URBIS

MELBOURNE APARTMENT MARKET CONDITIONS

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Urban Development Institute of Australia VICTORIA

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ACKNOWLEDGEMENT OF COUNTRY

Urbis acknowledges the Traditional Custodians of the lands we operate on.

We recognise that First Nations sovereignty was never ceded and respect First Nations peoples continuing connection to these lands, waterways and ecosystems for over 60,000 years.

We pay our respects to First Nations Elders, past and present.

The river is the symbol of the Dreaming and the journey of life. The circles and lines represent people meeting and connections across time and space. When we are working in different places, we can still be connected and work towards the same goal.

Title: Sacred River Dreaming
Artist: Hayley Pigram
Darug Nation
Sydney, NSW

STUDY BACKGROUND & APPROACH

In this report we provide evidence of apartment market activity in Melbourne over the last decade. We review how market and policy settings have changed and consider the impact on future supply that has followed.

We know it is more important than ever for the development industry and government to collaborate to unlock much needed housing. Therefore, we also explore how settings could be adjusted and what it would take to simultaneously stimulate new development without negatively impacting state government revenue.

In introducing this topic, we aim to stimulate constructive engagement on ways to move forward and mobilise the supply of a wider range of well-located housing in apartments.

PURPOSE

In this research Urbis is helping to answer these key questions:

1. What is the future supply pipeline of build-to-sell and build-to-rent in Inner and Middle Melbourne?
2. How has the rental market in Inner and Middle Melbourne been impacted in recent times?
3. What has been the impact of policy interventions on the Inner and Middle ring Melbourne apartment market?
4. What is the government's housing target and how is Inner and Middle ring Melbourne placed to meet this target?
5. What would it take to stimulate the apartment market without compromising government revenue?

APPROACH

- Identifying relevant developments from Urbis Apartment Essentials platform. This includes apartment developments with more than 25 units.
- Detailing historic and future supply across various stages in the property development cycle.
- Reviewing rental impacts from Urbis' Apartment Essentials platform.
- Using time series data to overlay the impact of policy intervention on the apartment market.
- Analysing the current capacity of the housing system and the deficit to meeting the government's housing target, including the role of apartments.
- Exploring changes to stamp duty and foreign purchaser charges and the indicative impact on government tax revenue of unlocking supply.

INNER AND MIDDLE MELBOURNE

EXECUTIVE SUMMARY

A Decade of Delivery Hits the Brakes

Between 2011 and 2021, Inner and Middle Melbourne experienced significant apartment construction, with approximately 10,000 apartments delivered per year. This included around 3,725 apartments added to the rental market each year, boosted by investment from both overseas and domestic buyers.

These buyers played an important role, enabling developers to meet presales hurdles required to finance construction, unlocking project completions. Government revenue from foreign purchaser stamp duty peaked in 2015-16, at the same time as apartment approvals peaked in 2016. However, since then stamp duty revenue has declined more broadly following not only increased foreign purchaser duty, but the removal of stamp duty concessions for investors, including off-the-plan property. Transaction volumes and duty collected have fallen in the years following these changes. In fact, all indicators of supply have fallen for apartments including launches, sales, approvals and completions.

Compounding the Cost Challenge

Challenging sales and development conditions have since been further compounded by higher interest rates and higher construction costs. Higher costs result in higher prices, while higher borrowing costs make it more challenging for buyers. The compounding impact of higher taxes on higher prices presents further disincentive to invest and risks prolonging a deeper deficit in housing supply.

How Bad is it?

The active pipeline of apartments going forward is around half the volume delivered around the peak of supply in 2015-2017. Of all the potential supply in the pipeline, around half remains inactive: approved, but not able to proceed. The consequences are clear when current delivery rates are applied to housing targets and the continued scarcity in the rental market.

How Could We Move Forward?

We can see that increasing stamp duty and foreign surcharges had a material impact on sales and supply in recent years. While far from being the only challenge in developing or purchasing apartments, their compounding effect on purchaser cost has ballooned and represents an even greater barrier to buy.

