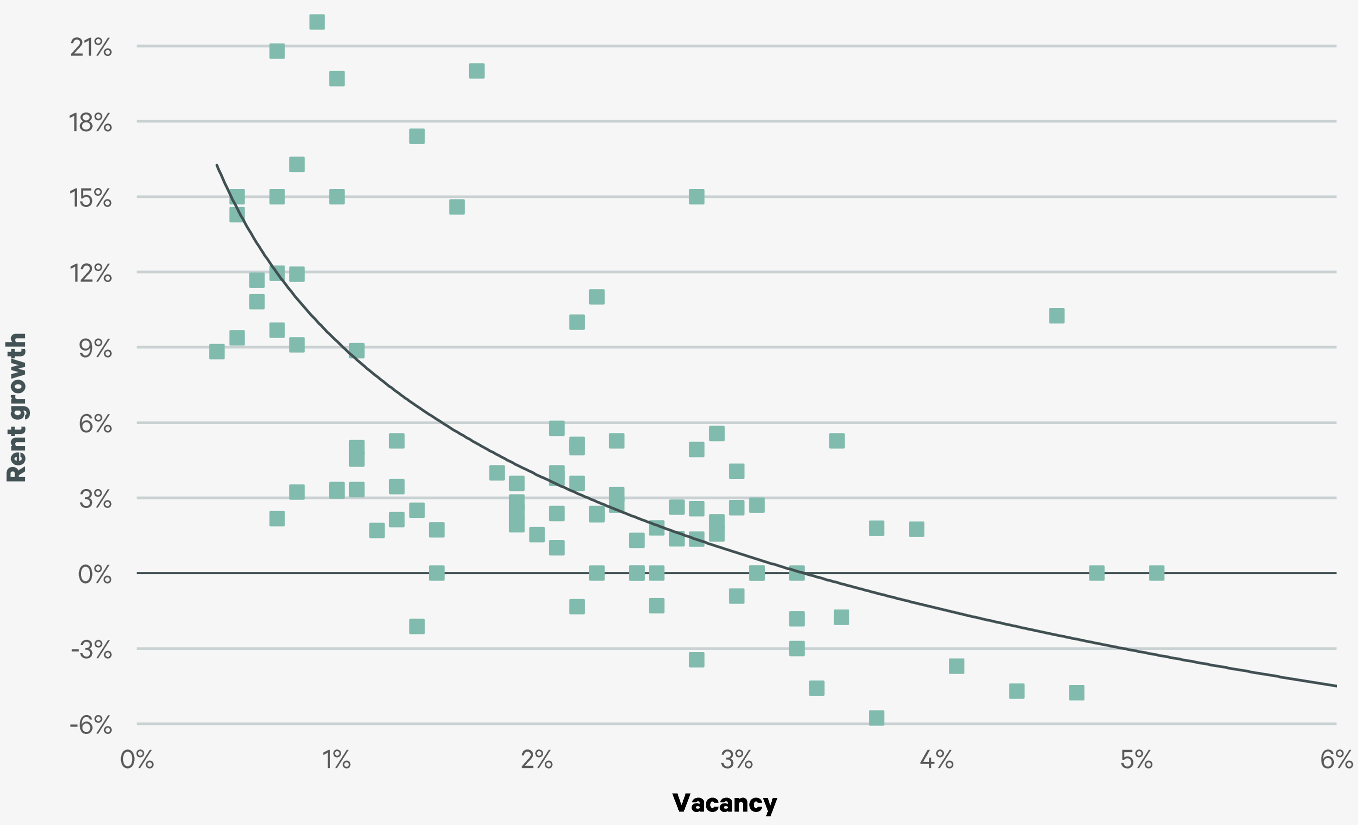
Rents and vacancy - **logarithmic**

Apartment rents and vacancy move in tandem, with lower vacancy spurring rent growth and vice versa. The relationship can be considered linear when vacancy ranges 3%-5%. However, when vacancy falls below 1.5%, rents start to exhibit more pronounced logarithmic growth.

Two thirds of capital city precincts currently have a vacancy rate below 1.5%. By 2026, nearly 80% of precincts will have a vacancy rate below 1.5%, in our forecasts. This should continue to provide a backdrop for robust rent growth.

This is similar to themes in commercial property. For example, Australia's record low industrial vacancy rate (0.6% as at June 2023) had spurred double digit rental growth.

