Back to the City

MaxCap Group Research – June 2024

After the exodus...

Packing your bags again. With the unprecedented lockdowns and re-openings of recent years, we have seen two dramatic shifts in population out of, and back into, the major capital cities. These are driving some remarkable trends in housing demand, rents and pricing.

Doing a big U-turn. The COVID years were marked initially back a hurried flight from densely-populated cities, in search of a socially-distanced lifestyle. Since then, there has been a massive population rebound within cities, partly accelerated by a renewed migration boom.

A broader uplift in rents. Amid a lack of available housing and a broad surge in rents, there is a widening performance gap taking hold, with city-centre and inner-urban rents rising more strongly, as tenants compete for a finite pool of housing closer to the central city cores.

Pricing patterns are clearly shifting. The pricing uplift of 2021 was clearly led by a range of lifestyle markets in the bush or by the beach. That pattern is unwinding with the return to work and living in the city. Inner-city markets have more scope to rise, given relentless demand.

Finding the next hotspots. We can identify forthcoming hotspots given the local patterns of housing demand and supply. Through this lens, we see more urgent undersupply in the major capital cities, and some oversupply risks in select sea-change and tree-change markets.

Follow the people (and their money). Out of these dramatic shifts, there are clear tactical investor choices ahead. There is a broad pattern of housing undersupply that will take some years to unwind, with key hotspots likely around specific parts of major capital cities.

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The ebb and flow of people

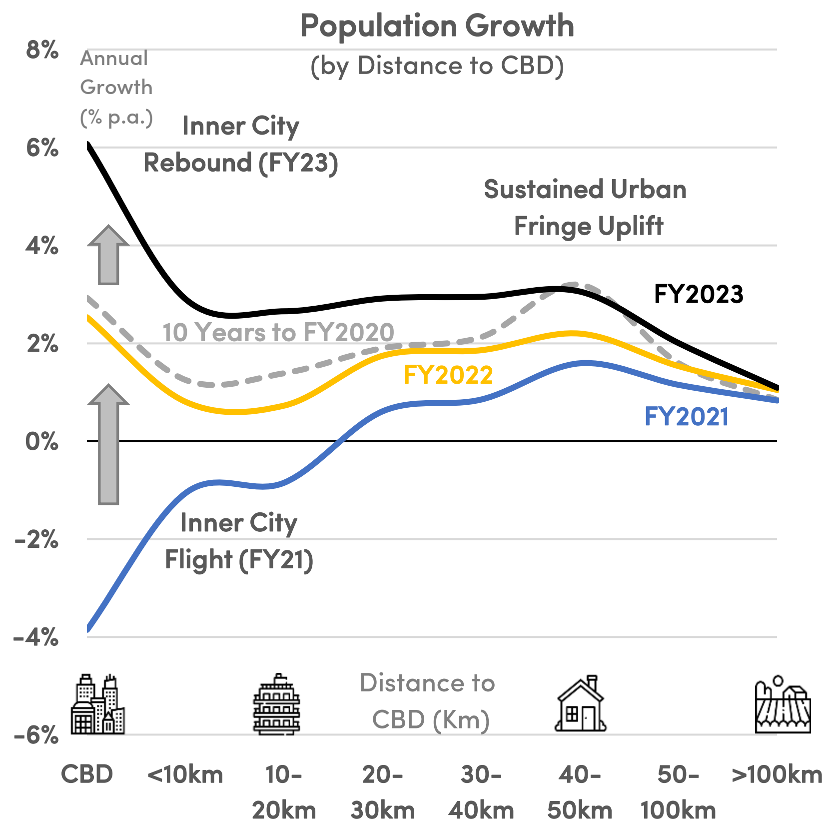
In recent years, we have seen several remarkable shifts in **living and lifestyle preferences**, markedly changing the landscape for population growth and housing demand.

- **The big exodus.** The pandemic restrictions of 2020 and 2021 drove a massive move away from the city, as remote work reduced the need to be in the office or even close to the city. More people sought out the cheaper, socially-distanced and more appealing lifestyle either by the beach or in the bush.
- **An uneven impact.** As Melbourne and Sydney faced harsh lockdowns through this time, it was not surprising to see the biggest movements out of these cities, particularly out of the crowded CBDs.[1] Indeed, parts of Melbourne posted the largest population falls in FY21 (Carlton: -18%, City East: -18% and City West: -14%).
- **Seeking the quiet life.** This pattern of inner-city flight prompted a big surge in housing demand for outer suburbia (for a larger backyard), for sea-change locations (by the beach) or tree-change locations (in the bush). In FY2021, the most popular choices were revealed to be around 40 to 50 kilometres away from the major capital cities.

