

Beyond Population ÷ 2.5: Understanding Housing Demand in Australia

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ECONOMICS

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Executive Summary

Much of the public debate on Australia's housing shortage relies on simplistic measures of housing demand, most commonly the practice of dividing population growth by average household size. Several commentators have recently revived this obtuse practice. Under this approach, a population increase of 420,000 people – as occurred in the latest 12 months of data – is assumed to require less than 170,000 additional homes.

While intuitive, this methodology substantially understates housing demand and has contributed to persistent misunderstandings about the causes of Australia's housing shortage. It also leads to an equally unhelpful discussion about the role of migration on housing and economic development.

Housing demand is not generated solely by population growth. It is influenced by household formation, demographic change, migration, ageing, relationship formation and breakdown, changing housing preferences, replacement of existing dwellings and broader economic conditions.

Housing demand is also affected by the availability of housing itself. When housing is scarce, households adapt by delaying formation, sharing accommodation, and accepting living arrangements that they would not otherwise choose.

As a result, observed household growth is not the same as underlying housing demand. How people live is not necessarily reflective of how they want to live.

This distinction is critical. Historically, housing demand forecasts that underestimate demand led to insufficient housing targets, inadequate infrastructure planning and policy responses that fail to address the underlying shortage. Poor economic forecasting of population growth, and of the volume of homes required for that population growth, has left us with a significant deficit of housing.

Australia's housing shortage is not the result of one source of demand being too high. It is the result of housing supply failing to keep pace with total demand growth.

Migration is an important contributor to housing demand and has accounted for a large share of population growth in recent decades. However, migration is only one component of total demand growth. Housing shortages emerge when housing supply fails to respond to demand from all sources, including migration, household formation, demographic change and replacement demand.

The recent Parkinson Review into Australia's migration system recognised the importance of migration to economic growth, labour force participation and fiscal sustainability. The Review implicitly highlights the need for housing, infrastructure and population planning to operate as an integrated system.

The Parkinson Review highlights that Australia should be planning housing around migration, not housing shortages.

This report argues that Australia requires substantially more housing than implied by simplistic population-based calculations.

A better way of thinking about housing demand is that it is created by three different types of factors – economic, population and demographic – that include the following:

- population growth,
- migration,
- household formation,
- demographic change,
- declining household size,
- replacement demand,
- housing preferences,
- vacancy requirements,
- and existing shortages.

Australia's housing challenge is not simply accommodating future population growth. It is building enough homes to accommodate future demand (of which, population growth is but one component) while reducing the housing shortage that already exists.

That is why Australia requires substantially more housing than implied by simplistic population-based calculations.

HIA's modelling indicates that Australia requires more than 250,000 homes per year under conditions in 2025, if we want affordability to improve. This figure reflects migration, demographic change, declining household size, replacement demand and economic growth. Even achieving the Housing Accord target of 1.2 million homes over five years is unlikely to restore sufficient homes for a growing population and economy.

The consequences of continued underbuilding are already visible through rapidly rising rents and home prices, overcrowding, declining affordability and increasing homelessness. The solution is not to deny demand exists, or to deny the importance of migration to stable economic development. It certainly isn't for policy to punish investors, naively believing it will help owner occupiers.

Demand and supply of homes in Australia is not, and has not, been in balance.

The solution is to build enough homes to meet the needs and wants of Australia's current and future population.

1. Introduction

Australia's housing shortage has become one of the most significant economic and social challenges facing the nation. Rents have risen sharply, vacancy rates remain near historic lows, and home ownership has become increasingly difficult for younger Australians. At the same time, public debate surrounding housing has become increasingly polarised, with competing explanations offered for why housing has become less affordable.

Some attribute the shortage to migration. Others blame investors. Others point to taxation settings such as negative gearing and capital gains tax arrangements.

While each of these factors may influence housing demand, supply or ownership, none explain the fundamental problem confronting Australia's housing market. At its core, Australia's housing shortage reflects a sustained imbalance between housing supply and housing demand.

This report argues that many popular explanations for Australia's housing shortage are built upon an incomplete understanding of how housing demand is generated.

Simplistic methodologies that estimate housing demand by dividing population growth by average household size have become increasingly common in public debate. While these calculations appear straightforward, they fail to account for the complex economic and demographic factors that determine the number of homes Australians require.

Housing demand is not equivalent to population growth. Nor is housing demand equivalent to observed household growth. Housing shortages suppress household formation, increase occupancy rates and conceal unmet demand. As a result, housing demand is often substantially higher than conventional measures suggest.

Understanding this distinction is essential because inaccurate estimates of housing demand lead directly to poor policy outcomes. When demand is underestimated, housing targets are set too low, infrastructure provision falls behind population growth, and shortages persist.

This report seeks to explain how housing demand should be measured, why common forecasting approaches often underestimate demand, and what these findings imply for housing policy in Australia. The central proposition is simple: that Australia's housing shortage is not the result of one source of demand being too high. It is the result of housing supply failing to keep pace with total demand.

This Report also builds upon the work undertaken in [HIA Housing Australia's Future](#).

Understanding how demand is generated is, therefore, the first step towards understanding how Australia's housing shortage can be resolved.

2. Housing Demand Is Not Population Growth Divided by 2.5

One of the most persistent misconceptions in Australia's housing debate is the belief that housing demand can be estimated by dividing population growth by the average number of people living in each dwelling.

Under this approach, a population increase of 420,000 people, which is consistent with that observed in 2025, and an average household size of 2.5 people per dwelling would imply a requirement for less than 170,000 additional homes.

This conclusion is wrong.

This calculation estimates only one component of housing demand and ignores many of the factors that determine how many homes need to be built. The distinction is important because this methodology is frequently used to argue that Australia has built enough housing, or that recent housing shortages are entirely the result of migration. Neither conclusion is supported by the evidence.

The Difference Between Population Growth and Housing Demand

Housing demand is generated by households. The challenge is that households are not static. They change over time because of economic, demographic and social forces, including, but not limited to:

- Young adults leaving the family home and establishing independent households.
- Couples forming households.
- Lower fertility rates
- Relationships breaking down.
- Older people increasingly living alone, given increased longevity and Australia's ageing population.
- Growth in single-person households.
- Families adjusting their housing consumption (reducing household sizes) as incomes rise and/or preferences change.
- Replacement of obsolete housing stock.
- Redevelopment and urban renewal.
- Migrants arriving at different stages of life and with different housing preferences.

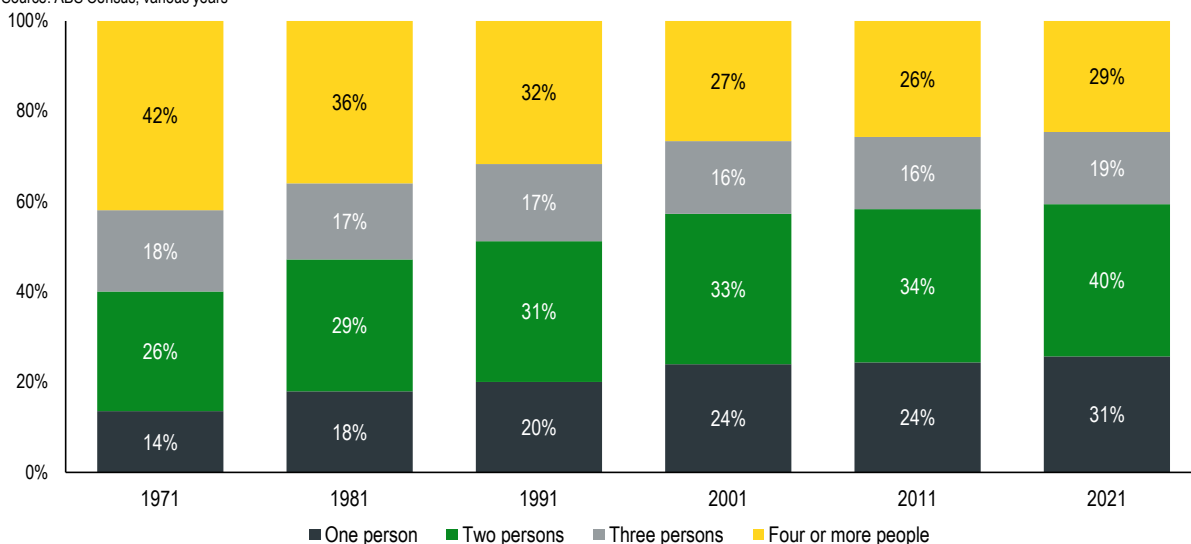
As a result, housing demand is shaped by much more than population growth alone.

