
BRIEFING NOTE: CAUSES AND CONSEQUENCES OF PERTH'S PRIVATE RENTAL MARKET IMBALANCE

January 2016

Introduction: All Change

In April 2012, the Community Housing Coalition of Western Australia (CHCWA) published a research paper titled, 'The Failure of Perth's Private Rental Market and why it matters'.

In 2012, the economy was booming with thousands moving to the State every month. That paper described the renter's dystopia that resulted, characterised by crippling high rents and a chronically low rental vacancy rate. It also described how successive years of market failure manifesting itself in increasing rents and limited new supply had precipitated a surge in demand for social housing as low income households got squeezed by the boom.

Almost four years later, the situation could scarcely be more different. Demand for rentals has fallen significantly in the face of surging supply. The rental vacancy rate has been rising sharply for over a year and rents are falling. There have never been more landlords looking for tenants in the private rental market in Perth than right now.

This paper will do the following:

1. Describe the 'state of play' in Perth's private rental market.
2. Account for the factors that have contributed to current market conditions.
3. Describe the implications and likely implications for community housing providers in Perth.
4. Discuss what factors will cause the market to rebalance and when that might occur.

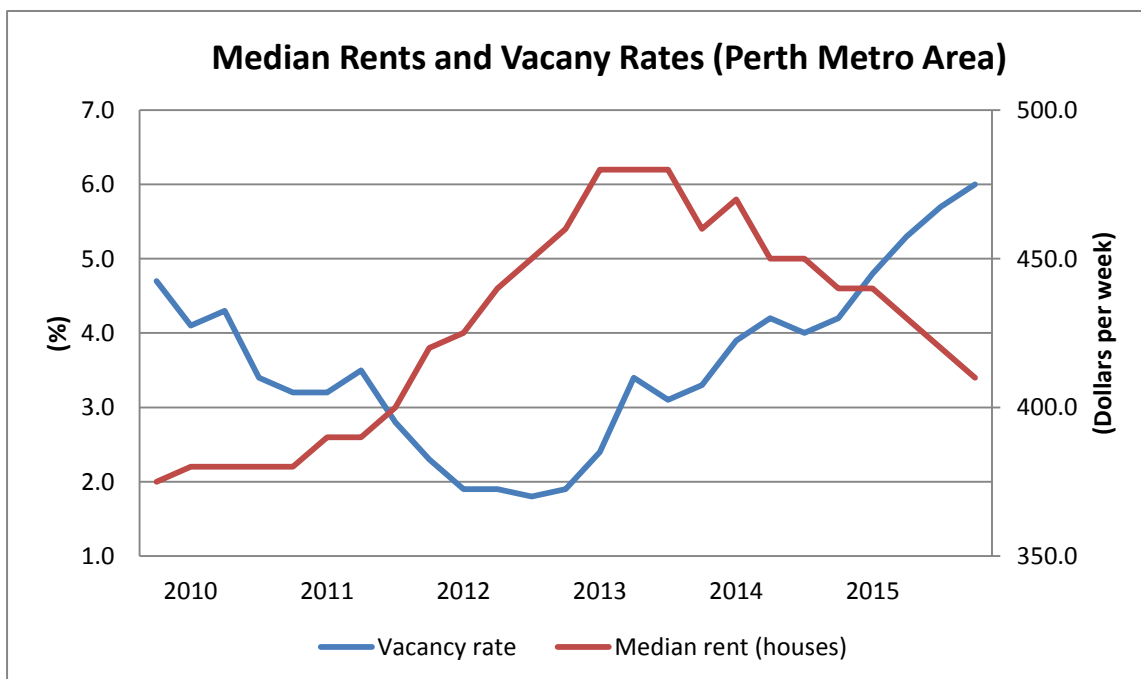
The current market: Renters Delight

The behaviour of the private rental market, like all markets, is determined by supply and demand. In the case of rentals, the key indicator is the rental vacancy rate. That relationship is shown in the graph on page 2. As the rental vacancy rates fall, rents increase and as they rise, rents fall. Consider the following:

- According to the latest available REIWA data there are 10,104 properties for rent in the Perth metropolitan area. That is an increase of 39% from this time last year.¹ The vacancy rate currently stands at 6% and has been trending up since the March quarter of 2013.

