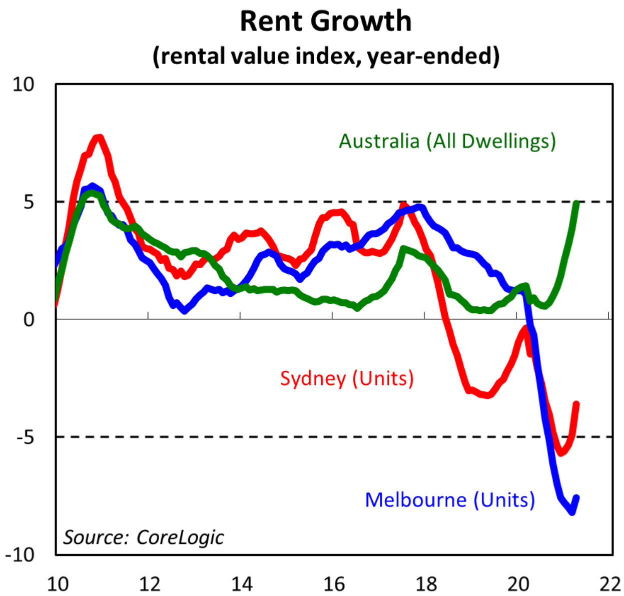
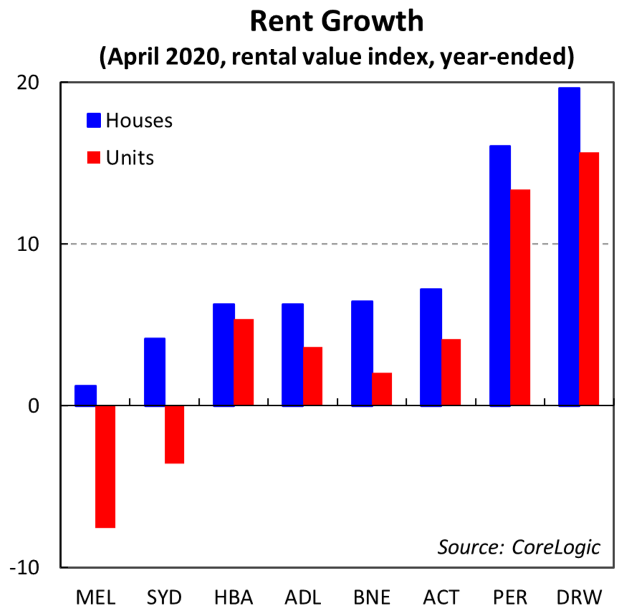
Friday, 21 May 2021

The Supercharged Housing Recovery

Rental Market Tightening But Weak Pockets Remain

- **The economic fallout from COVID-19 disproportionately impacted households with the closest ties to the rental market. Rent growth declined at the onset of the pandemic. Demand dropped at the height of the crisis while supply increased, as some holiday accommodation was shifted into the longer-term rental market.**
- **But over recent months, advertised rents have increased and residential vacancy rates have declined, in step with the broader economic recovery. The reversal of COVID-19-related rent reductions in 2020 is also likely contributing to a recovery in rents.**
- **However, the story is not uniform. In the year to April, rents declined 7.6% on Melbourne units and 3.6% on Sydney units. Units in these large cities have been hit particularly hard by the closure of international borders and the change in the way we work and live.**
- **Rental growth in Darwin and Perth has been very strong, partly reflecting limited rental supply. Interstate migration also provided a lift to areas outside of Sydney and Melbourne.**
- **The ongoing recovery in the labour market, unwinding rent reductions and a pullback in supply as properties return to the short-term rental market will put upwards pressure on rents.**
- **There are also signs of life in the market for Sydney and Melbourne units. Advertised rents in these segments have picked up from their pandemic lows in recent months. We also expect that growth in unit prices will start to pick up, as mounting affordability pressures in Sydney and Melbourne push some buyers away from houses towards less expensive units.**





The pandemic reduced demand for rentals while increasing supply

More often than not, economic analysis tends to focus on the housing market through the lens of home owners. But the rental market shouldn't be neglected. After all, one in three Australians households rent!

The economic fallout from COVID-19 disproportionately impacted households with the closest ties to the rental market. Job losses were more pronounced for younger workers, who are more likely to rent. Renters also tend to have lower incomes than home owners and spend a larger share of their disposable income on housing costs.

Subsequently, rent growth fell across the country following the onset of the pandemic. Many households requested rent reductions. Vacancy rates increased dramatically in some areas.

An increase in the supply of longer-term rental accommodation also contributed to the downward pressure on rents. Many landlords took down their short-term accommodation listings following the sharp fall in international and domestic tourism to instead list them on the longer-term rental market. On Airbnb alone, listings declined by 40,000 properties between February and May 2020, or around 20%.

Rental markets have begun to tighten but conditions are uneven

Advertised rents have increased over recent months and residential vacancy rates have declined, consistent with the recovery in the labour market. The reversal of rent reductions implemented in 2020 could also be contributing, with lease contracts typically lasting 6 or 12 months. In addition, some properties may be transitioning back to the short-term market to take advantage of domestic tourism, which would also contribute to a tightening in the longer-term rental market.