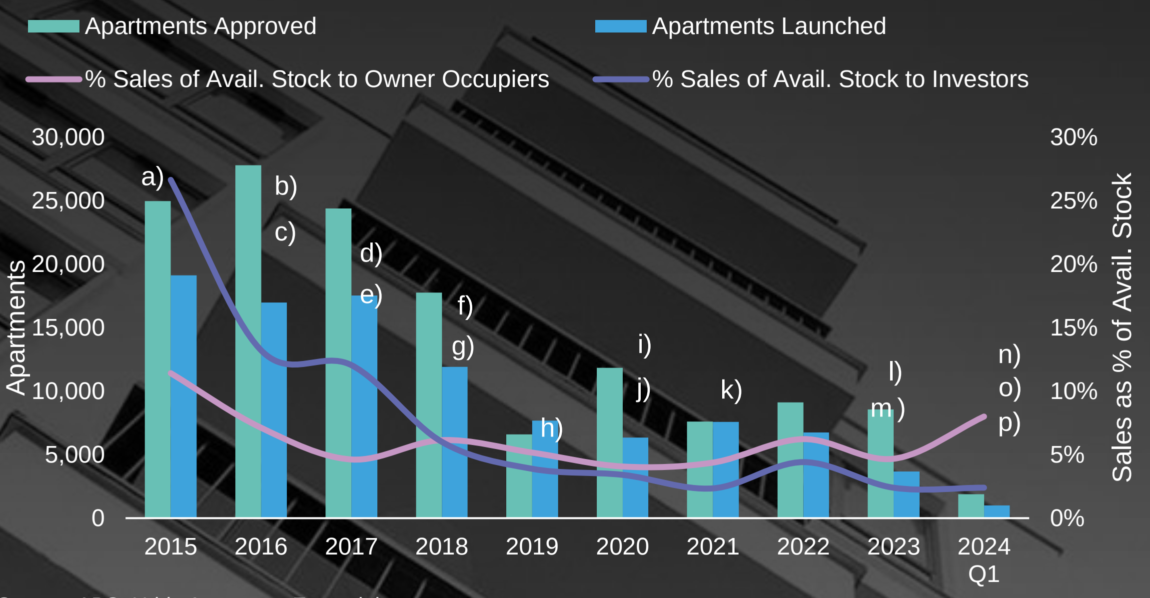
Given there is a large volume of approved apartments not yet in market, we believe winding back stamp duty charges could make a meaningful difference in unlocking investor activity that supported project delivery in the last apartment cycle.

If such measures are successful in mobilising the idle half of the pipeline over the next five years, this would effectively double the delivery of apartments in inner and middle Melbourne. Not only would that be valuable progress against housing targets, there is the prospect that revenue could recover and grow well beyond current collection even with reduced duties and targeted off the plan concessions on stamp duty.

MARKET TRENDS & POLICY INTERVENTIONS

In recent years, policy changes at local, state, federal, and international levels have cooled Melbourne's residential market, primarily targeting foreign purchasers and investors. Since the first foreign purchaser additional duty in 2015, demand from foreign purchasers has decreased through to Q1 2024. While these measures succeeded in cooling an overheated market, providing opportunities for local residents, they also led to fewer apartment project launches and approvals over time. The chart below overlays a series of interventions impacting market activity.

Impact of Policy Intervention on Inner & Middle Melbourne's Apartment Market



Source: ABS; Urbis Apartment Essentials

Policy Intervention – Demand and Supply Side Impacts*

a) Foreign Purchaser Duty 3%

b) Foreign Purchaser Duty 7% + China Reports Breaches of Capital Controls

c) City of Melbourne introduces C270 Planning Scheme Amendment

d) Removal of Stamp Duty Concession for Investors + APRA Lending Standards cap on investor lending + First Home Buyer stamp duty exemption and concession

e) Better Apartment Design Standards Introduced

f) Vacant Residential Land Tax

g) Shergold Weir Report into Building Compliance

h) Foreign Purchaser Duty 8% + Banks lower minimum interest rate for loan serviceability.

i) COVID-19 + HomeBuilder grant opens

j) Planning Fast Track for Shovel Ready Projects

k) HomeBuilder Grant closes + VHF Shared Equity Initiative + Increased Land Tax and Stamp Duty

l) Introduction of Windfall Gains Tax in July

m) Housing Australia Future Fund

n) Victoria Housing Fund funding boost, 7.5% short stay platform revenue levy, China capital outflow highest since 2016