¹ <http://reiwa.com.au/the-wa-market/perth-metro/>

- According to REIWA data, the last time the vacant rate reached 6% was the September quarter of 1991.² Given the growth in the city since 1991 it is likely that there have never been so many properties for rent in Perth as right now.
- According to SQM research asking rents for houses are down 10.7% year on year and 23.6% from 3 years ago. Asking prices for units are down 10.4% year on year and 19.1% from 3 years ago.³



Why has the market turned in favour of renters?

Again, it's a relatively straightforward interaction between supply and demand. During the last couple of years there has been a general deterioration in the economic fundamentals that influence demand at the same time as supply was surging. Specifically;

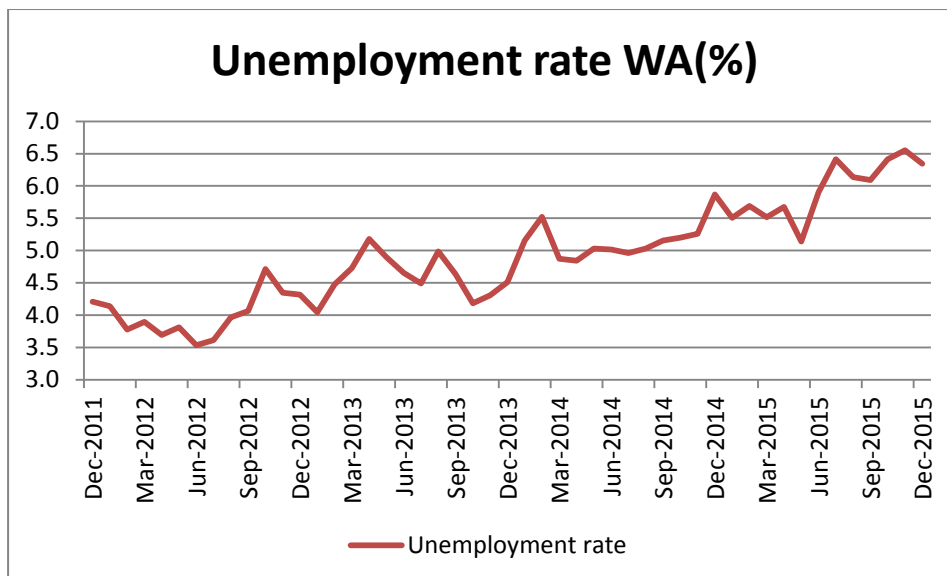
1. **Rising unemployment:** Driven mainly by the ongoing decline of the Mining and Resources Industry. The decline in the labour market is also evidenced by falling job vacancies in the State as measured by the Australian Bureau of Statistics (ABS). It should be noted that

² Data provided to CHIA by REIWA by request.

³ <http://www.sqmresearch.com.au/weekly-rents.php?region=wa%3A%3APerth&type=c&t=1>

unemployment in WA is rising at a time when it is falling or standing still in other States and Territories. Rising unemployment is having a significant impact on;

2. **Population growth and net migration figures:** Perhaps the single biggest contributing factor to the crisis that occurred in the rental market in 2012/13 was the sheer number of people moving to the State. At peak, approximately 1,500 people a month⁴ were moving to the State with most looking to settle in the Perth metropolitan area. The latest data available indicates that the net migration to WA both from interstate and overseas has collapsed. In other words, far less people are coming and far more are leaving. For example, “The gain in Net interstate migration in Western Australia has gradually increased from 2,200 persons in 2004-05 to peak at 11,400 persons in 2011-12 before decreasing to 1,000 persons in 2013-14.”⁵ See graph on page 5 for more information.



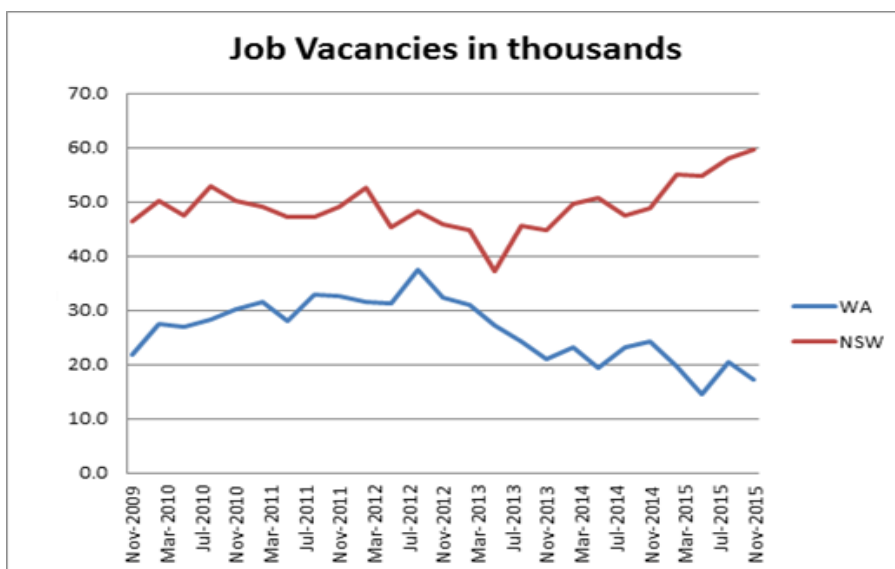
Source: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6202.0Dec%202015?OpenDocument> Table 8.