Figure 7: Residential rent growth and vacancy relationship – capital cities



Source: ABS, REIA, CBRE Research

Construction costs rising

Over the past 25 years, median apartment values in Australia have grown by a cumulative 300%, compared to inflation 100% and construction cost growth of 125%. In turn, this has provided an encouraging environment for developers.

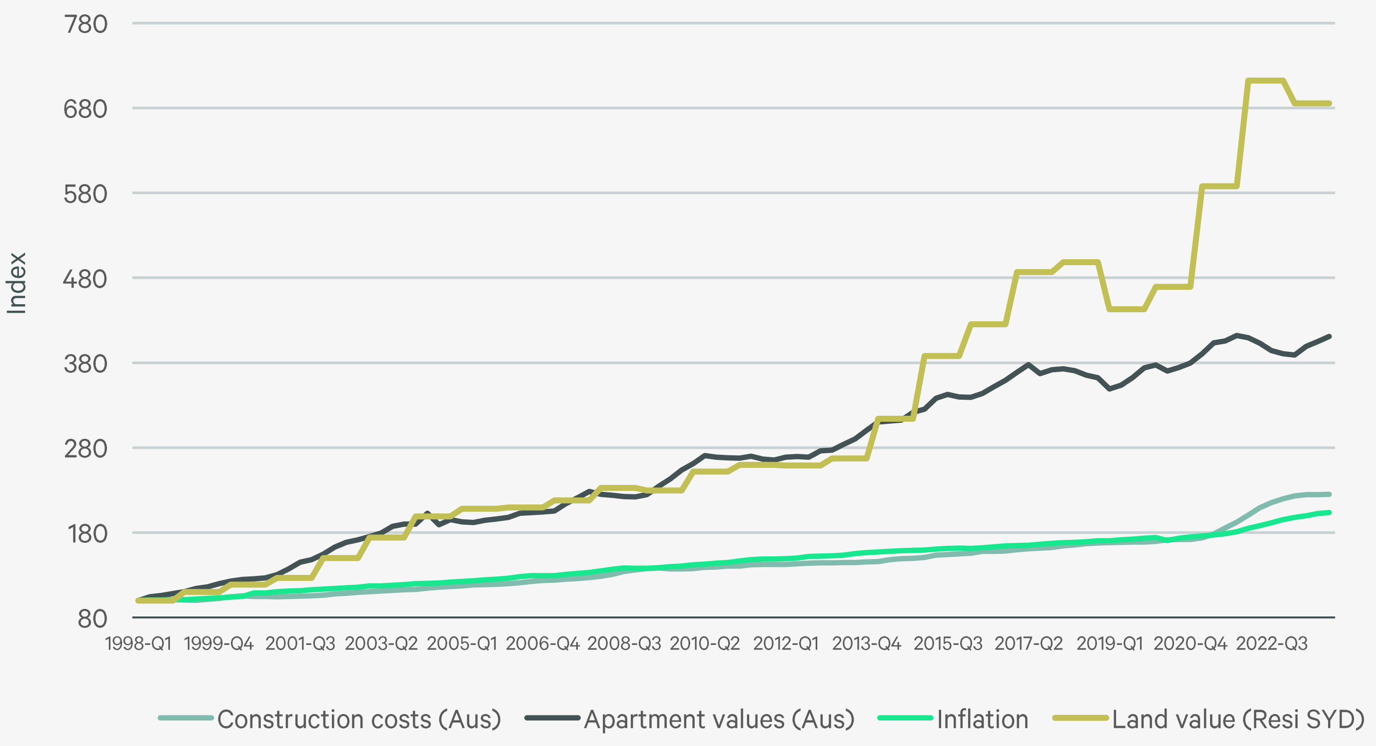
Land values have accelerated at an even faster pace of +600%, with limitations on stock in desirable locations - inner-city regions and access to amenities/transport infrastructure.

Construction costs for residential have increased by 37% over June 2020-June 2023, well in excess of growth in inflation. Construction cost growth now appears to be easing on better availability and pricing for raw materials. However, tight labour markets, particularly in Brisbane, may keep upward pressure on the cost to build new supply.

The stricter energy requirements and liveable housing standards will also impact the cost of new builds over the year to come.