Household formation is affected by economic factors such as unemployment and economic growth. The number of homes required also depends on demographic factors such as who those people are, how they form households, what type of housing they occupy and how the existing housing stock evolves over time.

A population increase of 420,000 people translates into demand significantly more than 170,000 homes.

Proportion of dwellings by number of occupants

Source: ABS Census, various years



Housing Demand Exists Even Without Population Growth

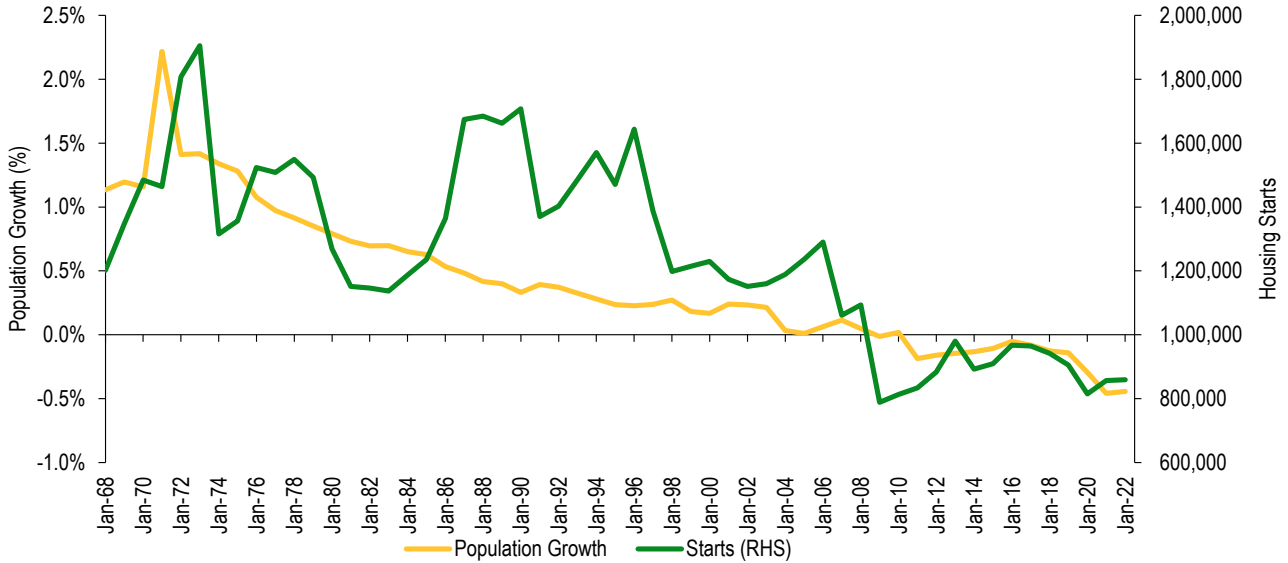
One of the clearest flaws in the 'population divided by household size' methodology is that it implies housing demand falls to zero when population growth falls to zero.

Even in the absence of population growth, housing demand continues to be generated by the above-listed factors. This can be observed in Australia and overseas examples.

Japan has observed very weak aggregate economic growth for more than 30 years and their population has been declining for a decade and a half, and the country still commenced construction of almost 1 million homes per year over the last decade. Population growth is clearly not the only factor creating demand for homes.

Japan Housing Starts Vs Population

Source: World Bank

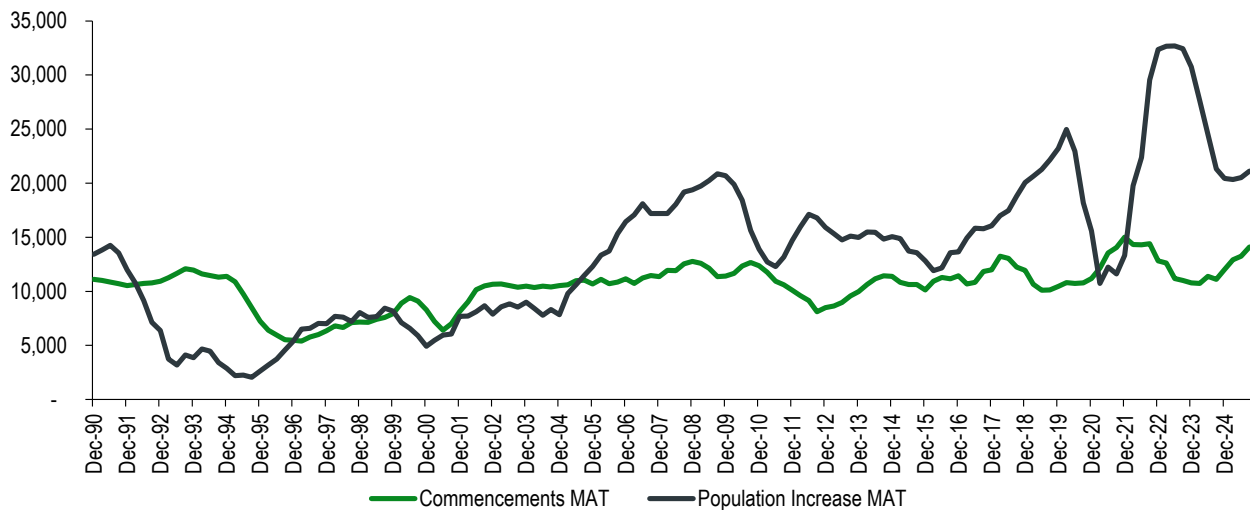


Similarly, during the COVID period Australia continued building homes at near-capacity despite net overseas migration briefly turning negative. And from the early 90s to the mid 2000's South Australia commenced 9,000 homes per year with minimal population growth.

South Australia Population growth (MAT) vs Commencements

(MAT)

Source: ABS



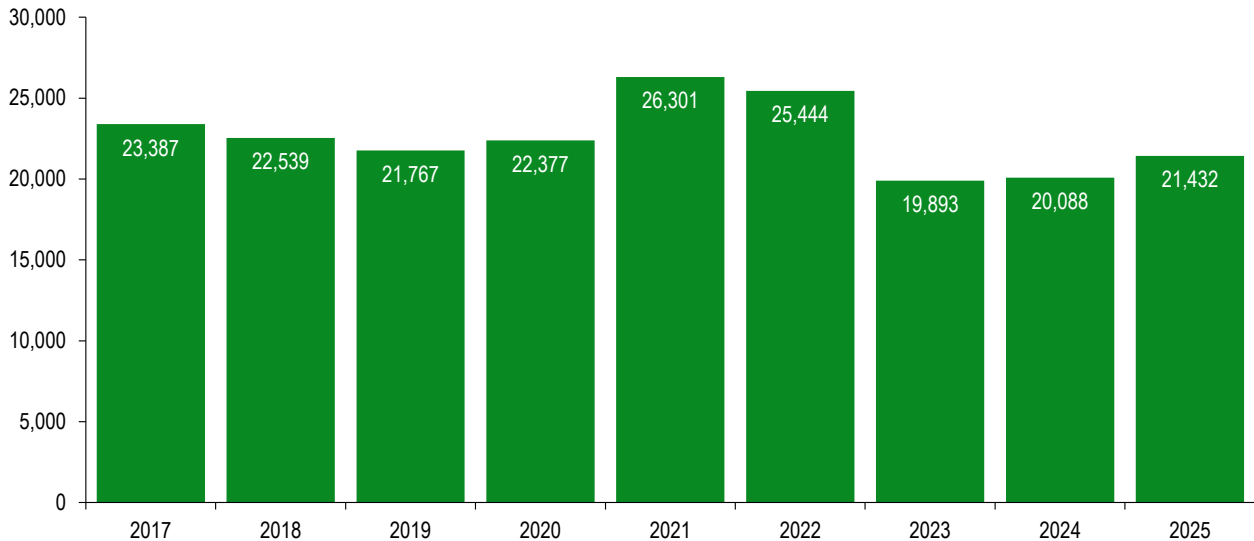
The Demolition Problem

Another major weakness of the 'population divided by household size' approach is that it assumes every newly constructed home adds one dwelling to the housing stock.

Each year at least 20,000 homes are demolished and replaced. Older homes are removed through redevelopment. Knockdown-rebuild activity replaces existing housing stock with newer homes. Medium density apartment buildings are replaced with higher-density developments.

Demolition Approvals

Source: ABS



As a result, not every dwelling completion represents a net addition to housing supply.

Over the past decade Australia has averaged approximately 22,500 dwelling demolitions per year. Consequently, 170,000 dwelling completions may result in a net increase in housing stock of closer to 147,500 dwellings.