With the post-pandemic reopening, we have seen **a big U-turn** in people's locational preferences, driving resurgent housing demand within the city core, supercharged by two distinct sets of drivers.

- **Return to the city.** As more workers return to the office and students return to class, we have seen a sharp rebound in population growth in the hearts of capital cities. Indeed, locations in Melbourne (Carlton: +18%, City East: +16% and City West: +16%) and Sydney (Ultimo: +19%) all saw outsized population rebounds in FY2023.
- **A renewed migration boom.** Meanwhile, the reopening of international borders has boosted population growth across all segments, markedly adding to the inflows of people into the city centre.

The initial outflow and subsequent inflow of people occurred mainly in the heart of the capital cities. The current migration boom is adding broadly to growth.



[1] CBD = Central Business District
Source: Australian Bureau of Statistics, MaxCap Group (June 2024)

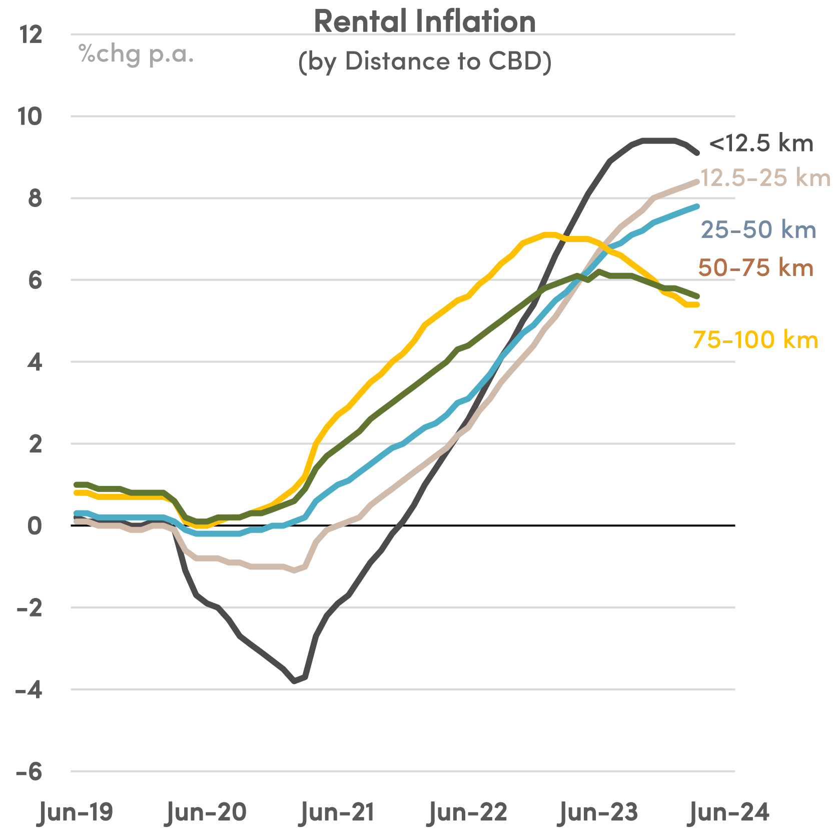
The big turnaround in rents

The dramatic disruptions in population growth are playing out very clearly in the patterns of housing demand and **rental inflation**.

- **The big dipper.** Certainly, the massive outflow of people in 2020 and 2021 drove a surge in inner-city rental vacancy and a meaningful rental correction, which was notably more severe within a radius of 12½ kilometres around the city centre, extending well into the suburban mid-ring, to a distance of around 25 kilometres from the city.
- **A rush for distance.** Meanwhile, the headlong rush to the suburbs, the beach or the bush drove a corresponding upsurge in housing demand and the acceleration in rents farther away from the city, as residential markets more than 50 kilometres away from the city led the acceleration in rents well into 2021 and 2022.
- **A concerted rebound.** In 2023 and 2024, we have seen a broad-based recovery in the rental market, as the return of tenants outpaced the supply of housing across many locations, which pushed residential vacancy rates to 1% or lower and an outsized rental upswing across nearly all segments of the housing market.
- **The city leads the way.** Amid this broad rental upswing, we are seeing considerable differences in the relative pace of rental growth since 2022. Indeed, with the turnaround in the population, the inner-city locations have started to outperform by some margin, although the trailing, outlying markets are still posting very respectable rental gains.