However, the story is not uniform – rental conditions for owners of apartments in Sydney and Melbourne are still weak. In the twelve months to April, rents declined 7.6% on Melbourne units and 3.6% on Sydney units.

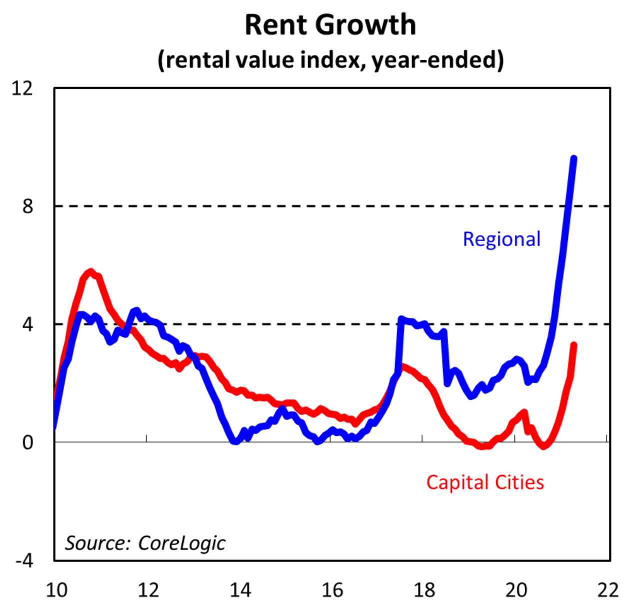
This reflects a shift in preferences underpinned by the massive changes in our lifestyles over the past year. It has accelerated the legitimisation of working from home and seen demand for more living space. The greater sensitivity around health has also drawn Australians to less densely populated areas. These segments have also been hit hard by the closure of international borders and the subsequent drop in international arrivals.

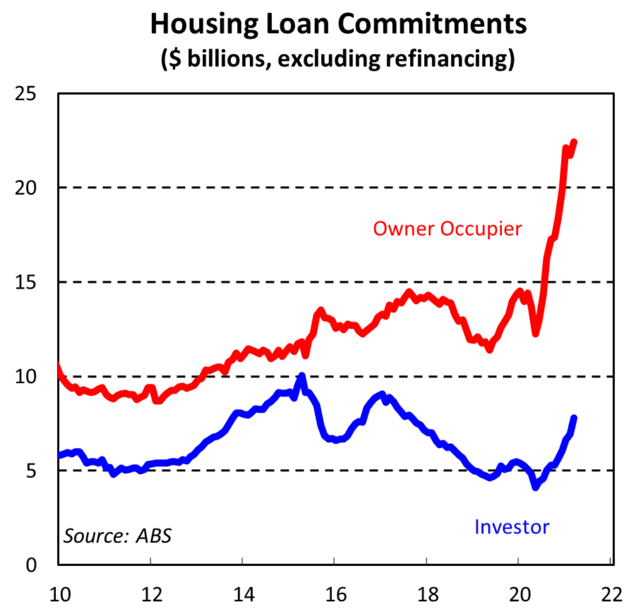
Relatedly, in the past year, rents in regional areas have increased by more than rents across the combined capital cities, mirroring the patterns in dwelling prices. In April, annual growth in rents was at 9.6% in regional areas and 3.3% across the combined capital cities. Similarly, rents on houses have grown by more than rents on units.

Rental growth in Darwin and Perth has been very strong, partly reflecting the limited supply of rental stock. Net interstate migration also provided a lift to some areas outside of Sydney and Melbourne.

The weakness in rental conditions for Sydney and Melbourne apartments could partly explain why the heat in the housing market has been driven largely by owner-occupiers. Housing loan commitments show that lending to owner occupiers has surged, while the increase in lending to investors has been more modest. The weakness in this segment of the rental market may be deterring some potential investors. However, we are seeing signs that more investors are being drawn to the market – in March new lending to investors hit its fastest monthly growth in almost

18 years. The tightening in the rental market and the fear of missing out after remarkable price growth over recent months may be tempting investors.





Outlook

The ongoing recovery in the labour market, the unwinding of rent reductions and a pullback in supply as some properties transition back to the short-term rental market will put upwards pressure on rents around the country.

There are also signs of life in the rental market for Sydney and Melbourne units. Advertised rents on Sydney and Melbourne units have picked up from their lows in recent months. The freeze on rental evictions concluded at the end of March which may contribute to an increase in rents in the June quarter. The eventual reopening of international borders and the return of international students and tourists will provide a considerable boost to demand.

Other dynamics at play in the housing market will also put upwards pressure on rents for units relative to houses. We expect the coming upturn in residential construction will be dominated more by stand-alone dwellings than in the most recent upcycle which was led by multi-density properties. In other words, the coming lift in dwelling stock will put more downward pressure on rents for housing rather than units. We also expect that growth in unit prices will start to pick up as mounting affordability pressures in Sydney and Melbourne will push some buyers away from houses to less expensive units.

The key takeaway is, as life starts to return to normal, we expect rents will continue to gradually increase while the weakness in some pockets of the market is set to unwind.

Matthew Bunny, Economist
Ph: (02) 8253 0023

Contact Listing

Chief Economist
Besa Deda
dedab@stgeorge.com.au
(02) 8254 3251

Economist
Matthew Bunny
matthew.bunny@stgeorge.com.au
(02) 8254 0023