This distinction is critical because new households occupy net additions to housing stock, not the gross number of dwellings completed each year.

Household Size Is Not Fixed

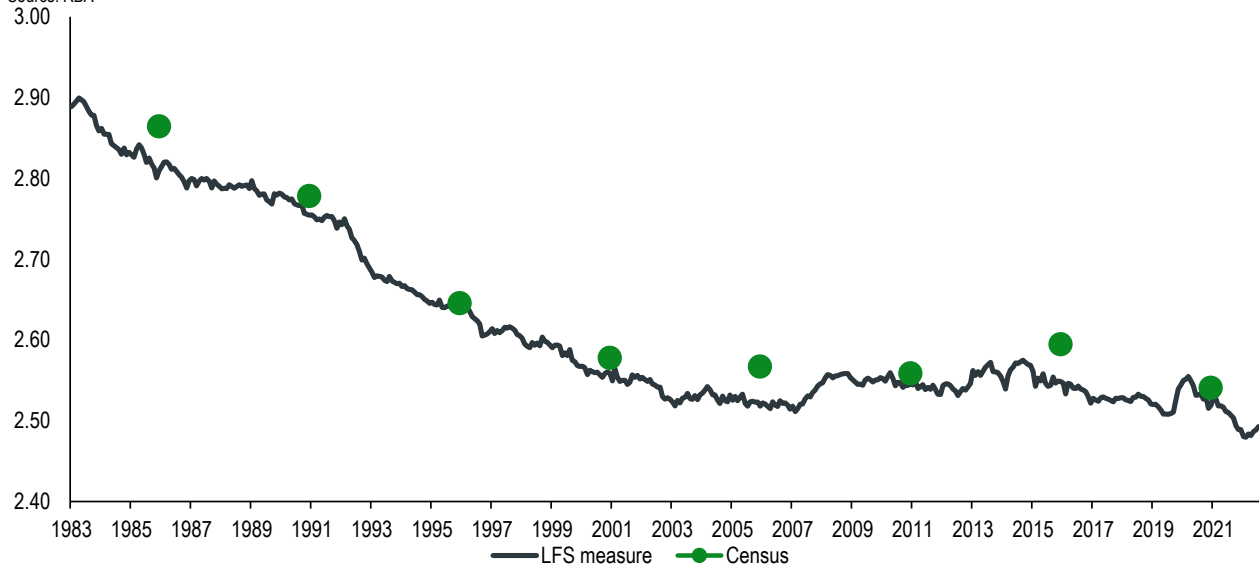
The 'population divided by household size' methodology also assumes that household size is constant through time. It is not. Australia's average household size has been declining for decades.

A decline in household size is a consequence of rising wealth and is evident across developed economies. The wealthier we become, the fewer people we want to live with. This reflects several long-term trends, listed above.

A decline in household size from 2.5 people per home, to 2.4 people per home mean that a resident population of 30 million people would require an additional 500,000 homes without any population or economic growth. At the current rate, this would require nearly three years of home building, just to accommodate the existing population's requirements without including migration, population growth, demographic or economic factors.

Average Household Size

Source: RBA

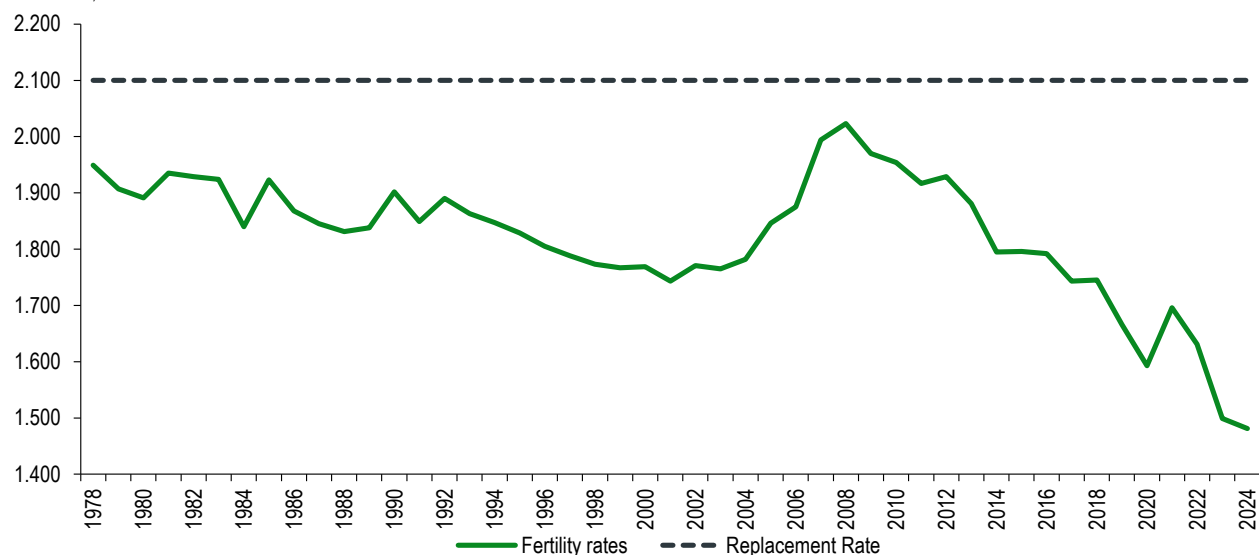


- The plateau in the average number of people per homes that has occurred since around 2007 is likely the consequence of a shortage of housing stock.

These trends mean that the number of dwellings required for a given population increases over time. Even if population growth remained unchanged, declining household size would increase housing demand. This is one of the reasons that housing demand frequently grows faster than population growth alone would suggest.

Fertility Rates - Australia

Source: ABS, World Bank



The decline in fertility also impacts the average number of people per home. Fewer children per household will, with time, see a decline in the average number of people per household. With this, a shift to higher density housing as the number of single households, and households without children, accelerates this decline in the average number of people per home.

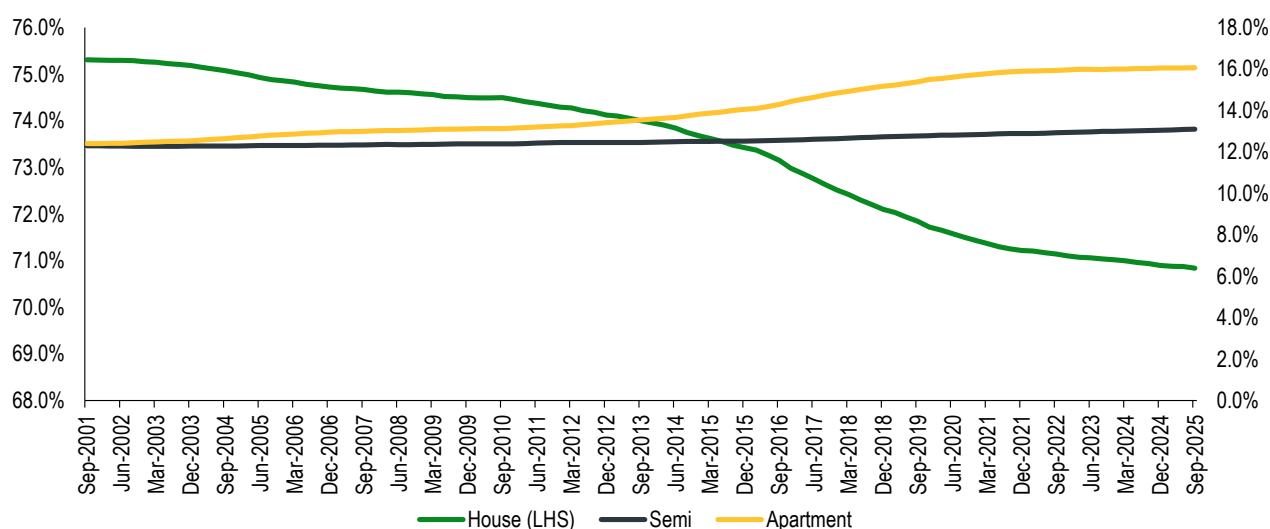
New Homes Accommodates Fewer People

Changes in the composition of housing stock further complicate simplistic population-based calculations. Detached homes typically accommodate more residents than apartments.

As cities become denser and a larger share of new housing is delivered through apartments and medium-density developments, the average number of occupants per new dwelling tends to decline.