3. **First time buyer demand:** Although trending down more recently, First time buyer demand for housing has remained quite resilient during the same time as broader economic fundamentals have deteriorated. This is important because first time buyers are likely to vacate a rental property to move into home ownership thus adding supply to the overall stock of rental properties.

⁴ <http://www.domain.com.au/news/more-coming-to-wa-but-where-can-they-live-20130108-2cdvg/>

⁵ <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/3412.0Main%20Features62013-14?opendocument&tabname=Summary&prodno=3412.0&issue=2013-14&num=&view=>

4. **Strong Investor Demand:** Investor demand for housing spiked in WA from 2011 only abating in 2015. Between the 2006 and 2011 census median rents in WA increased by 76.5%, significantly more than any jurisdiction.⁶ Rising rents and supply shortages continued into 2012 and 2013. It is likely that these market conditions provided the rationale for many new investors, typically mum and dad investors, to buy an investment property or add another investment property to their portfolio. According to research conducted by the Bankwest Curtin Economics Centre, investor demand for housing in WA rose steadily from 2011, peaking in the last quarter of 2014 with over 40% of total housing commitments being taken out by housing investors, the highest level since 2003.⁷ See graph on page 6. Strong investor demand contributed to;



Source: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6354.0Nov%202015?OpenDocument>, Table 2

5. **A building boom:** From 2011 to the beginning of 2015, when housing completions began to drop, WA experienced one of the largest housing construction booms in decades. At peak, in 2014 WA started a record 32,084 homes; compared to a Long term average of 20,535.⁸ The

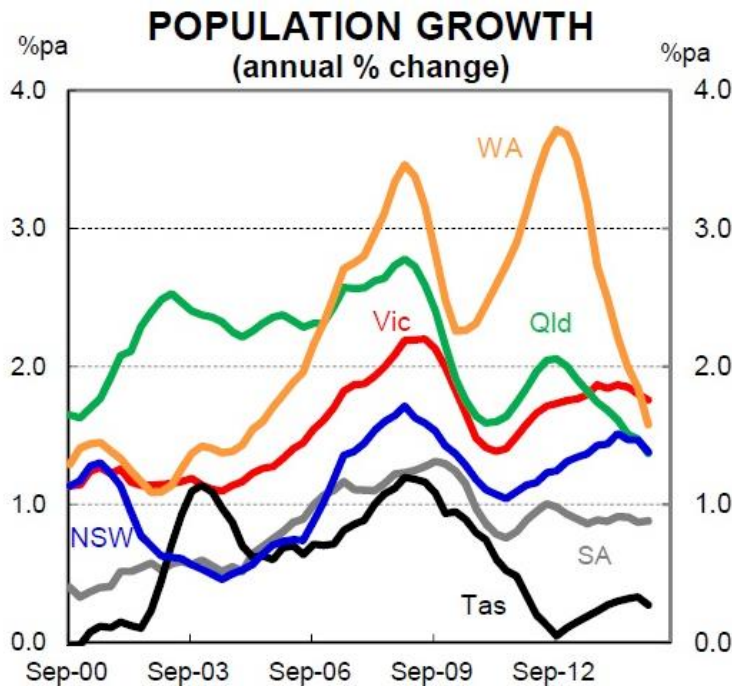
⁶ <http://commhousing.com.au/census-shows-wa-recorded-highest-rent-increases-in-country/>

⁷

<http://webcache.googleusercontent.com/search?q=cache:JeUTMFHP3WYJ:www.aph.gov.au/DocumentStore.ashx%3Fid%3D257bc7fd-0eff-45f4-9542-9406967f2d2a%26subId%3D353233+&cd=3&hl=en&ct=clnk&gl=au>

⁸ https://hia.com.au/~media/HIA%20Website/Files/IndustryBusiness/Economic/presentations/WA_IOL_July2015.ashx

building boom was also bolstered by changes to the First Home Owners Grant Regime, which was changed to provide larger grants to buyers buying new properties rather than existing ones and a sustained period of low interest rates. See Graph on page 6.