The relationship between construction costs and apartment capital values has broken-down. This has hampered supply.

Figure 8: Apartment values vs construction costs. Last 25 years



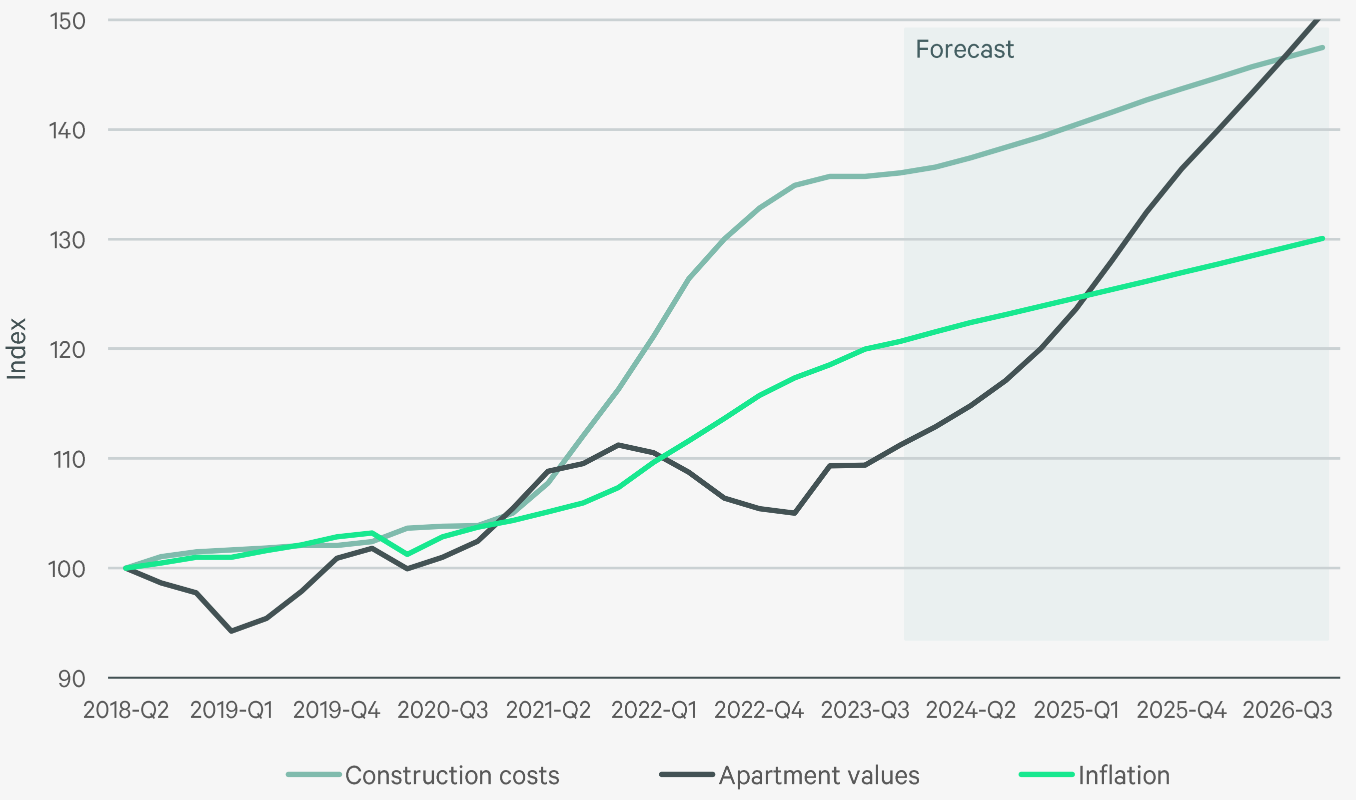
Source: ABS, REIA, CBRE Research

Values to reflect replacement cost

In the last 5 years, values have not kept pace with construction costs. This disparity is currently at 25%. It makes the existing stock of apartments an attractive market for investors, particularly during a period of tight vacancy and strong employment levels. We would expect this disparity to close-out and revert to a premium.

We expect apartment values to accelerate from 1H 2024 and 2025 as consumers adapt to higher income, low supply and scope for falling interest rates.