Share of dwelling stock by type

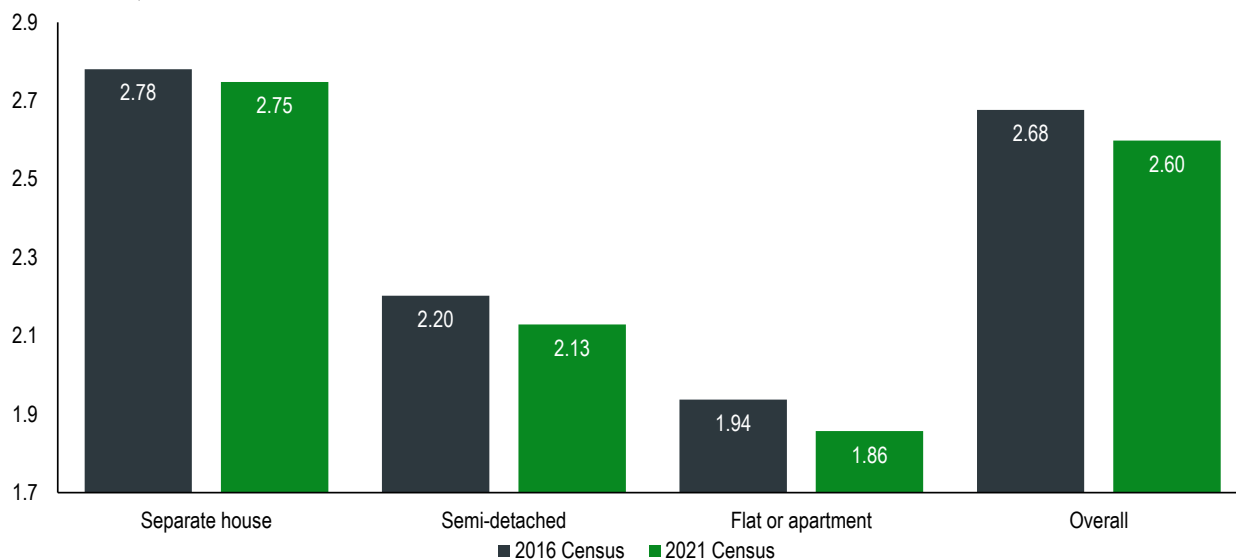
Source: ABS Census, ABS, HIA economics, RBA



This means that a growing share of housing construction consists of dwellings that accommodate fewer residents than the existing housing stock. Consequently, the number of dwellings required to accommodate a growing population increases over time. This effect is particularly important in Australia’s largest cities, where most future housing supply is expected to occur in medium and higher-density forms.

People per household

Source: ABS Census, 2016 and 2021



Housing Demand Is Suppressed By Housing Shortages

Perhaps the most important weakness in the ‘population divided by household size’ methodology is that it assumes observed household formation accurately reflects housing demand.

In reality, housing shortages suppress household formation. When housing becomes scarce or unaffordable, households adjust. Young adults remain in the family home longer. Friends share accommodation. Couples delay separation. Families occupy housing that no longer suits their needs. Adult children return home.

The result is that more people live in fewer dwellings. Average household size increases. Observed household formation slows. Demand appears lower than it actually is.

This creates a paradox: the more severe the housing shortage becomes, the more the shortage conceals itself. People adapt to the shortage rather than disappear from the housing market altogether. As a result, observed household growth is often an unreliable measure of underlying housing demand.

Why This Matters

The purpose of housing demand forecasting is not to estimate how many households currently exist. It is to estimate how many homes Australians would occupy if suitable housing were available.

Housing demand is not equivalent to observed household growth. Housing shortages suppress household formation, increase occupancy rates and conceal unmet demand. As a consequence, simple population-based calculations consistently understate housing demand and risk leading policymakers to underestimate the number of homes required.

The number of homes required to accommodate population growth is not the same as the number of homes that need to be built.

3. Housing Demand Is Not Household Growth

Household growth and housing demand are not the same thing. While household projections are a useful indicator of future housing requirements, they can still underestimate underlying demand because they are influenced by the availability of housing itself.

In other words, household formation is not entirely independent of housing supply. Housing shortages influence how households form, how many people occupy each dwelling, and ultimately how many households are observed.

As a result, household projections should be viewed as one component of housing demand forecasting rather than a complete measure of housing demand.

The Difference Between Households and Housing Demand

A household is typically defined as a group of people who live together in a dwelling. Housing demand is the number of dwellings people would choose to occupy if suitable housing were available.

In a well-supplied housing market, household growth and housing demand may be similar. In a constrained housing market, however, the two begin to diverge. When housing is scarce, people alter their behaviour. The result is that household growth becomes constrained by housing availability.

Demand continues to exist, but it is no longer fully reflected in observed household formation. This is one of the reasons housing shortages can persist for years while official measures suggest demand has been met.

Housing Demand Is Endogenous To Supply

Many discussions of housing demand assume that demand exists independently of supply. In practice, the relationship works in both directions.

When housing becomes more abundant and affordable, households form more readily. Adult children move out sooner. Shared households split into separate dwellings. People are more willing to relocate for employment opportunities. And the number of households increases.

This means housing demand is partly endogenous to supply.

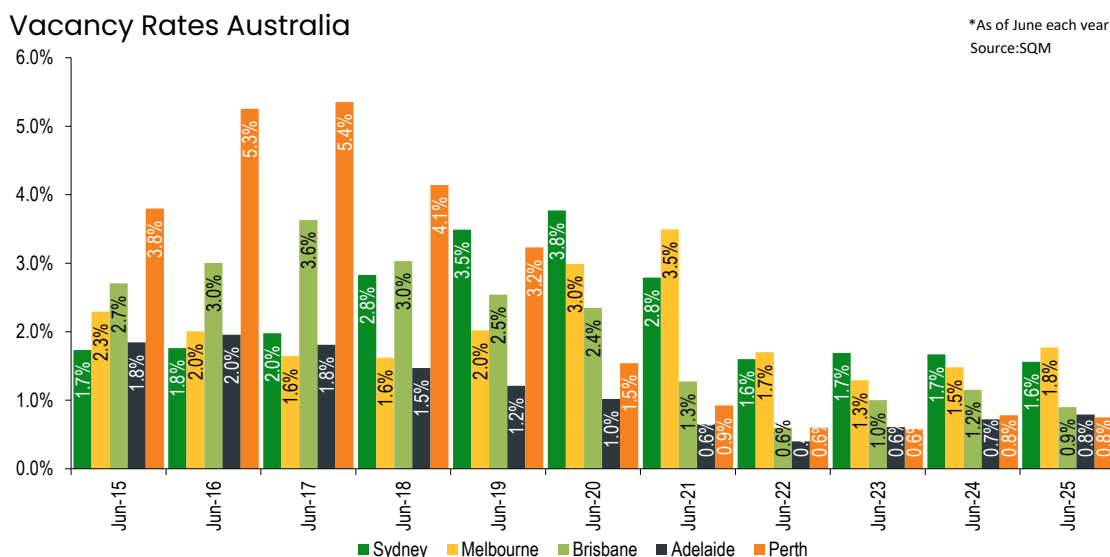
Increasing supply does not simply reduce prices. It also enables previously suppressed housing demand to emerge. This helps explain why housing shortages are difficult to eliminate once they become established.

Building only enough homes to accommodate existing households may not be sufficient because some demand remains hidden until additional housing becomes available.

Why Housing Demand Is Difficult To Measure

Housing shortages are unusual because they rarely appear as obvious shortages. When supermarkets run out of food, shelves become empty. When housing becomes scarce, people adapt. Households become larger. Spare bedrooms become occupied. Young adults remain at home longer. Shared housing arrangements become more common. People accept housing outcomes that differ from their preferences.

The market continues to function, but it functions differently.



4. The Million Vacant Homes Myth

Few housing myths have been as influential, or as persistent, as the claim that Australia has more than one million vacant homes. The contention is simple: on Census night, approximately 10 per cent of Australia's dwelling stock is recorded as unoccupied. Based on a housing stock of around 11 million dwellings, this implies that more than one million homes are vacant.

The conclusion often drawn is that Australia does not have a housing shortage. Instead, the argument suggests that existing homes are simply being left empty. If Australia already has one million spare homes, then building more housing appears unnecessary. Housing shortages become a distribution problem rather than a supply problem.

Unfortunately, this interpretation fundamentally misunderstands what the Census measures.

What The Census Actually Measures

The Census does not measure long-term vacancy. It records whether a dwelling is occupied on a single Tuesday night every five years.

As a result, many dwellings classified as 'unoccupied' on Census night are simply because that household is on holidays.

An 'unoccupied' home on the Census night is not necessarily a vacant home and includes:

- holiday homes,
- farm houses,
- short-term accommodation,
- homes undergoing renovation and repairs,
- recently sold properties,
- rental properties between tenants,
- deceased estates,
- dwellings whose occupants were temporarily away,
- newly completed homes awaiting occupation.