o) Housing Target for Councils Announced

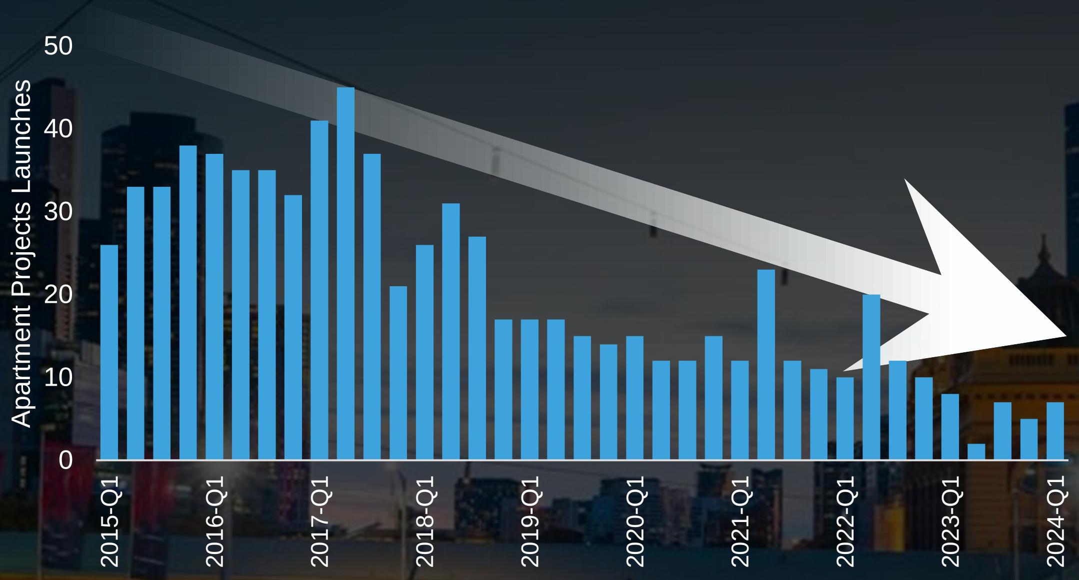
p) Vacant Residential Land Tax to expand to all Victoria from 2025 onwards

**Other noteworthy interventions/policy changes include: Metropolitan Planning Levy (2015), Cladding Rectification Levy (2019), 8% Open Space Contribution (2012), Building Permit Statutory Fees (2019) and Authority Fee Increases (water, sewerage).*

INNER & MIDDLE MELBOURNE: COOLING APARTMENT ACTIVITY

Developers in Melbourne have traditionally relied on off-the-plan sales to support their residential projects. Pre-selling apartments is typically a pre-requisite to unlock funding for construction, while offering a convenient entry point for both local and overseas buyers. Policies that increased taxes and tightened lending conditions softened overall purchaser demand and reduced activity from both domestic and international investors. This has had a substantial impact on new apartment launch activity in recent years as demonstrated by the chart below.

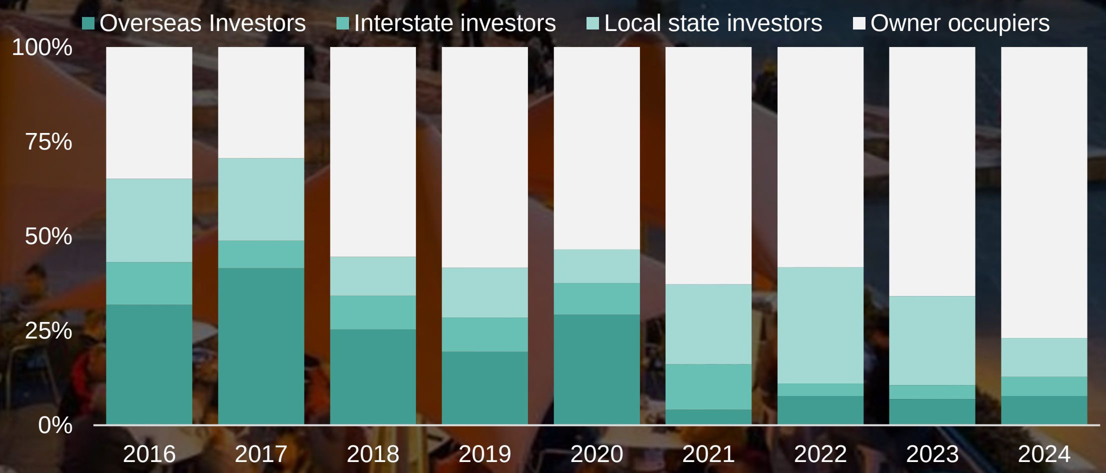
New Apartment Project Launches Over time



Source: Urbis Apartment Essentials

The speed and volume of off-the-plan sales from local and overseas investors has progressively decreased following changes in duties in 2016-2017. Owner occupiers now make up a larger share of a much smaller buyer pool. There has been a clear reduction in apartment supply coinciding with reduced investor participation in the market.

