Speculative Vacancies 11: Empty homes in Melbourne 2019–2023

A window onto the economics of waiting and the hidden barriers to housing supply

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Prosper's 11th *Speculative Vacancy* report, released in July 2024, revealed startling statistics on unoccupied housing in Melbourne, illustrating how speculative incentives are holding back housing from the market.

Since 2007, our Speculative Vacancy series has shone a light on the role of vacant land and housing on supply and affordability.

Using data supplied by Melbourne's three water retailers, and revealing trends in vacancy across time and locations, our reports have drawn attention to this phenomenon and nudged public opinion towards support for curbing the witholding of land and housing from use or occupancy, for purely speculative purposes. Recent reports have gone further by including original analysis that deepens our understanding of the causes and consequences of vacancy.

This year's report focused on an economic explanation for vacancy that arises from the ongoing trade-off property owners face between flexibility and yield. The report linked vacant homes with 'land banking', where developers delay feasible projects and set prices to slow sales in expectation of higher returns in future.

Empty homes and land banking both result from similar economic incentives and tax system distortions, giving us a clear 'window' onto this critical aspect of economic behaviour, which creates a hidden barrier to faster housing supply, driven by private incentives, not public regulations.

Below are edited highlights from the report.

Thirty-thousand (30,000) people in Victoria have no home. We know that because we count them. But how many homes have no people? That number is hard to find, and is often seen as irrelevant to housing affordability.

The eleventh report in our Speculative Vacancy series examines unoccupied housing in Melbourne from 2019 to 2023, covering a unique period marked by a sudden and substantial surplus of housing, followed by a rapid tightening after COVID restrictions eased.

Basing our counts of empty and underused dwellings for the years 2019 to 2023 on water usage data, averaged over the calendar year, we found that in 2023, 27,408 dwellings (1.5% of all homes) were left totally empty over the year, with a further 70,453 (3.7% of all homes) barely used.

Overall, 97,861 dwellings (5.2% of all homes) were vacant – equal to one in 20 homes across the city.

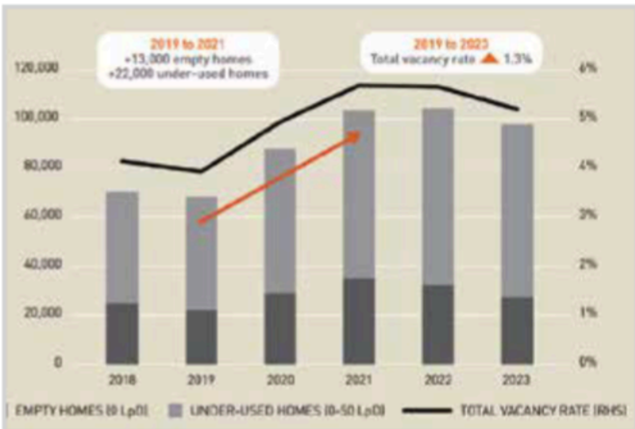

Figure 1: Empty and under-used housing measured by water data, calendar year

Vacancy rates surged during the pandemic, jumping more than 50% from previous levels (Figure 1). Between 2019 and 2021, an additional 35,000 homes, or 1.8% of the housing stock, became vacant.

