

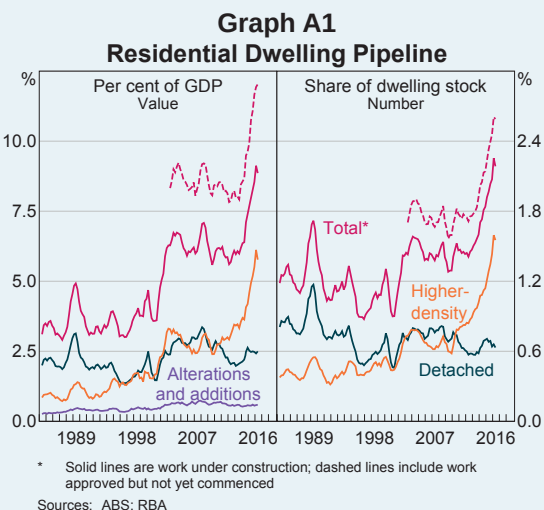
Box A

The Pipeline of Residential Dwelling Work

Dwelling investment has supported growth in output and employment over recent years, as the Australian economy continues to adjust to the large decline in mining investment. The pipeline of work to be done on residential dwellings has increased rapidly since 2013 to historically high levels, and this should continue to support dwelling investment over the next couple of years.

In late 2016, the estimated value of work to be done on residential dwellings was equivalent to 12 per cent of GDP and the number of dwellings to be completed increased to more than 2½ per cent of the dwelling stock (Graph A1).¹ This large pipeline of work primarily reflects strong growth in building approvals for higher-density dwellings (such as apartments).²

Residential building approvals have been almost 50 per cent higher than their long-term average over the past two years. The rise has been supported by low interest rates, population growth and strong growth in housing prices, particularly in the eastern states.³ Compared with previous housing cycles, a much larger proportion



of recent activity has been in higher-density building rather than detached houses. Higher-density building approvals have accounted for around half of all residential building approvals in recent years, compared with a long-run average of less than one-third (Graph A2). Furthermore, within the higher-density segment, there has been a shift in approvals towards higher-rise apartments; the number of apartment blocks with four or more storeys now contributes around one-third of total approvals, up from around 10 per cent in 2010.⁴

Apartments take longer to build than detached houses, which has contributed to the increase in the pipeline of work to be done. The average completion time for an apartment in 2016 was around six quarters, almost three times longer than for detached dwellings and twice as long as

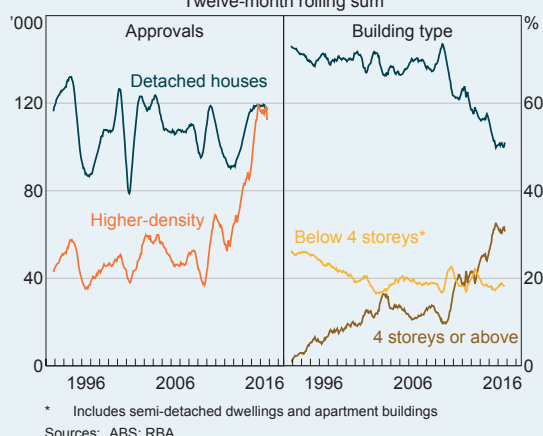
1 The Australian Bureau of Statistics (ABS) publishes two measures of the pipeline of work: one based on the estimated nominal value of work to be done and the other on the number of dwellings to be completed. A key difference is that the nominal value of the pipeline subtracts the value of work already completed on a given building job (which can contain multiple dwellings), while the number of dwellings in the pipeline only declines upon full completion of a building job. The ABS also distinguishes between work yet to be done and work approved but yet to be commenced.

2 The ABS defines a 'building approval' as a permit to begin construction and should not be confused with a development application, which is granted at an earlier stage of a project's development. Residential building approvals add to the pipeline of work to be done in both value and volume terms, regardless of whether work has commenced or not.

3 For more details on these developments by state, see RBA (2016), 'Box B: The Housing Market', *Statement on Monetary Policy*, August, pp 42–44.

4 There has also been an increase in the number of dwellings approved but not commenced in recent years, but this has remained at slightly more than 15 per cent of the total pipeline during this period.

Graph A2
Residential Building Activity
Twelve-month rolling sum



for townhouses. While average completion times for each dwelling type have been broadly steady over the past decade, the shift towards more apartment building has seen the overall average completion time for dwellings increase.

There are a number of possible factors driving the shift towards higher-density housing. Supply-side factors include changes in planning policies and increased availability of former industrial (or ‘brownfields’) sites, which tend to support higher-density dwellings, relative to urban fringe (or ‘greenfields’) sites, which are mostly used for detached housing. Factors supporting the demand for higher-density dwellings include the lower cost of apartments relative to detached houses and rising demand for inner-city dwellings, partly because of demographic change and foreign purchases. The shift towards higher-density housing is more in line with international norms, as Australia’s existing housing stock is heavily concentrated in detached houses and its cities have unusually low density compared with those in other industrialised economies.⁵

While the large pipeline of residential building work is expected to support dwelling investment and employment over the next couple of years, there are risks associated with the high level of activity and the shift to higher-density buildings. Much of the apartment construction is geographically concentrated, particularly in inner-city Melbourne and Brisbane.⁶ This increases the chance that (localised) oversupply could develop, and would exacerbate the effect on local area prices if that were to occur. In addition, because both approval lags and completion times are longer for apartments, developers might not be able to respond in time to price or other signals of waning demand, so a general oversupply is more likely to build up. If these risks materialise, there could be an increase in the proportion of newly completed apartments that fail to settle and a rise in the share of work yet to be commenced that is not undertaken.

The shift to higher-density construction has affected the interpretation of the pipeline as a leading indicator of future dwelling investment. An approved apartment takes around three times as long to complete as a detached house, which means that the pipeline of work to be done provides information on dwelling investment further into the future. However, the longer lag between the decision to build a higher-density dwelling and its completion means that the impact on the supply of housing, including prices and vacancy rates, may be less predictable than in the past. ❖

5 For more details, see Shoory M (2016), ‘The Growth in Apartment Construction in Australia’, *RBA Bulletin*, June, pp 19–26 and RBA (2014), ‘Submission to the Inquiry into Housing Affordability’, Senate Economics References Committee, February.

6 For more details see RBA (2016), ‘Box B: Banks’ Exposures to Inner-city Apartment Markets’, *Financial Stability Review*, October, pp 25–28 and Kent C (2016), ‘Australia’s Economic Transition – State By State’, Address to the Australian Business Economists Conference Dinner, Sydney, 22 November.