Off-the-plan Buyer Trends Over Time

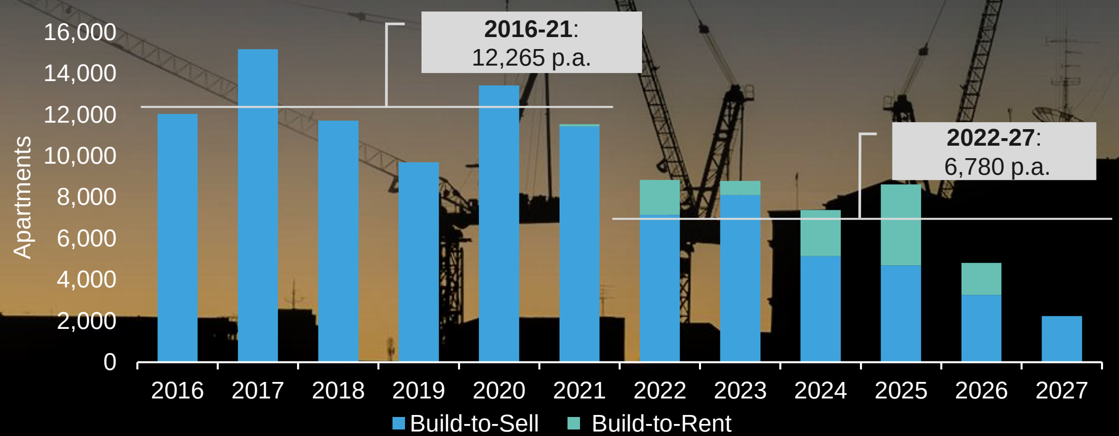


Source: Urbis Apartment Essentials

INNER & MIDDLE MELBOURNE: FUTURE APARTMENT SUPPLY

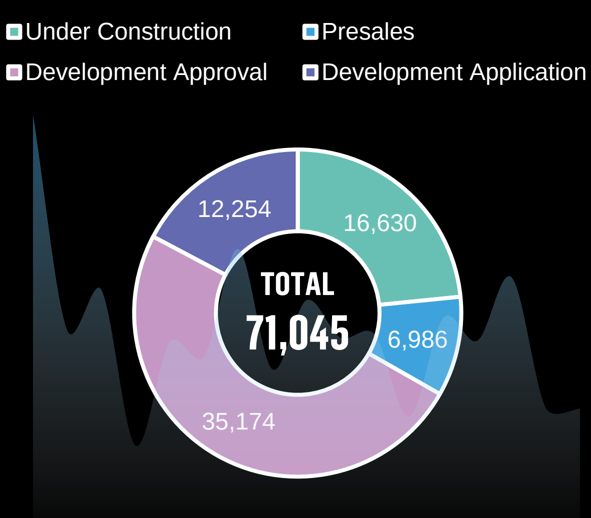
The apartment volume and future pipeline between 2022-27 is expected to be close to half of the annual average achieved between 2016-21, further emphasising the supply shortage as population growth and overseas migration continue to increase the demand for housing. Meanwhile approximately half of the potential future pipeline remains idle, with 35,000 units approved by not yet launched.

Future Apartment Pipeline (Active Projects)



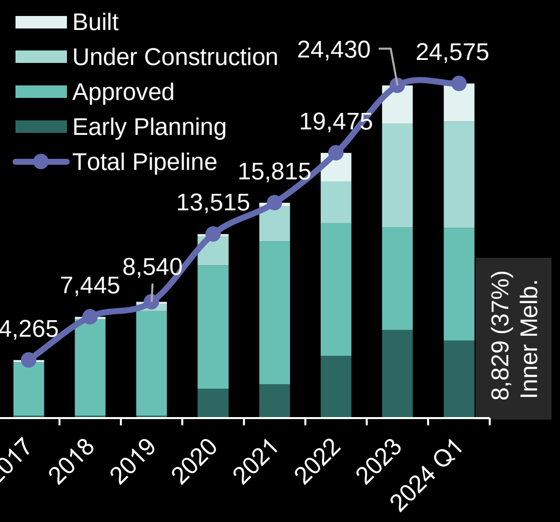
Active Projects: Built, Under Construction or in Presales (Built-to-Sell)
Source: Urbis Apartment Essentials.

Future Pipeline by Status (2024-29)



Note: Includes Build-to-Sell and Build-to-Rent projects.
Source: Urbis Apartment Essentials.

Build-to-Rent Supply



Note: Based on BTR projects in Greater Melb.
Source: Urbis Apartment Essentials.