Source: <http://www.businessinsider.com.au/charts-australias-population-hit-a-record-high-in-2014-but-the-pace-of-growth-is-slowing-quickly-2015-6>

In sum, what we are witnessing now is a strong increase in the supply of rental properties following a sustained surge in investor demand for housing and an attendant building boom in the face of falling demand principally due to deteriorating conditions in the labour market and anaemic population growth levels precipitated by the end of the mining boom.

Implications for Perth based CHPs

The current condition of the private rental market is likely to have several implications for Perth based CHPs. In fact, the effects are likely already being seen. They can be divided into positive and negative implications:

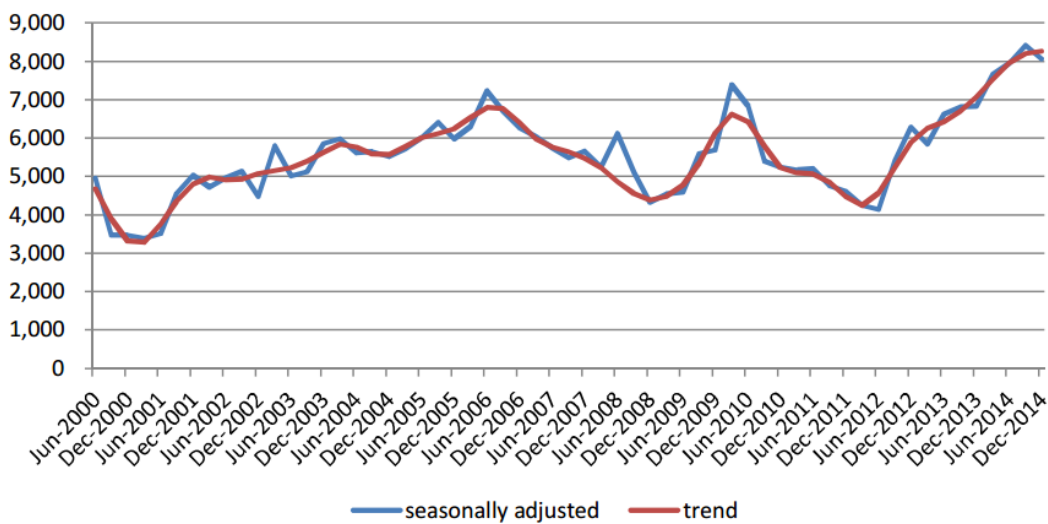
Positive

1. Greater choice for tenants ought to lead to less demand for long term and short term social housing. Rents have fallen and continue to fall which makes renting more affordable for people on lower incomes. In addition, the current market imbalance gives a significant edge to tenants over landlords and should precipitate a situation where private sector landlords

are more amenable to renting their properties to households from more disadvantaged socio-economic groups.

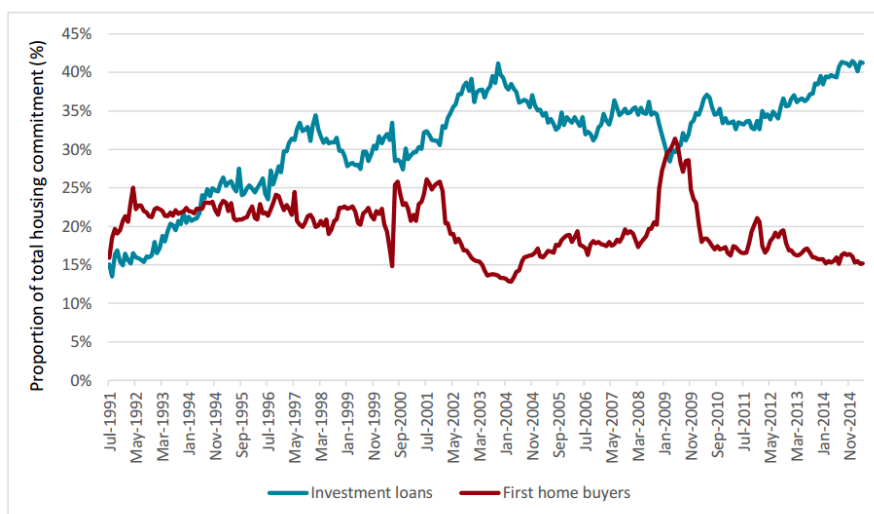
2. CHPs operating crisis and transitional properties should be able to find it easier to locate suitable properties in the private rental market to transition clients thus freeing up space for other households experiencing primary or tertiary homelessness.