A home that is vacant for one night is not equivalent to a home that is permanently empty. The ABS has provided more detailed explanations.

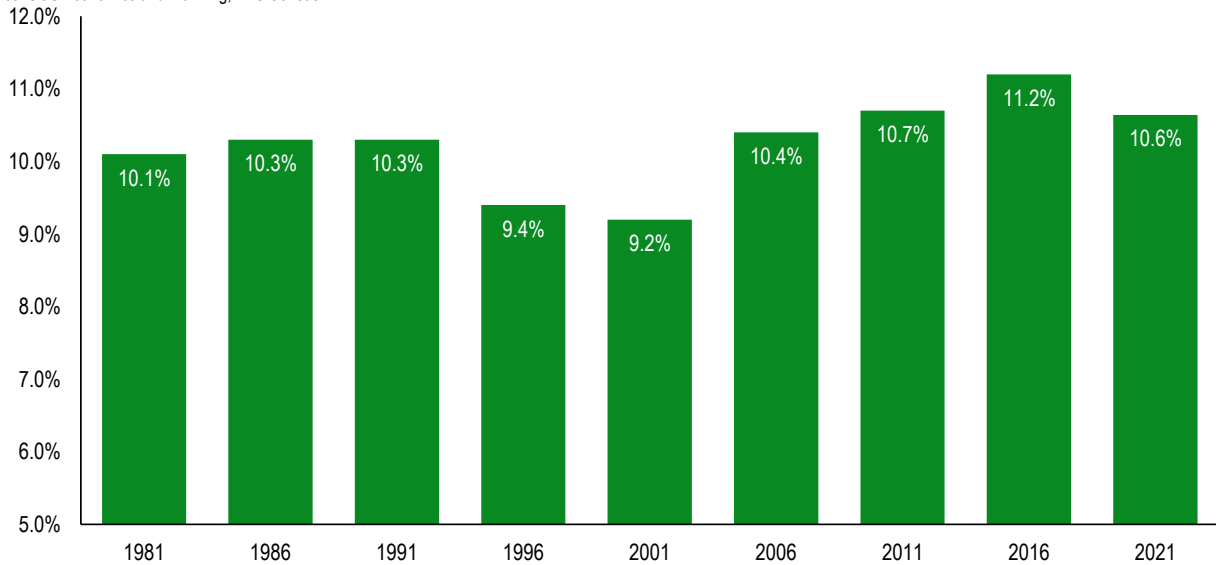
The Persistence Problem

The 'million vacant homes' is not the smoking gun that some argue.

The Census has reported the same '10 per cent of homes' as vacant since the first modern census in 1986. This is consistent with data from other developed economies and largely reflects the proportion of households that are away from home, on Census night. If these homes represented a large and growing stock of permanently vacant housing, one would expect housing market conditions to become progressively less constrained.

Unoccupied homes through time

Source: SGS Economics and Planning, ABS Census



The behaviour of the housing market is inconsistent with the existence of a vast pool of genuinely unused housing.

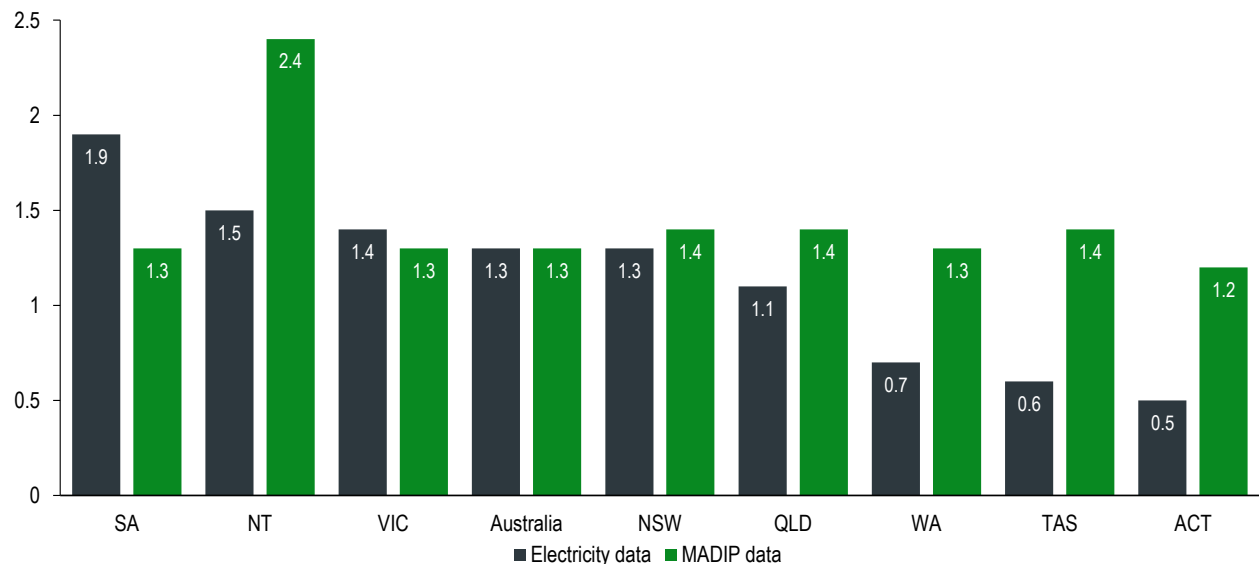
What The Data Suggests

The Multi-Agency Data Integration Project (MADIP) combines information from multiple government datasets and allows housing occupancy to be assessed using actual patterns of use rather than a single Census night snapshot. One of the most revealing findings is that only a very small share of dwellings appears to have no ongoing utility consumption.

Analysis of electricity consumption suggests that the proportion of dwellings that are persistently unused is closer to 1.3 per cent of the housing stock than the 10 per cent often cited from Census data. These homes are likely to be in areas without employment opportunities.

Percent of dwellings classified as inactive

Source: ABS



A certain level of unoccupancy is healthy in a well-functioning housing market. Homes are constantly transitioning between owners and tenants. Properties undergo renovation. Some homes serve seasonal purposes.

Short term rental accommodation, that is predominantly occupied on weekends and during school holidays, would also be vacant on a Tuesday during school term. There should be sufficient homes to house the resident population and have sufficient accommodation to permit holidays.

A well-functioning housing market would also provide renters with options on the location and type of dwelling they desire. The question should be whether there are enough vacant homes to accommodate people seeking housing.

Unoccupancy Is Not Waste

A common misconception is that every unoccupied dwelling represents wasted housing.

A housing market with 100 per cent occupancy is a housing market that cannot function efficiently. People moving for work, family or education need homes to move into. Landlords need time to undertake maintenance. Newly completed homes need time to be marketed and sold. Properties need to transition between occupants.

Historically, rental vacancy rates of around 3 to 5 per cent have been associated with more balanced housing markets.

Australia's recent experience of vacancy rates around 1 per cent reflects an acute shortage of available housing, not an excess of empty homes.

Why The Myth Matters

The million vacant homes claim is not simply a statistical misunderstanding. It has influenced public debate, policy proposals and media commentary for years. The danger is that it directs attention away from the underlying causes of Australia's housing shortage.

If policymakers believe Australia already has sufficient housing, they are less likely to pursue reforms that increase housing supply. Housing shortages become framed as a problem of allocation rather than production.

The result is that attention shifts away from planning systems, infrastructure funding, construction capacity and housing delivery. This matters because housing shortages cannot be solved by redistributing homes that do not exist.

If Australia genuinely had one million spare homes available for occupation, we would expect:

- low rents,
- stable home prices,
- healthy vacancy rates,
- limited overcrowding.

The market is telling us that housing supply is failing to keep pace with total demand.

5. Migration, Economic Growth and Housing Demand

Migration has become one of the most contentious issues in Australia's housing debate.