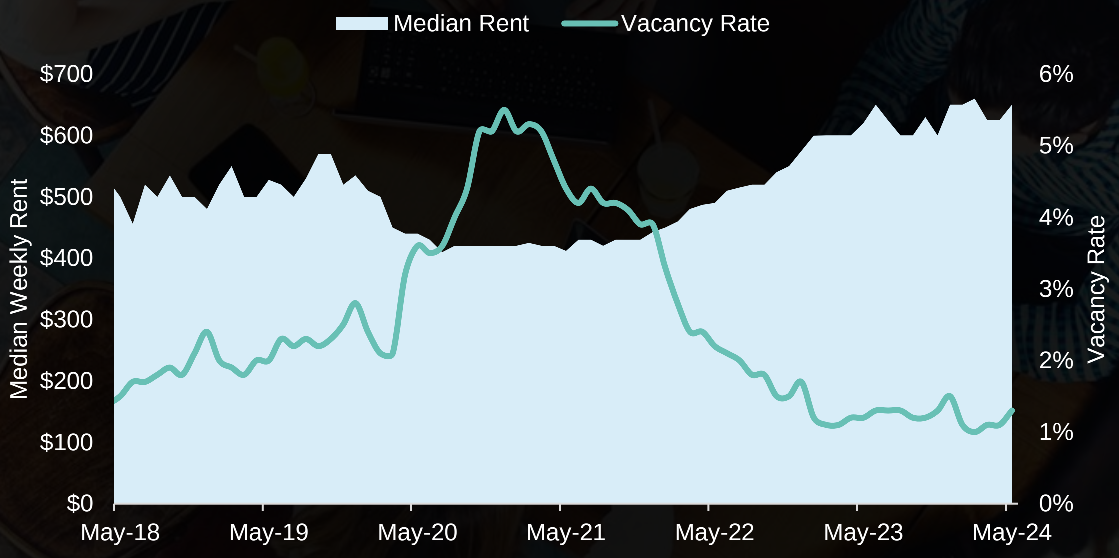
One half of the apartment pipeline is approved but remans inactive. Only one-third of the future apartment pipeline is made up of projects that are preselling or under construction. The rest are permit-approved projects that haven't made it to launch for sale or those under application.

The BTR pipeline in Melbourne has grown by 34% annually since 2017. As at Q1 24, one-third is in the inner city. Despite more than 12,000 apartments in permit-approved and under application projects, only 48% have financial backing. This underscores the need to find ways to tackle financial viability of all apartment projects, both built-to-sell and build-to-rent.

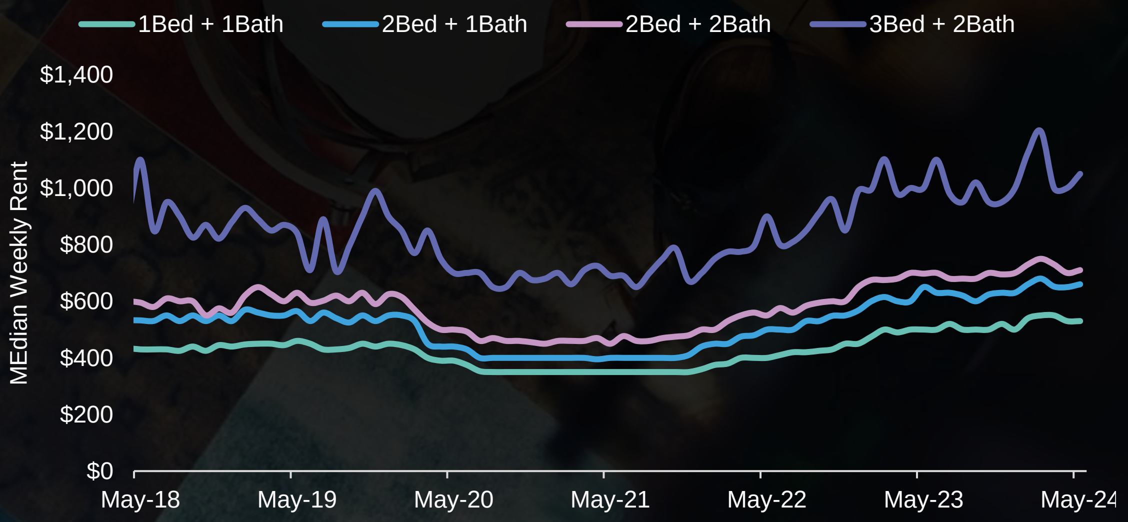
INNER & MIDDLE MELBOURNE: APARTMENT RENTAL IMPACT

The impact of growing demand and stalled supply is being acutely felt in the rental market. Melbourne's vacancy rate stood at 1.3% in May 2024, below the longer-term average of 2.6% from 2018-24. This has driven up the median weekly rent by 4.8% over the past year and 16.4% on average over the last three years. A 2024 survey by the Property Investment Professionals of Australia cited increased taxes, changes to tenancy legislation, and rising interest rates as the main reasons behind an investor sell-off in residential property. Greater scarcity in the rental market is showing via a fall in the number of active rental bonds in Victoria by 15,600 in the year to March 2024. Unlocking new supply must be a priority.