Figure 9: Apartment values vs construction costs. Last 5 years and forecast



Source: ABS, REIA, CBRE Research

Demand supportive of higher values

CBRE's Q1 2024 Residential Valuer Insights revealed that 44% expect apartment value growth over the next 12 months, with highest conviction in Brisbane metro, Gold Coast/Sunshine Coast and Sydney metro. Nationally, 4x as many valuers expect price growth vs price fall.

FIGURE 10: Expectations of apartment value movement in the next 12 months, Australia wide.

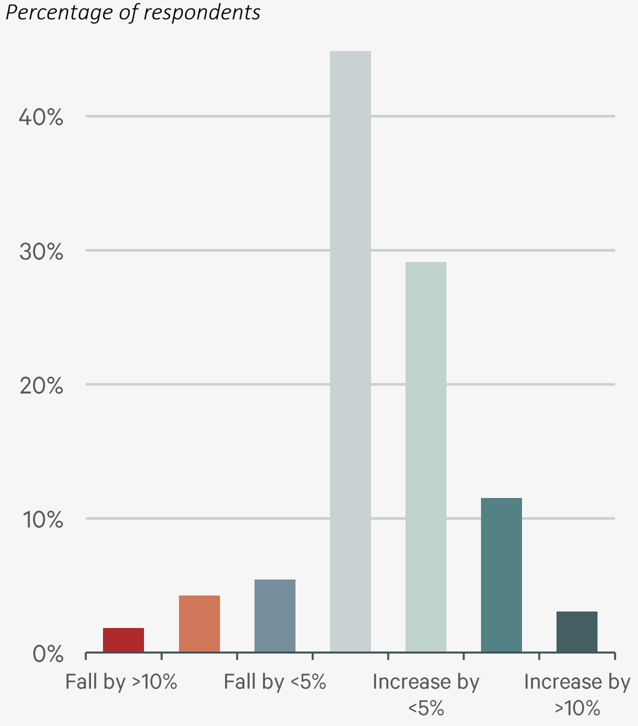
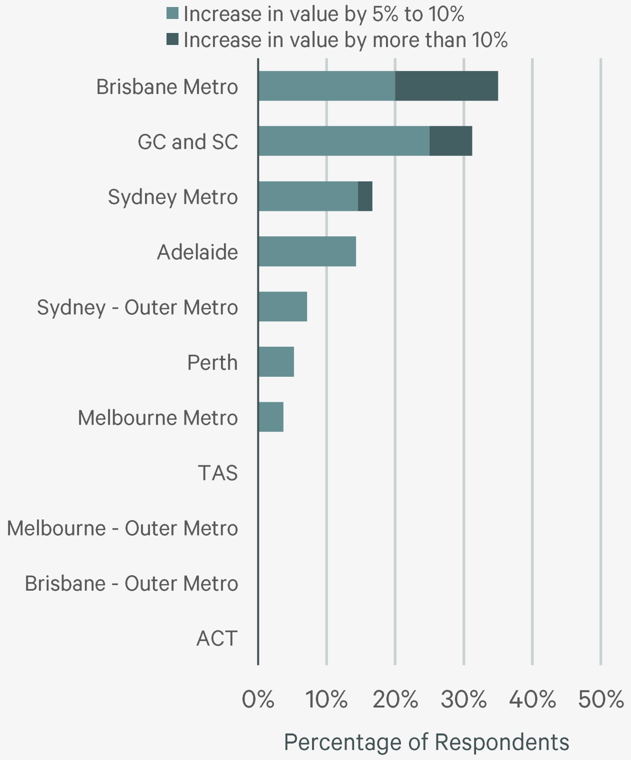


FIGURE 11: Responses indicating that apartment values are expected to increase by 5% or more.



Source: CBRE Research

Sydney

CBRE estimate Sydney's apartment delivery will average 14,500 pa over 2024-28. Demand for housing stock (apartments and communities) is likely to average 30,000 pa over the next 5 years. This should continue to drive down city-wide vacancy from 2.2% to 0.7% over 2023-2028.