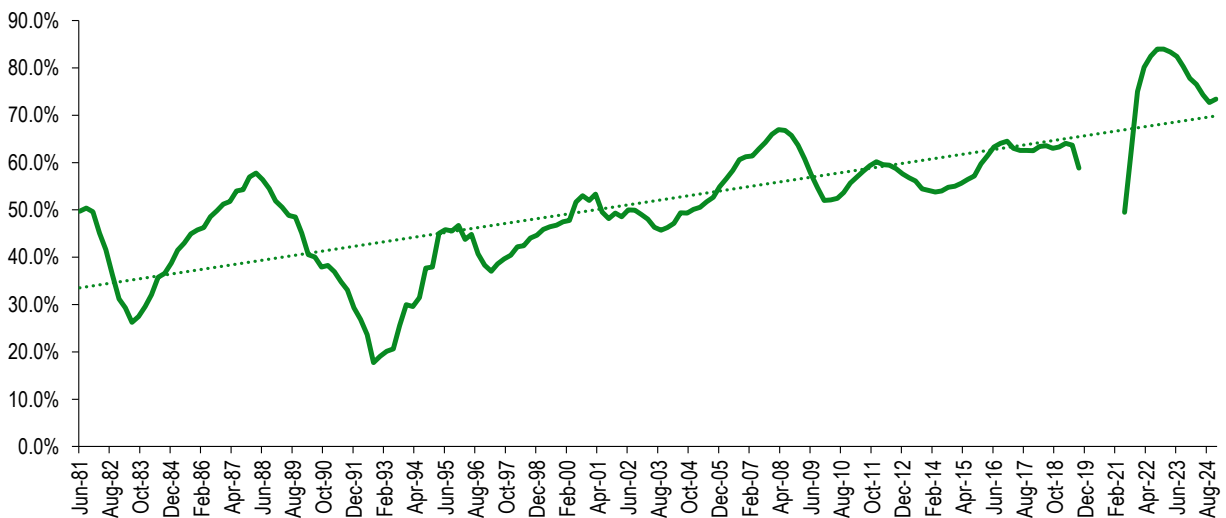
In recent years, rising rents, low vacancy rates and worsening affordability have led many commentators to conclude that migration is the primary cause of Australia's housing shortage. A common argument is that reducing migration would reduce housing demand and therefore resolve affordability challenges.

There is an element of truth in this argument. Migration is a major contributor to housing demand. Over the past two decades, net overseas migration has accounted for a substantial share of Australia's population growth and has, in most times, exceeded natural increase as the primary source of population growth.

The question, however, is not whether migration creates housing demand. The question is whether Australia has built enough homes to accommodate that demand.

NOM as a share of population growth

Source: ABS



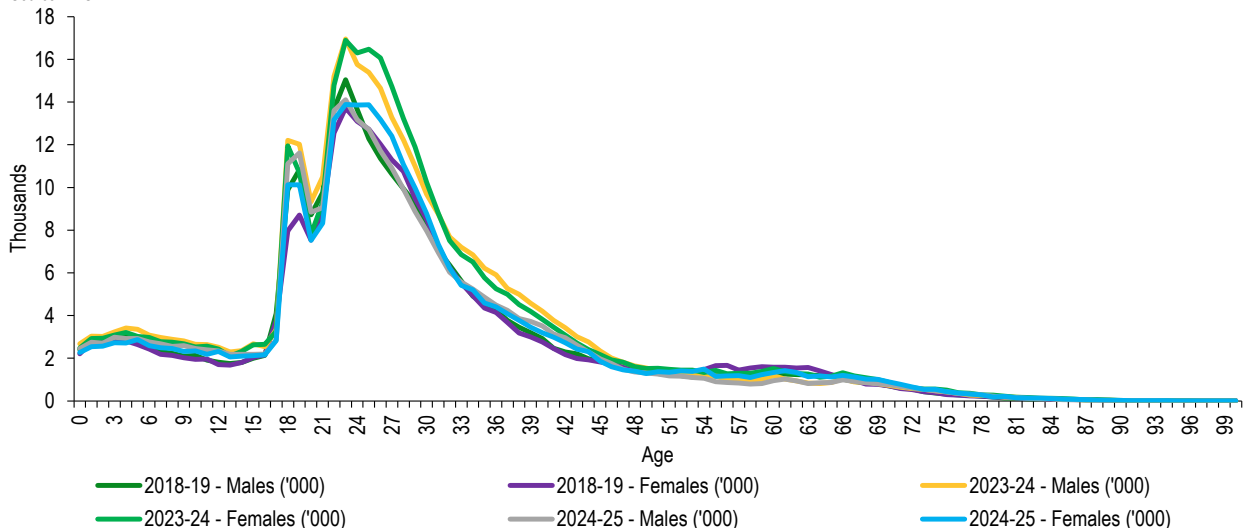
Migration Creates Demand

Migration is different from many other forms of population growth because migrants are disproportionately concentrated in age groups most likely to form households.

Most migrants arrive between the ages of 18 and 40.

Overseas migrant arrivals - age and sex

Source: ABS



2018-19 - Males ('000)
2023-24 - Females ('000)

2018-19 - Females ('000)
2024-25 - Males ('000)

2023-24 - Males ('000)
2024-25 - Females ('000)

These are the years in which people typically:

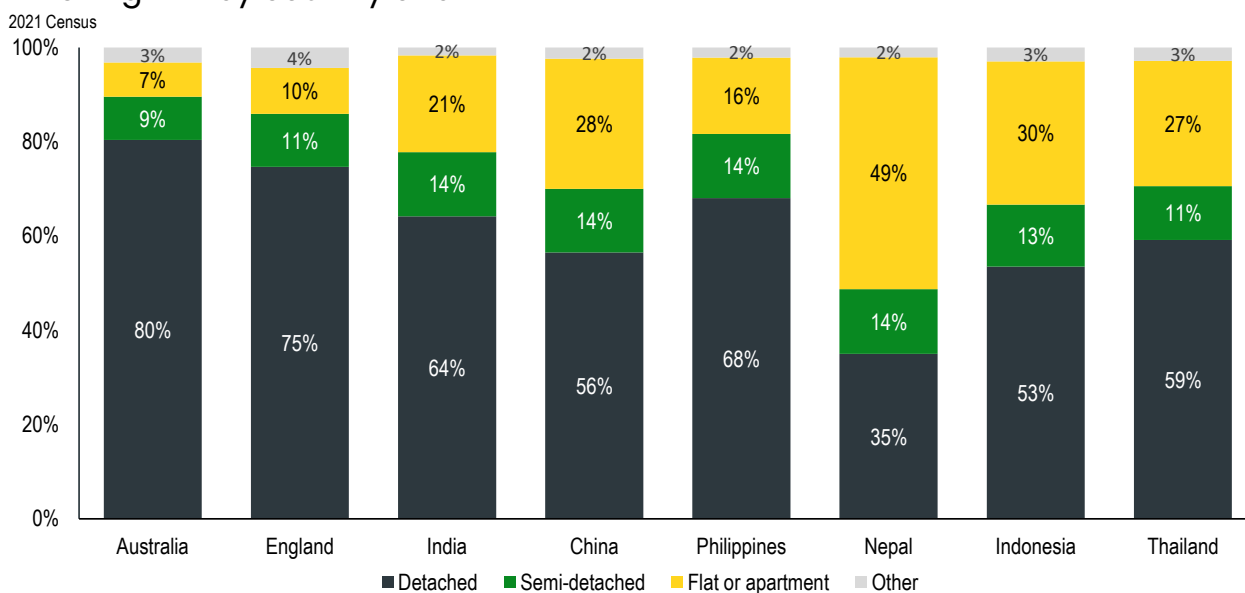
- leave the family home,
- enter the workforce,
- form partnerships,
- establish independent households.

As a result, migration generates more immediate housing demand than natural population growth through births. A newborn child generally remains within an existing household for many years. A working-age migrant often requires accommodation immediately.

This is one of the reasons migration has such a significant influence on rental markets.

Many migrants initially enter the rental market before transitioning into home ownership over time. The result is that migration often affects rental demand first, before influencing owner-occupier markets.

Dwelling mix by country of birth



The country of origin also appears to influence the type of dwelling preferred by new migrants and therefore could have an impact on the average volume of people per home, but this isn't well understood and is influenced by the shortage of stock over recent decades.

The Contribution of Migration to Economic Growth

While migration increases housing demand, it also plays a critical role in Australia's economy.

Migrants contribute to:

- labour force growth,
- workforce participation,
- skills development (the capacity of the building industry to increase supply of new homes),
- tax revenues,
- business formation,
- economic growth.

Migration also helps offset some of the economic challenges associated with an ageing population. Without migration, Australia's workforce would grow more slowly, economic output would be lower, and government revenues would be reduced.

The benefits of migration are numerous and significant – their impact on housing is just easier to see. Nonetheless, migration policy cannot be viewed solely through the lens of housing demand.

The Parkinson Review

The Independent Review of Australia's Migration System, led by Dr Martin Parkinson AC PSM, provides one of the most comprehensive examinations of migration policy undertaken in recent decades.

The Review concluded that migration is essential to Australia's long-term prosperity and economic performance. Importantly, the Review did not argue that migration should be reduced in response to the failure of housing supply to keep pace with population growth.