Rents & Vacancy In New Buildings



Median Weekly Rent Over Time

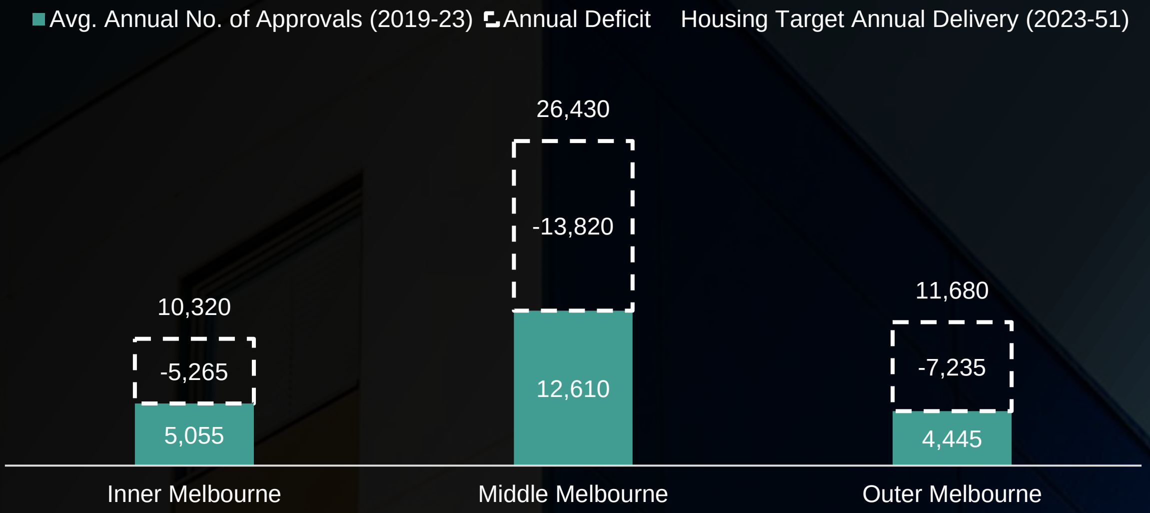


Sources: SQM Research, Urbis Rental Intelligence

GREATER MELBOURNE HOUSING TARGETS

Following on from the Housing Statement released in September 2023, in June 2024 the State Government outlined its proposed target for new homes in each local government area. Comparing these annual housing targets with average annual building approvals between 2019-23 reveals a clear deficit, underscoring the challenge faced by the State Government in meeting its 2051 target[1].

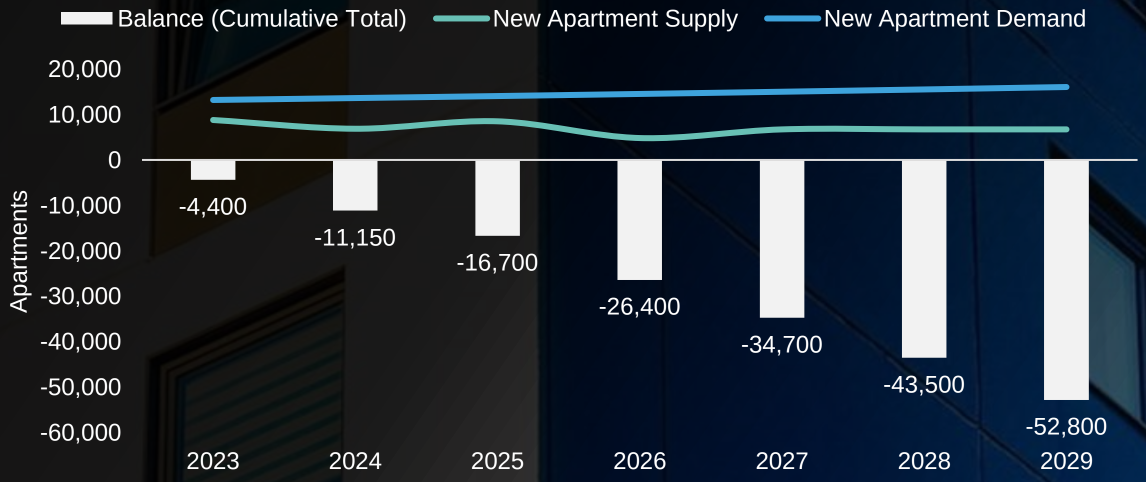
Melbourne's Housing Target & Historical Annual Approval Data[2]