Figure 5: Total dwelling commencements in WA, June 2000 - December 2014
Source: ABS Cat No 8752.0 Table 34



Source: http://www.planning.wa.gov.au/dop_pub_pdf/HIFG_April_2015.pdf

Figure 13 Housing Finance Commitments, by Buyer Type, July 1991 to December 2014 (%)



Source: <http://www.apf.gov.au/DocumentStore.ashx?id=257bc7fd-0eff-45f4-9542-9406967f2d2a&subId=353233>, p23

Negative

1. The vast majority of CHPs use an income based rent setting methodology which sets an upper limit on the rent that can be charged to tenants benchmarked against market rents. As market rents fall the maximum limit charged (typically 74.9% of market rent) will fall too. Those CHPs with tenants being charged rents at the maximum (74.9% of market rent) will receive less income as market rents fall with a corresponding negative impact on the organisation's bottom line.

Members who use the rent setting calculator issued by CHIA in WA (and before that, CHCWA) will be aware that it recommends the use of market rent figures supplied by the Australia Taxation Office.⁹ It is likely that the market rent figures for Perth (which can be applied anywhere in WA) will be reduced in response to falling rents since it was last updated. CHIA expects the table the ATO to publish updated figures in June of this year and will disseminate them to members once published.

2. Falling demand for rentals is indicative of the deterioration of broader economic fundamentals underpinning the real economy. Should, for example, unemployment continue to rise, it is likely that we will see an increase in demand for social housing and for services provide by CHP's who deal extensively or exclusively with clients experiencing primary or tertiary homelessness.

When will the rental market recover?

REIWA contend that the market equilibrium is reached when there is a vacancy rate of 4.0% which, in turn, will allow for moderate price inflation. At some point in the future, the rental market in Perth will find equilibrium again. In order for that to happen the supply overhang currently present in the market will have to be eroded. This will happen in two interrelated ways:

1. Increased demand for rentals. This could come from several sources: an increase in net migration to the State, an increase in household formation as, for example, rates of young adults leaving the family home and entering rented accommodation increase. Falling rents will likely create extra demand from this group. Any occurrence that could make the transition to home ownership more difficult; escalating house prices, tighter lending criteria, an interest rate hike.
2. A significant fall in the volume of new housing being built. Demand for housing from all quarters is falling and this is flowing through to housing completions (more on that later). Eventually, household formation rates resulting from a growing population should absorb the

⁹ Those figures are available here: <https://www.ato.gov.au/printfriendly.aspx?url=/Business/Bus/GST-and-non-commercial-rules---benchmark-market-values/#Table1>



supply overhang providing its impact on the demand side is greater than the supply sides propensity to provide additional properties to the market.

It is impossible to say for sure how long this process will take to play out. However, several key economic indicators provide clues as to how both the demand and supply side for rental properties and housing more generally will develop over the coming months:

Building slow down

At present, there is an oversupply of housing in Perth. The level of stock on the market for sale is hovering around 15,000¹⁰ (market equilibrium is thought by REIWA to be about 1200) with sales volumes at very low rates historically. Taken in isolation, this suggests, but does not demonstrate, an oversupply. There are households who would buy but are prohibited from doing so because they don't have the necessary deposit saved and/or sufficient income to service the mortgage on a property suitable for their needs. However, conditions in the private rental market confirm it. Essentially, with rents falling and so many landlords struggling to find tenants, it is impossible to argue that demand for housing, in the housing market exclusive of the social housing system, outstrips supply. In fact, the opposite is true.

It should come as no surprise then that industry forecasts for new housing completions in WA show a precipitous decline in the volume of new dwellings that will be built over the coming years. The Housing Industry Forecast Group forecasts that dwelling completions in WA, having peaked at 31,158 in 2014-15 will fall to 23,000 in 15-16 and 20,000 in 16-17.¹¹ In other words, the number of new dwellings built in 2016-17 will be 36% lower than 14-15 according to this forecast.