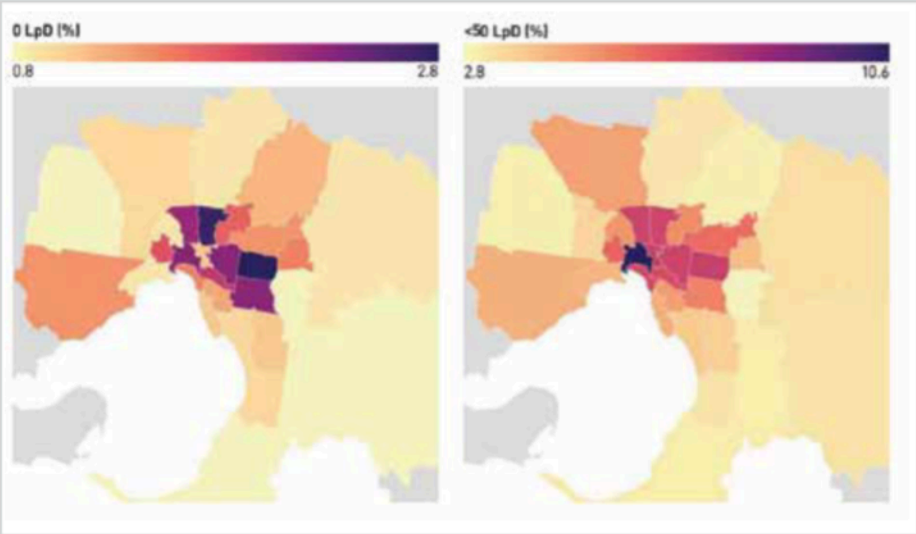

Figure 2: Low and zero-use vacancy rates by LGA, 2023

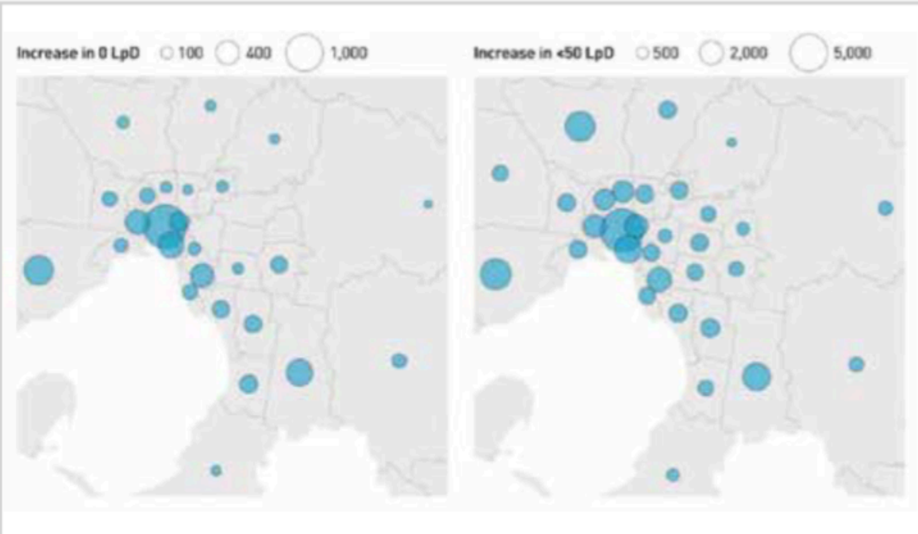

Figure 3: Increase in low and zero-use vacancy by LGA, 2019-2023

For every five new homes built over these years, two additional homes were left idle.

Empty homes remain widely dispersed across the city, but the fastest growth since 2019 has been in the City of Melbourne, where 10,000 homes are now vacant – equivalent to half the new builds in this area over the last five years.

In 2023, Whitehorse LGA had the highest zero-use vacancy rate at 2.8%, and the City of Melbourne had the highest zero plus low-use vacancy rate at 10.6% (Figure 2). Both LGAs recorded over 2,000 dwellings with zero water use in 2023.

The number of empty dwellings in the City of Melbourne almost tripled from 2019 to 2023, from about 800 to about 2,200. The central city saw a total of 10,000 dwellings either empty or underused in 2023 – a number equivalent to half of the dwellings added to the housing stock in this area by construction over the past five years (Figure 3).

That many renters cannot afford to outbid the convenience value of an empty property speaks of deep inequality, the root cause of unaffordable housing.

But vacant homes also illustrate how housing supply is at the mercy of speculative incentives. Low interest rates and taxes that favour capital gains over rental income make it rational for some owners to choose the flexibility of an empty home over the cash it could yield.

The economic explanation for vacancy boils down to the relative value of these two desirables – flexibility and yield – with the decision to leave a home vacant depending on the trade-off between option value and cash returns.

Empty property offers higher option value . If rents are low, landlords can avoid locking in low returns and the challenge of raising rent later. When sales prices are low, vendors can postpone sale, keeping the property untenanted to ensure the buyer pool includes owner-occupiers. If an owner plans to occupy their property in the future, keeping it empty makes this easier. The idea that property owners balance flexibility against yield is a catch-all explanation for these many and varied situations.

The pace of new housing construction results from the same economic tradeoff. Owners of vacant land can find land banking (preserving flexibility) more profitable than exercising their development option (taking the cash), which explains why the market supplies new housing well within regulatory limits.

Barriers to supply take centre stage in housing debates, with zoning rules often blamed for restricting supply. But this story underplays the role of land speculation. It is true that public rules limit what can be built, but within that, it is private incentives that determine how much housing we actually get.

As a stylised fact, most profitable (feasible) development sites are not developed in any given year. Prosper's Staged Release report illustrated this for greenfields land. Built properties are often also put to market slowly, with infamous examples such as the Gold Coast's "Jewel" tower giving lie to the claim that developers will ever voluntarily flood the market with product and drive down their own returns.

The reason the private sector regulates the pace of housing supply even with no public regulation in sight is that speculation pays. Developing land commits it to a specific use, but delaying development banks that option for the future, which can be even more profitable. The trade-off between these two sources of profit sets the market pace of new supply.

Taxing vacant homes or vacant land, as the Victorian Government proposes, can push more properties into use, but also carries risks. Broad-based land taxation would accelerate land development more efficiently, while also raising revenue.

Speculation is a contentious topic. The dominant narrative on housing supply, supported by vested interests, seeks to blame local democracy and public good regulation for problems that are not of their making. The natural monopoly inherent inland markets creates problems that policy can't break. These problems are being unfairly pinned on ordinary people and their desire for stable community The reality is far more nuanced.

For a more effective housing policy, we will need to confront not only inequality, but the impact of speculation on supply. Shifting tax off productive activity and onto land rents – the efficient and equitable source of public finance – is one way we can undermine the incentive to withhold land from productive use, making the most of our common wealth. •