Source: State Government of Victoria, ABS; Urbis

Inner and Middle Melbourne's Apartment Pipeline & Demand Over Time[3]

Melbourne's apartment market will need to be stimulated and grow to stand a chance of meeting the State Government's housing target, however, current supply lags demand. Between 2024-27, the pipeline is projected to fall short by an average of 7,340 apartments per year in inner and middle ring Melbourne[4]. Further recovery is required to unlock a bigger pipeline.

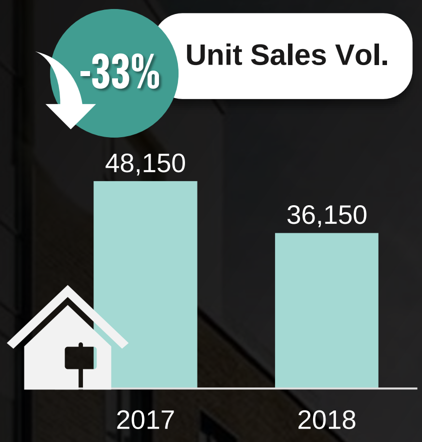


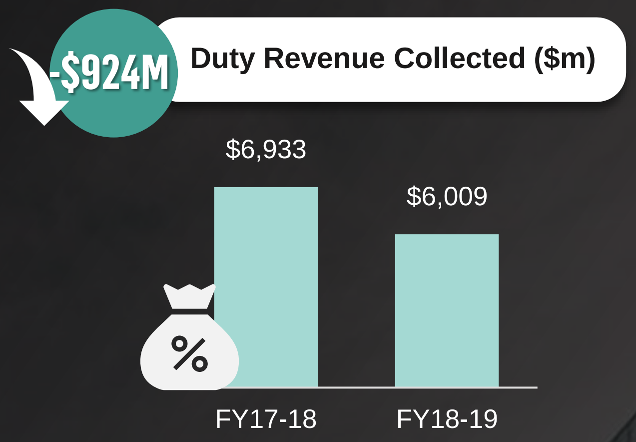
Sources: State Government of Victoria; Urbis

HOW HAVE THESE CHANGES IMPACTED GOVERNMENT REVENUE?

In 2017, the Victorian Government introduced changes to the off-the-plan stamp duty concessions. These concessions were previously available to all buyers, but the changes meant they were now only accessible to owner occupiers intending to live in the property. This had a cooling effect on investor activity, as the concessional benefits from buying off-the-plan were no longer available to overseas or domestic investors.

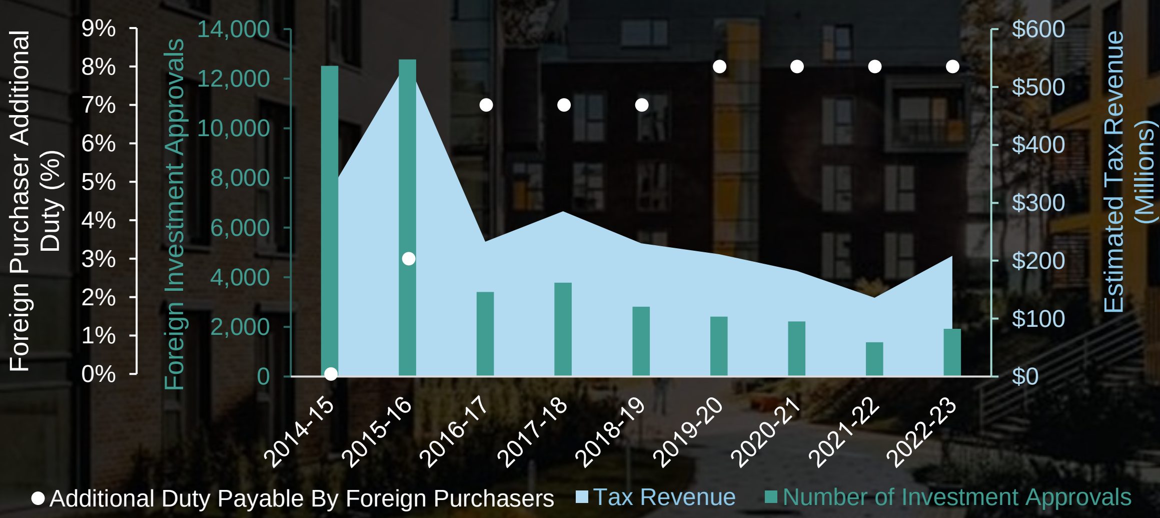
The policy shift, while aimed at making housing more affordable for first home buyers, contributed to softened sales activity overall, given investors made up a sizeable share. This saw a 33% decrease to the volume of apartment sales, associated with a $924 million reduction in state revenue in the following year.