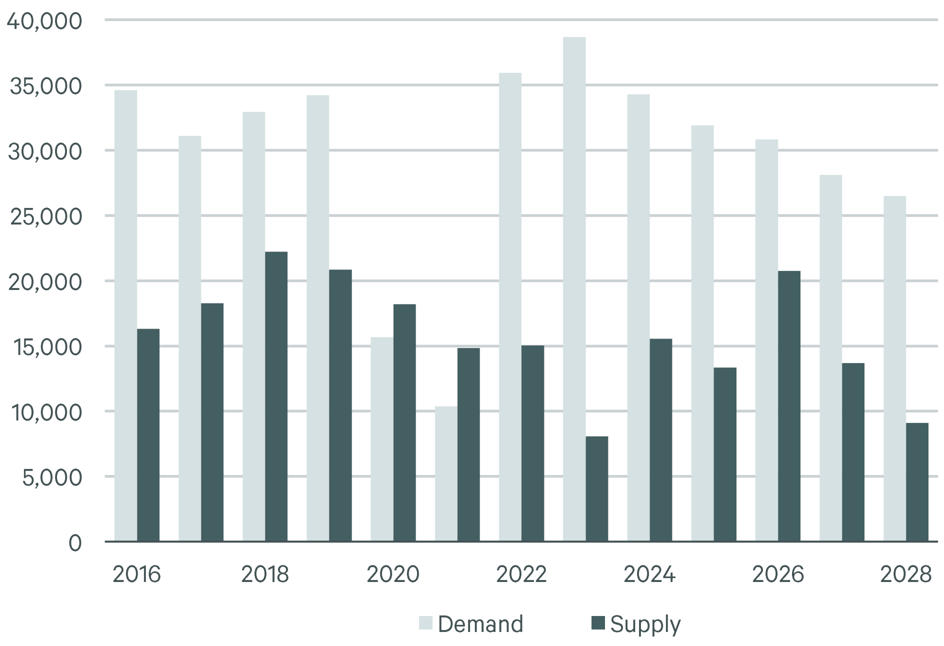
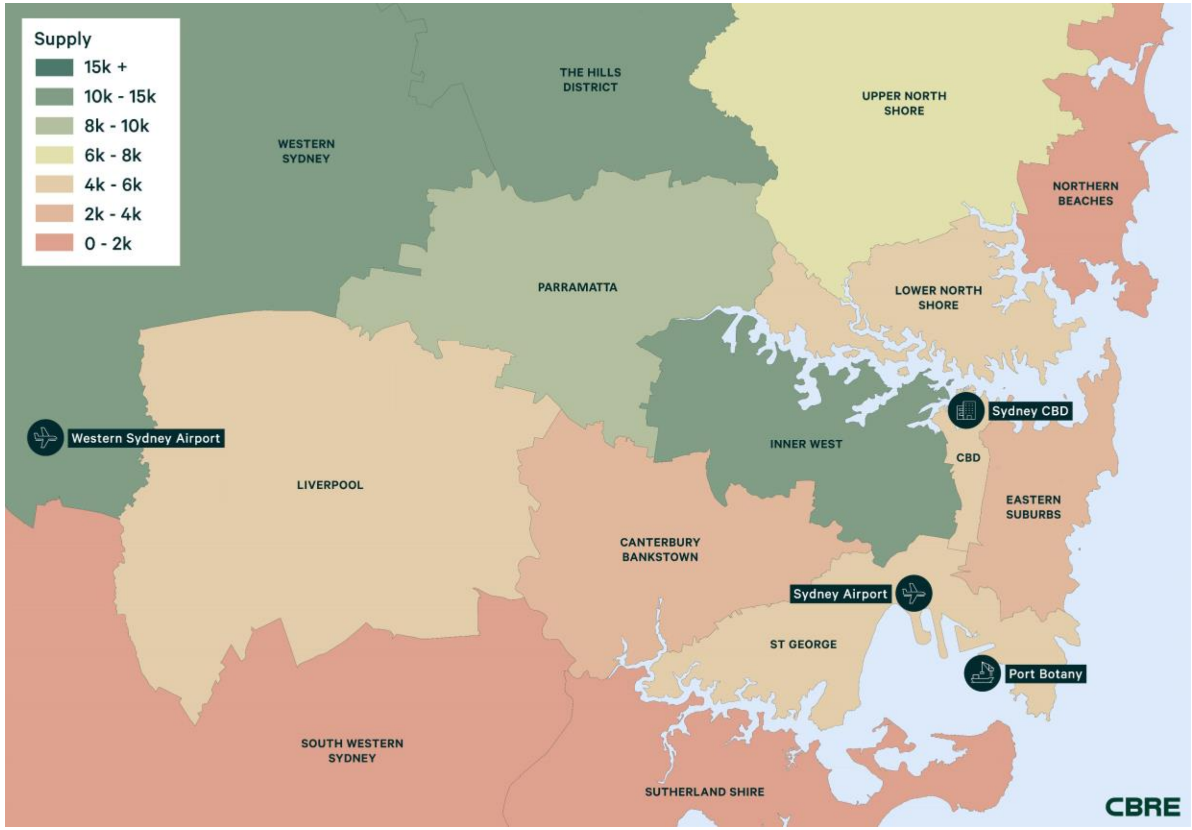