Instead, the Review emphasised the need for migration policy, infrastructure planning, workforce planning and housing delivery to operate as an integrated system. The Parkinson Review effectively recognises that population growth is a foreseeable outcome of government policy.

Australia should not sacrifice the benefits of migration because of the historical failure to build enough housing – poor housing policy is not a reason for poor migration policy.

Why The Debate Matters

The risk in focusing exclusively on migration is that it encourages policymakers to treat demand suppression as the primary solution to housing shortages. Reducing migration may reduce housing demand. It may also reduce labour supply, economic growth and government revenue.

More importantly, it does not address the structural barriers that prevent housing supply from responding to demand. Planning delays remain. Infrastructure constraints remain. Land supply constraints remain. Labour shortages remain. Construction costs remain.

Housing affordability ultimately depends on the relationship between supply and demand.

Policies that address only one side of that equation are unlikely to provide a durable solution.

Reducing migration to a level that would 'fit' with home building volumes of 170,000 homes a year, is no guarantee that 170,000 homes will continue to be built each year under such a lower migration scenario.

It is however clear that the supply and demand for homes in Australia is not in balance.

6. What NHSAC Gets Right, And What It Misses

The National Housing Supply and Affordability Council (NHSAC) has made an important contribution to Australia's housing debate. Unlike many commentators, NHSAC does not estimate housing demand by simply dividing population growth by average household size.

The NHSAC uses household formation modelling to estimate the number of additional households expected to form over the Housing Accord period. This represents a significant improvement over many of the simplistic approaches that dominate public discussion.

The Council's work recognises an important reality: housing demand is generated by households, not people.

This is an important distinction and one that is often overlooked.

The NHSAC's methodology represents a substantial improvement over population-based measures, and forecasts that Australia will undersupply homes every year of the Housing Accord.

NHSAC's Forecast

The State of the Housing System Report forecasts that approximately 900,000 additional households will form during the five-year Housing Accord period. The Council also estimates that net additions to Australia's housing stock will total approximately 862,000 dwellings over the same period.

This implies a shortfall of approximately 38,000 dwellings relative to projected household growth. Importantly, NHSAC notes that this estimate does not account for all existing unmet housing need.

While the NHSAC forecasts approximately 900,000 additional households during the Accord period, the government's Housing Accord target is 1.2 million homes. The existence of a target 300,000 homes above projected household growth is itself an acknowledgement that household growth does not fully capture Australia's housing requirements.

The Council recognises that Australia entered the Accord period with an existing housing deficit.

Household Growth Is Not Housing Demand

The key contribution of NHSAC is that it shifts the debate away from population growth and towards household formation. The challenge is that household formation itself is influenced by housing availability. When housing is scarce, fewer households form than would otherwise occur. This creates a problem for forecasting.

The result is that the NHSAC household projections understate the number of homes people would occupy if sufficient housing were available.

The Housing Accord Target

One of the most important implications of this discussion concerns the Housing Accord target itself. The National Housing Accord aims to deliver 1.2 million new homes over five years.

The objective is to:

- accommodate future demand,
- improve affordability,
- increase vacancy rates,
- reduce overcrowding,
- reduce homelessness,
- and begin addressing Australia's accumulated housing shortage.

In other words, the Accord target implicitly recognises that Australia requires more housing than would be suggested by household growth alone.

Why 1.2 Million Homes May Still Be Insufficient

The NHSAC projections suggest that around 900,000 additional households will form during the Accord period.

At first glance, this might imply that building 1.2 million homes should comfortably meet demand. As discussed in previous chapters, housing demand is influenced by:

- declining household size,
- demographic change,
- replacement demand,
- temporary migration,
- changing housing preferences,
- suppressed household formation,
- and existing shortages.

These factors mean that underlying housing demand is likely to exceed projected household growth. This is one of the reasons HIA's housing demand modelling produces materially higher estimates of required housing supply than methodologies based solely on household formation.

Under current conditions, Australia likely requires more than 250,000 homes per year to accommodate demand growth and begin restoring balance to the housing market.

This is substantially higher than the level of construction currently being achieved because Australia is not starting from equilibrium.

Key Finding

NHSAC correctly recognises that housing demand is generated by households rather than population alone. It also correctly identifies that the shortage of housing stock will increase each year of the Accord period.

7. Why Housing Supply Has Failed To Respond

In a well-functioning market, increasing demand leads to higher prices, which encourages additional investment and new supply. As new supply enters the market, prices stabilise and shortages are resolved.

There are only two sources of market failure in economic theory. One is where there is imperfect competition as one side of the market has excess market power or information. There is no evidence to suggest that there is a lack of competition within new home building in Australia. There are many suppliers of materials that compete with imported materials and there are many builders competing to attract customers.

The second source of market failure is caused by government policies that result in inefficient allocation of resources. Up to half of the cost of a new house and land package are taxes, fees and charges imposed by government.

Land Is Different

Among all housing inputs, land occupies a unique position. Governments have limited influence over global commodity prices. They have limited influence over international supply chains. They have limited influence over demographic change.

They have significantly greater influence over the availability and cost of development-ready land.

The supply of land is heavily shaped by:

- planning systems,
- zoning decisions,
- infrastructure provision,
- development approvals,
- taxation and charges.

These are largely government policy decisions. As a result, land costs are one of the areas where government action can have the greatest influence on housing affordability.

Infrastructure Matters

Before homes can be built, land requires:

- roads,
- water,
- sewerage,
- electricity,
- telecommunications,
- schools,
- community infrastructure.

The cost and timing of this infrastructure often determines whether housing can proceed. In many parts of Australia, infrastructure constraints have become one of the largest barriers to housing supply. This is why infrastructure funding is such an important housing policy.

Recent commitments to increase infrastructure funding recognises an important reality that housing cannot be delivered without the supporting infrastructure required to service new communities.

Infrastructure investment is housing policy.

Labour Constraints

The housing industry is also constrained by labour availability. Low unemployment levels are a 'double edged sword' for the building industry. It creates demand for new homes and limits the availability of skilled tradespeople. The building industry faces strong competition for skilled and unskilled labour from other industry sectors.

Over the long term, skilled labour costs are likely to rise faster than the national average as competition for workers intensifies. This creates additional pressure on housing costs and reduces the industry's ability to rapidly expand supply.

Materials Costs

Construction materials have historically become more affordable over time as manufacturing productivity improved. The future may look different.

The housing industry now faces:

- higher energy costs,
- geopolitical uncertainty,
- more volatile global supply chains,
- increasing transport costs,
- growing competition for critical materials.

These factors are likely to place upward pressure on construction costs relative to historical experience. As a result, future housing supply may become less responsive to rising demand than it was in previous decades.

Why Rising Prices No Longer Generate Enough Supply

The interaction of these cost pressures creates an important consequence. Historically, modest increases in home prices could encourage additional construction.

Today, the threshold is much higher. Before a project becomes financially viable, home prices must first rise sufficiently to cover:

- higher taxes,
- higher land costs,
- higher infrastructure costs,
- higher labour costs,
- higher material costs,
- higher financing costs,
- higher regulatory costs.

In effect, the housing market now requires larger price increases before supply responds. This is one of the reasons housing shortages can persist even while prices are rising rapidly. The price signal is being partially absorbed by rising production costs.

The Role of Government

The purpose of government is not to perfectly forecast housing demand. Nor is it to decide who should be able to live in a home. The role of government is to ensure that the housing system can respond when demand changes.

This means:

- maintaining adequate land supply,
- investing in enabling infrastructure,
- ensuring planning systems remain responsive,
- supporting workforce development,
- removing unnecessary barriers to housing delivery.

A well-functioning housing market should be capable of accommodating stronger demand when it occurs.