In addition, the Victorian Government implemented extra stamp duty on foreign buyers to soften overseas demand, improve affordability for local buyers, encourage local investment, stabilise the market, and generate tax revenue. When additional duty increased to 7% in FY17, foreign purchaser activity fell by 73%, leading to a 57% decline in tax revenue. The additional duty rose to 8% in FY20 and remains unchanged. While the state government intended to create more opportunities for local buyers, decreased demand from foreign investors contributed to fewer apartments being delivered and a decline in the overall tax revenue. This trend has continued.

Impact of Policy Intervention on Market Activity (Financial Years)



Sources: State Revenue Office Victoria, Foreign Investment Review Board, Pricefinder; Urbis

HALVE THE PROBLEM & DOUBLE THE RETURN?

Reflecting on the downward slide in both the pipeline and revenue we ask what would be a win-win opportunity to explore? To recap, around 7,000 new apartments are estimated to complete each year between 2022-27 in inner and middle ring Melbourne. Applying recent buyer splits and stamp duty rates implies an associated $346 million in revenue each year.

Meanwhile there are 35,000 apartments approved but not active. Could we reduce barriers to purchase and unlock investment in these homes by winding back duties on off the plan apartments? Achieving that feat over the next five years would effectively double delivery. If this were to be achieved, even at half the current foreign buyer duties, and with concessions for off the plan buyers, there would be revenue upside for government.

The scenario below presents a picture of what half the foreign duty and nearly doubling the revenue ($640m) could look like when applied to double the pipeline. We recommend exploring these settings further. While certainly not the sole challenge in housing delivery, it is a lever that can be pulled (or simply pushed back) and has previously had a significant impact.

Halving Stamp Duty to Double Delivery & Revenue:

Apartment Price	$1,000,000
Construction Cost	$550,000

	OWNER OCCUPIER		LOCAL INVESTOR		FOREIGN INVESTOR	
	Current Scenario	Uplift Scenario	Current Scenario	Uplift Scenario	Current Scenario	Uplift Scenario
Additional Foreign Duty %	-	-	-	-	8%	4%
Additional Foreign Duty Payable	-	-	-	-	$80,000	$40,000
Total Stamp Duty Payable (with OTP Concession)**	$21,970	$21,970	-	$25,070	-	$65,070
Total Stamp Duty Payable (without OTP Concession)	$55,000	$55,000	$55,000	$55,000	$135,000	$95,000
Annual Completions (24-27)	7,000	14,000	7,000	14,000	7,000	14,000
% Buyers	75%	50%	15%	30%	10%	20%
No. Buyers	5,250	7,000	1,050	4,200	700	2,800
Annual Revenue	**$194M**	**$259M**	**$58M**	**$162M**	**$95M**	**$220M**

TOTAL ANNUAL REVENUE	Current Scenario	Uplift Scenario
	$346,400,000	$640,600,000

***Assumes half of all applicable concession buyers purchase an off-the-plan apartment prior to construction and pay at a lower dutiable value of $450,000 (the apartment price minus construction cost).*

NOTES

1 **Demand-Supply Gap Analysis**: By comparing the projected annual new apartment demand against the annual new apartment supply, we can assess the apartment pipeline's alignment with the State Government's 2051 housing target. This analysis highlights the demand-supply gap over the next five years and identifies the shortfall in the current supply pipeline.

2 **Annualised Dwelling Requirement:** We have calculated the annualised dwelling requirement from the State Government's 2051 housing target, starting from the existing supply in 2023.

3 **Apartment Market Implications:** Using Census data from 2016 and 2021, we analysed the proportion of apartments in Melbourne and projected a straight-line trend to estimate the growth in apartment proportion through to 2029. Considering this proportion against the housing target provides an estimate of the annual new apartment demand until 2029.

4 **New Apartment Supply Tracking:** Utilising Urbis' Apartment Essentials database, which tracks new apartment supply in Inner and Middle Melbourne, we have the annual new apartment supply up to 2026. We then assumed that the average annual delivery of apartments between 2024 and 2026 will continue through to 2029.