What happens next? From a top-down perspective, housing demand (from population growth) continues to outpace housing supply (from development) by a substantial margin, which will likely sustain low vacancy rates and further rental growth ahead. Meanwhile, the flow of people – back into the city centre – will also prolong this performance gap in rents, adding to the uplift in the CBD markets of Australian capital cities.

Residential rents are rising on a broad basis, given the lack of available housing stock across Australia. The turnaround is more pronounced in the city centres.



Source: Australian Bureau of Statistics, MaxCap Group (June 2024)

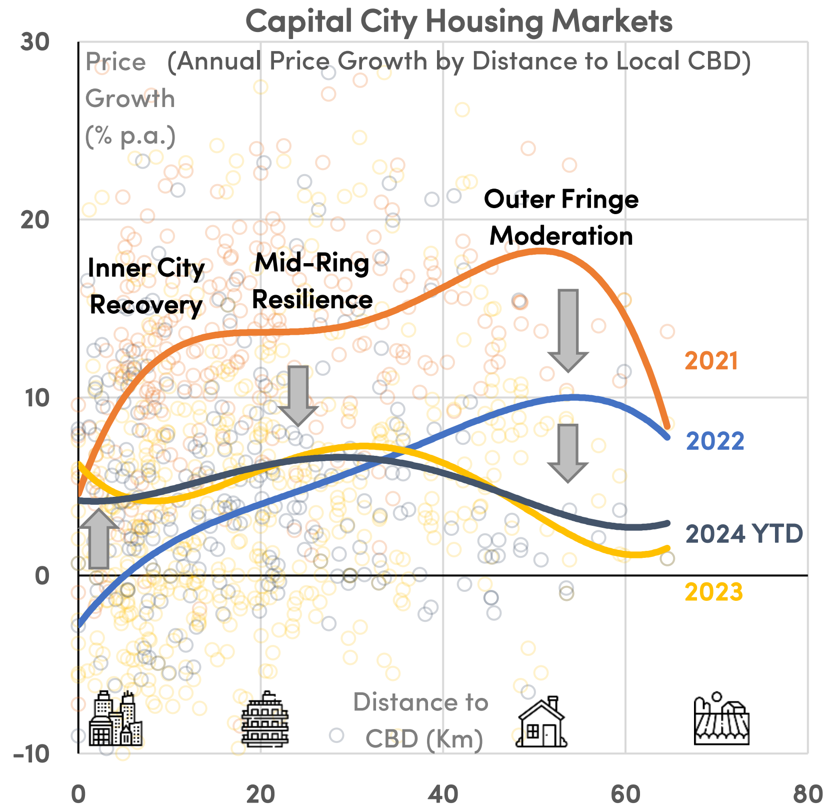
The shifting market landscape

Given the very distinctive patterns of population movement and rental inflation, it is fascinating to see somewhat different outcomes in **housing prices** across major capital cities.

- **Heading out of town.** With the population outflow in 2021, we have seen a big gap between the robust price gains outside of cities in the urban fringe and the relative price weakness in the city core. In the context of low interest rates at that time, the housing market was well supported by lower mortgage repayments and broadly rising prices.
- **Coming back to the city.** As external and internal borders reopened, we have seen a marked reversal, as people gravitated back into cities for work and study, driving a flatter profile of price gains between inner- and outer-ring locations. Meanwhile, aggressive increases in mortgage rates since 2022 have broadly diminished price gains for all locations.
- **Mid-ring suburban resilience.** Through all these dramatic population shifts out of and back into the city, there has been remarkable resilience in traditional mid-ring suburban markets, where population growth continued steadily and prices growth slowed to a moderate (but still positive) pace, despite the adverse drag from higher interest rates.
- **Regional variations persist** across the capital cities. Specifically, the Melbourne CBD has lagged the pricing recovery this cycle, despite a handy surge in population, as investors contend with new state taxes and regulatory uncertainty. Meanwhile, Brisbane and Perth continue to surge broadly, little affected by the initial pandemic and now lifting further on the back of robust population gains. Interestingly, Perth is still seeing a massive shift towards the urban fringe, with buyers still drawn by an appealing sea-change lifestyle outside of the city.