Figure 12: Sydney apartment supply over 2023-28



Melbourne

CBRE estimate Melbourne's apartment delivery will average 10,000 pa over 2024-28, nearly 40% below Sydney. Demand for housing stock (apartments and communities) is likely to average 37,000 pa over the next 5 years. This should continue to drive down city-wide vacancy from 1.7% to 1.0%.

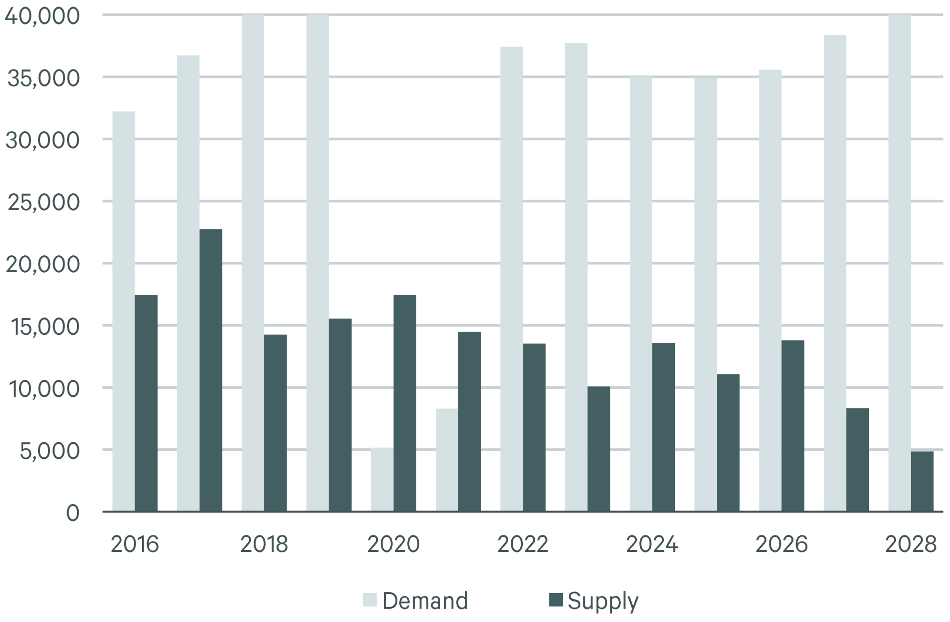


Figure 13: Melbourne apartment supply over 2023-28

Brisbane

CBRE estimate Brisbane's apartment delivery will average 5,200 pa over 2024-28. Demand for housing stock (apartments and communities) is likely to average 18,000 pa over the next 5 years. This should continue to drive down city-wide vacancy from 1.1% to 1.0%.