A chill wind on Main Street

The building slowdown will over time return the private rental market to equilibrium. However, the length of time that takes will also be influenced by demand side factors. The building slowdown will also impact demand and have a negative multiplier effect across the economy. Less housing being built means less jobs for people employed in the industry and related industries. Contemporaneously, it is likely that the mining and resources sector will continue to shed jobs, many of which are construction related jobs. "Figures from Deloitte Access Economics...highlight the employment challenge ahead for WA. DAE found investment in WA for definite and planned projects fell \$21.2 billion or 8.5 per cent between September and December. With \$105 billion of LNG projects to be completed next year, the future looks tough for WA"¹²

¹⁰ <http://reiwa.com.au/about-us/news/perth-market-snapshot-for-the-week-ending-26-january/>

¹¹ http://www.planning.wa.gov.au/dop_pub_pdf/HIFG_October_2015_Report.pdf

¹² <https://au.news.yahoo.com/thewest/wa/a/30671333/perth-s-north-feels-jobs-heat/>



The construction industry and the mining and resources industry are major employers in WA and it's not clear what sector(s) of the economy will pick up the slack left behind to allow the economy to rebalance.

In addition, the State government's ability to increase spending in response to slowing business and household spending will be stymied by the parlous state of its budgetary and debt positions. Finally, the stimulatory effect of any further cuts to interest rates will be limited by the fact that rates are already at historic lows.

In a worst case scenario for WA, unemployment will continue to increase ameliorated only by an increase in the number of people leaving the State, or the country to find work. This will negatively impact on demand for housing at all levels and elongate the time it takes for the rental market to rebalance.

Landlords rushing for the door

The high vacancy rate is likely putting pressure on Perth's landlords, particularly, highly leveraged landlords who have bought rental properties in the last few years. This, in turn, has the potential to exacerbate falls in property prices as investors look to divest. This phenomenon was described by the Curtin Business School in its submission to the Senate inquiry on Home Ownership last year:

"In Australia overall, investment property debt makes up around 37% of total housing debt while owner occupied housing debt takes up a share of 63%. However, there are some noticeable differences across states and territories. In the territories, investment property debt takes up almost half (48%) of total housing debt. This is followed by a 43% share in WA. In all other states, the share of investment property debt is less significant, at 40% or less.

The increasingly dominating presence of investors in property markets is a source of concern, especially in jurisdictions such as WA and the territories. Property investors are more likely than owner occupiers to sell their investment properties during housing market slumps, especially if they are highly leveraged. Indeed, recent research has found that evidence that negatively geared investors are more likely to churn in and out of rental property investments than equity-oriented investors to preserve tax shelter benefits (Wood and Ong 2010). Hence, the presence investors could lead to instability in housing markets if they are highly leveraged."¹³

In fact, it is likely that a significant proportion of the supply overhang in the home sales market is from housing investors looking to divest in light of such poor market conditions for landlords. The effect of these sales on the total stock of private rental properties in the market is likely neutral or close to neutral. This is because if the property is bought by another investor there is no net loss. Equally, if it is bought by an owner occupier, in most cases, they will transition from another owner occupied property to make the purchase or a rental property thus freeing up that property for another household.

¹³ [file:///C:/Users/barry/Downloads/Sub_17%20\(2\).pdf](file:///C:/Users/barry/Downloads/Sub_17%20(2).pdf), p23-24



Conclusion

In the space of a few short years, Perth has gone from having the most undersupplied rental markets in Australia to the most oversupplied.

Existing market conditions present both threats and opportunities to community housing providers. An increased supply of rental properties and falling rents should already be alleviating pressure, to some degree, on social housing waitlists as well as reducing demand for crisis accommodation. However, those same falling rents will have a deleterious impact on CHP's revenue, particularly those CHPs with high numbers of tenants already paying the typical 74.9% of market rent maximum.

On the other hand, as this paper has demonstrated, the current state of the private rental market is a function the ongoing deterioration of the State's economic fundamentals. It is inevitable that any further declines in the performance of the real economy, particularly increases to the unemployment rate, will create extra demand for community services including community housing.

The scope and scale of that same deterioration in the State's economic fortunes will, in the final analysis, be the key factor in determining how long it will take the private rental market and the housing market more broadly to rebalance.

This document was written and distributed by Barry Doyle, Project Director WA, Community Housing Industry Association of Australia (CHIA)

barry.doyle@communityhousing.com.au

Tel: 041 550 2060