8. Victoria: A Real-World Case Study

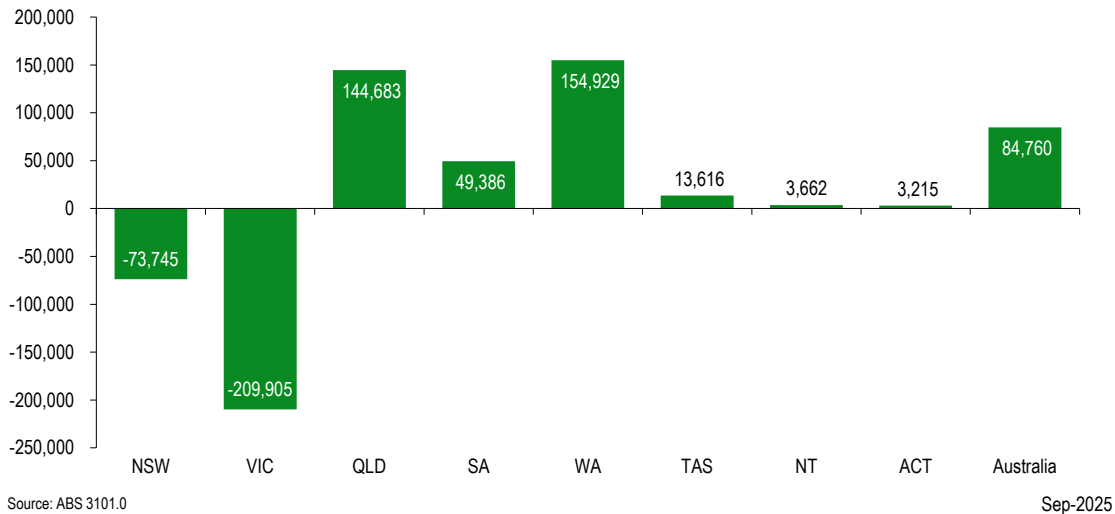
Victoria provides a practical example of what happens when demand growth slows relative to supply.

Over the past several years, Victoria has been the only mainland state where home prices have remained broadly stagnant while most other Australian markets have experienced substantial growth. At a time when national home prices increased significantly and markets such as Western Australia have seen prices more than double in just the last six years, Victorian home prices increased only marginally.

The Demand Side Of The Equation

Prior to the pandemic, Victoria experienced some of the fastest population growth across all developed economies, for almost two decades. The state's population increased by approximately 2 per cent per year during the decade leading up to 2020. This strong population growth contributed to strong housing demand and significant upward pressure on home prices.

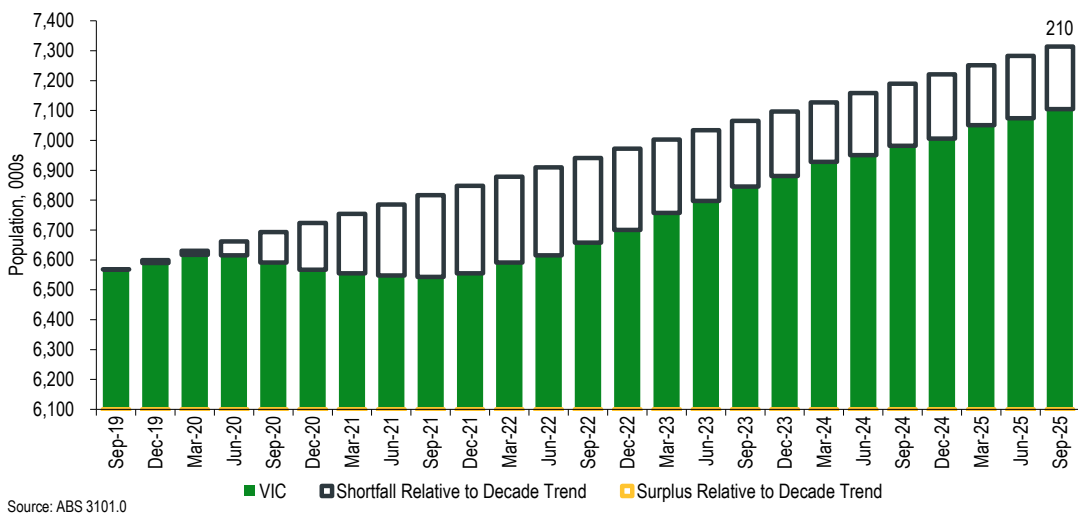
Population vs Pre-Pandemic Trajectory, by state



The pandemic disrupted this trend and Victoria experienced a substantial outflow of residents during the lockdown period, with population growth falling well below its pre-pandemic trajectory.

Although overseas migration subsequently returned, population growth remained below the trajectory that had previously been anticipated. As a result, Victoria's population today remains materially below the level that would have been expected based on pre-pandemic trends.

VIC Population Trajectory



Slower population growth means slower growth in housing demand.

The Supply Side Of The Equation

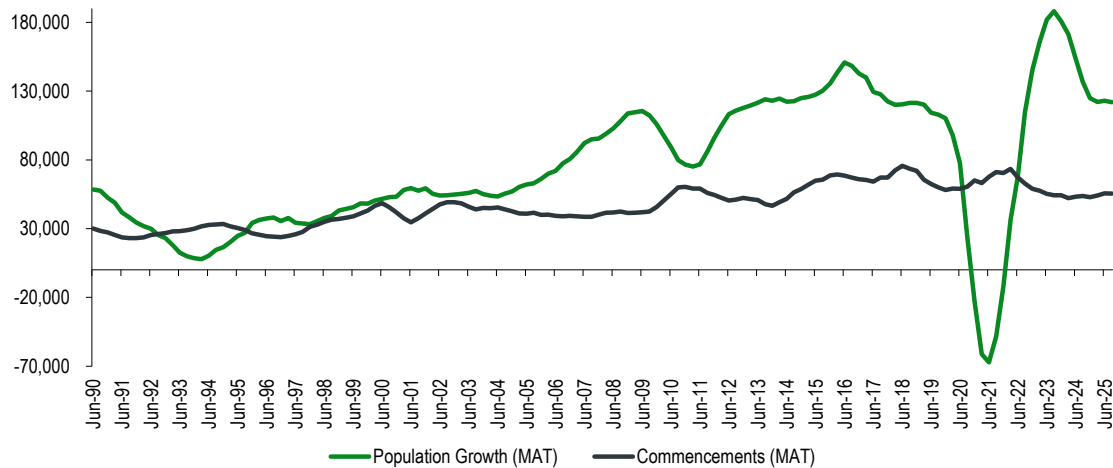
Despite the disruption associated with the pandemic, Victoria continued to build substantial volumes of housing. The state delivered housing at a pace that was much closer to underlying demand than many other jurisdictions.

Apartments that were commenced last decade continued to be completed into the 2020s. The pandemic also led to a dramatic shift in demand towards detached houses in outer suburban and regional areas, sustaining the inflow of new supply from this segment too.

Importantly, housing construction did not fall by the same magnitude as population growth. The result was a narrowing of the gap between supply and demand.

Victoria commencements vs population growth

Source: ABS



The Confidence Effect

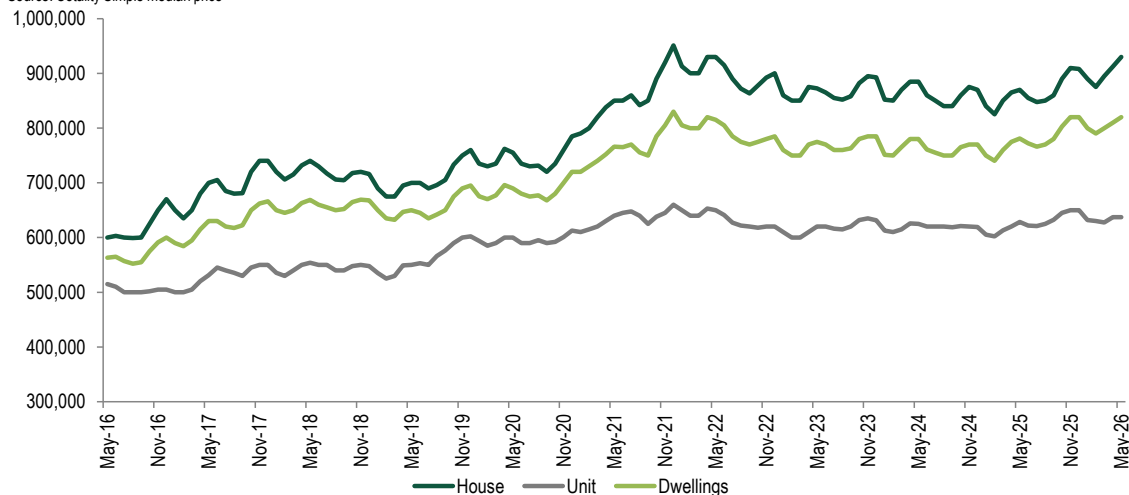
Victoria also provides an example of how policy settings can temporarily influence housing demand through investor confidence. Changes to land tax arrangements increased the cost of housing investment and encouraged some investors to exit the market. This increased the number of established homes available for purchase.

While these changes influenced market conditions, they did not alter the underlying relationship between supply and demand. The number of homes available for occupation remained largely unchanged. Ownership changed. Housing supply did not.

This distinction becomes particularly important when considering policies aimed at investors, including recent changes to negative gearing and capital gains tax arrangements.

Melbourne Median Dwelling Price

Source: Cotality Simple median price



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