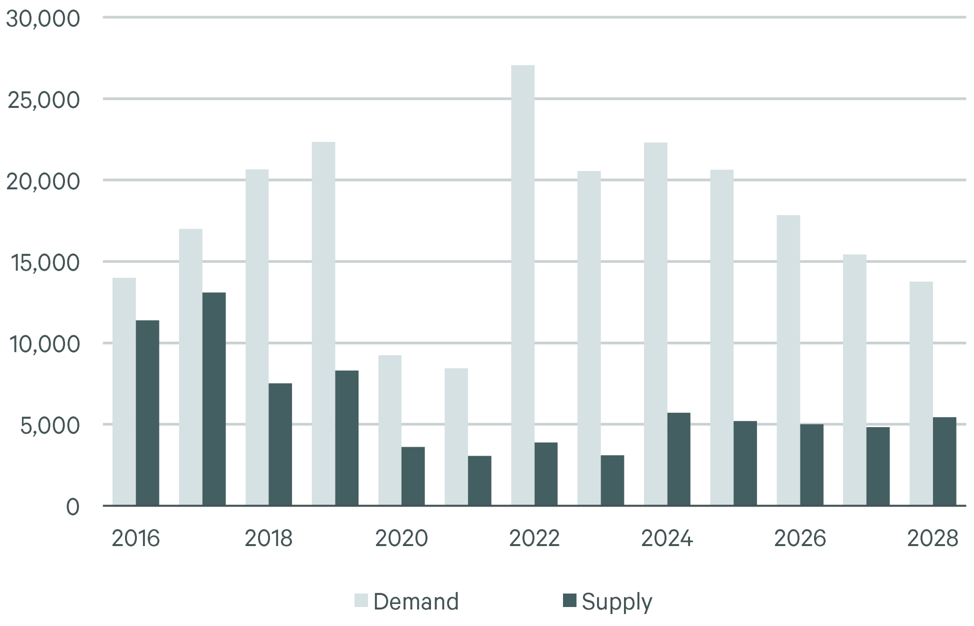
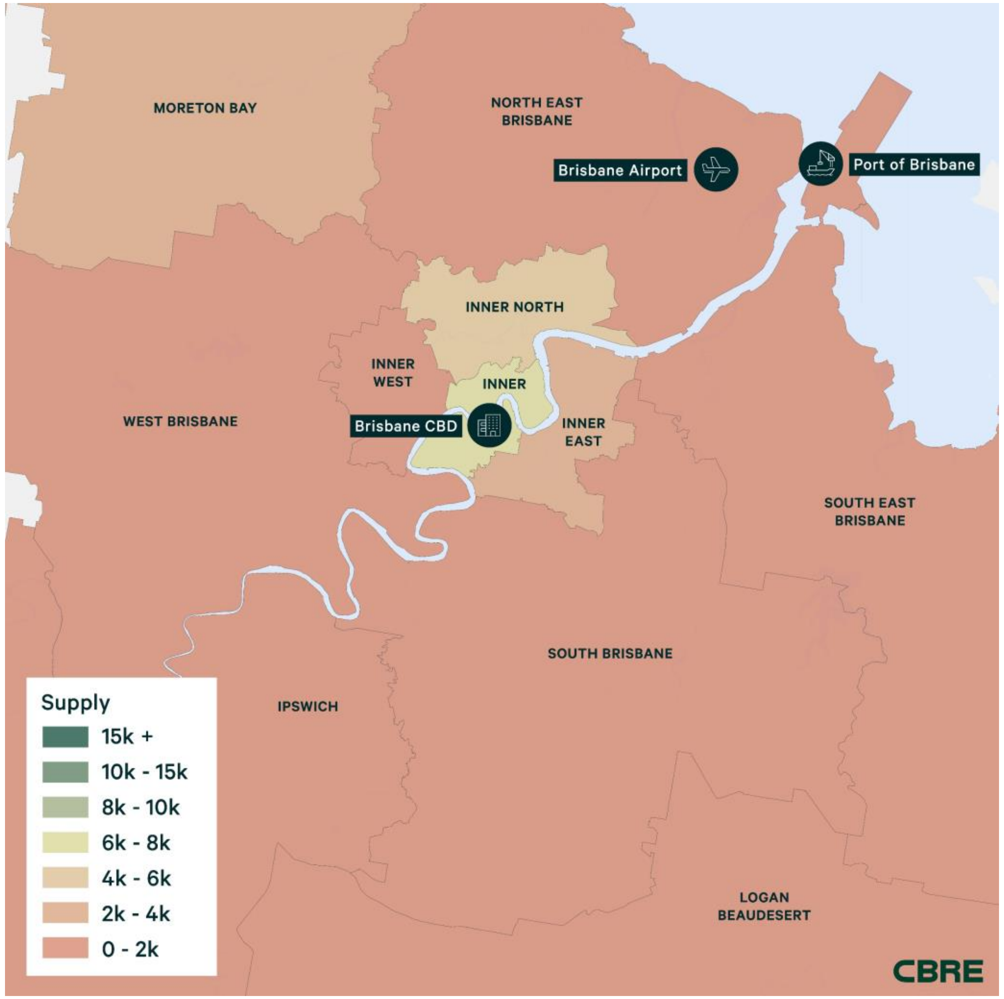


Figure 14: Brisbane apartment supply over 2023-28



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