Looking ahead, the prospect of modestly **lower mortgage rates** should provide broader support for price gains in 2025. Meanwhile, the **sustained population shift** back into the city should support relatively stronger price gains for CBD and inner-ring locations over the next year.

The pattern of price growth has changed markedly in recent years, given higher interest rates, the retreat of sea- and tree-changers and a return to the inner city.



Source: Australian Bureau of Statistics, MaxCap Group (June 2024)

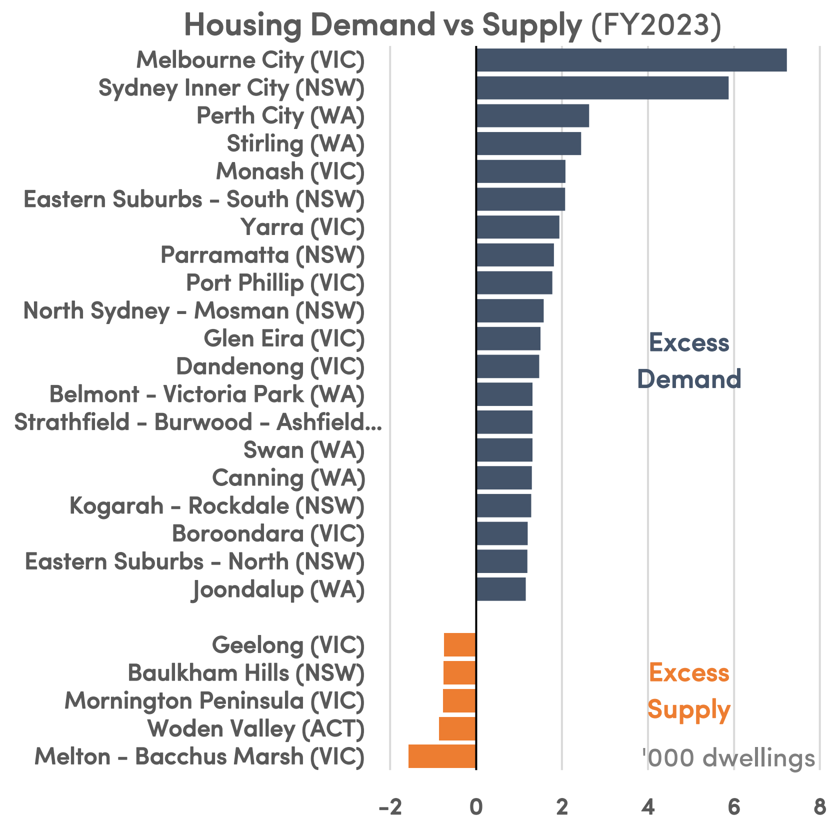
Finding the next hotspot

Given the broad and persistent state of housing undersupply in Australia, we are looking at a constructive investment landscape within the residential market for several years ahead. However, **all real estate strategies are local**, and greatly dependent on location-specific demand and supply drivers.

- In this context, we can readily identify the likely **local demand-supply balance** for each location (across 336 'SA3' statistical areas), by assessing the rate of regional population growth, alongside the pace of local building approvals as an indicator of forthcoming housing supply.
- In general terms, many parts of Australia are seeing some degree of **excess housing demand**, with population growth running ahead of the development pipeline by a sizeable margin. More specifically, the pattern of that demand-supply imbalance is highly skewed by location.
- Indeed, the areas with the **most acute undersupply** are located in the major capital cities, specifically within the core parts of Melbourne, Sydney and Perth, where there are massive gains in population (from outer suburbs and overseas) and insufficient supply.
- Meanwhile, there are **spot locations of excess supply** across the Australian East Coast, particularly across familiar sea-change locations outside of Sydney and Melbourne, where there are clearer patterns of slower population growth and / or sizeable building supply pipelines.

Altogether, we are looking at a **broad pattern of housing undersupply** in Australia persisting for several years ahead, strongly concentrated around major capital cities, where the rampant growth in housing demand is not being matched by new supply additions. Notably, there are a few, select spots of potential oversupply, particularly as more people relocate back towards the city, at the expense of slightly less fashionable locations around the beach or the bush.

There are a lot of regional variations in housing demand and supply. Amid a general state of undersupply, the largest imbalances are in the heart of major capitals.



Note: Housing demand is derived from population growth and local household size, while housing supply is driven by building approvals. Source: Australian Bureau of Statistics, Proptrack, MaxCap Group (June 2024)

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