URBIS

A SPOTLIGHT ON BUILD-TO-RENT ACROSS AUSTRALIA

Prepared May 2024

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Disclaimer

MARKET OVERVIEW AND INSIGHTS

TRENDS & OPPORTUNITIES

While this report focuses on the state of play for build-to-rent (BTR) as we know it today, there are several emerging trends and opportunities we are tracking. We will continue to share insights and welcome further discussion on opportunities in this space, including:

- Affordable BTR as a mid-market product
- Mixed Assets: Premium + Co-living + Affordable
- Single Family Rentals (Horizontal BTR)
- Sustainable & Net Zero BTR Developments
- Shopping Centre Asset Optimisation with Living Sector
- Repurposing Office Stock
- Construction Innovation & Modular Building
- Consolidation of Assets & Portfolios

Growing pressure on housing supply across the country has sparked interest in a broader range of housing typologies. BTR is seen as having the potential to provide improved housing supply and expand the spectrum of housing on offer.

While BTR is well established in international markets such as the USA and UK, it is still new to the Australian market. We have seen global interest in the market nationally with over 50,000 BTR apartments in planning, approved with a permit, under construction or built. However, there is a great deal of uncertainty in this pipeline given current funding constraints.

This leaves us asking: Will BTR housing play an increasing role in delivering supply and household choice or will the momentum stall until conditions change?

Like the wider housing sector, BTR has been significantly impacted by land pricing and the dramatic rise in construction costs. In addition, BTR capital investment has been affected by a combination of the following factors:

- Further tax reform required to bring BTR investment in line with commercial asset investment.
- Planning policy frameworks to provide sufficient incentive to compete with the BTS market and therefore certainty.
- Political risk and uncertainty of change and inconsistency.
- Investing in platforms that are yet to build up a portfolio and track record.
- Conviction in ongoing demand and revenue metrics over the longer term and alignment to product pitch.

Due to the combination of these factors, BTR investment is proving challenging and is putting the pipeline and therefore delivery of additional housing at risk.

01 POLICY AND PLANNING

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Given the lack of national definition for “build-to-rent”, there has been inconsistency in how existing frameworks have been applied within Policy, Planning, and Taxation. This is causing issues given the inherent risk associated with undertaking a project that has a lack of clarity in how local council will assess plans, and how state specific taxation will be applied. This is on top of the international inconsistency for Australia from a foreign investment perspective.

The industry has concern on the need to level the playing field and provide consistency across the nation for how these projects are assessed. This is driven by a desire to reduce risk to a proportionate level, by providing greater certainty and equivalizing investment for foreign funds when comparing Australia to other countries.

The latest legislation introduced into Federal Parliament improves some of the key national taxation issues, via the lowering of the managed investment trust (MIT) tax to 15% across both capital gains tax and rental income. The legislation also allows the extension of the time period beyond 15 years for the concessional rate. However, the tax concessions do come with a 10% affordable housing requirement, to be offered at a minimum 25% discount to market rent which may constrain the full viability impact this tax change could have.

From a state perspective, New South Wales has led the way in terms of providing an asset specific planning policy framework for BTR, with the key policy moves to permit BTR in commercial zoned land, flexible application of the Apartment Design Guide and introducing non-discretionary development standards.

More recently, City of Sydney LGA has proposed further policy changes to incentivise BTR in Central Sydney. However, despite policy incentives, BTR supply is well below Victoria.

Victoria and Queensland have not yet established a specific land use definition or assessment criteria for BTR, with these elements defaulting to the build-to-sell (BTS) requirements. However, individual councils have started making concessions on elements like apartment sizing, private open space, and reduced car parking in recognition of BTR specific development types where there may be larger communal areas or lower rates of car ownership. In these instances, conditions of approval are usually enforced to ensure approved BTR developments are not able to 'flip' to BTS in the future for a minimum period, or in perpetuity.

In Western Australia, there is not currently a separate land use or development criteria for BTR proposals, however, a number have achieved approval without significant issue. A key consideration is the diversity of the dwelling mix, size of dwellings, and car parking provisions.

In the table below, we have captured the key policies in our largest states, where much of the BTR activity is occurring.

FEDERAL POLICIES

MIT WITHHOLDING TAX FOR FOREIGN INVESTORS SET TO 15%

DEPRECIATION RATE FOR BTR ASSETS INCREASED FROM 2.5% TO 4%

	NSW	VIC	QLD	WA
BTR Criteria (Tax Eligibility)	• 50 units minimum • Owned in one-line • Held in unified ownership for at least 15 years • Managed by a single entity • Leases up to 3 years must be offered			• 40 units minimum Plus, criteria similar to the other states
Planning Policy	Housing SEPP and SSD assessment pathway	No specific BTR policies		
Land Tax Relief	50% Land Tax concessions through to 2041 available	50% Land Tax concessions if operational before 2032, for up to 30 years and full exemption from Absentee Owner Surcharge	50% Land Tax concessions from 1 July 2023 until 2043	50% Land Tax concessions for up to 20 years, available from FY2023/24
Foreign Investor Tax Relief	Foreign Investor Duty and Land Tax Surcharge relief	Australian based entities can be exempt from Foreign purchaser duty	Foreign Investor Land Tax exempt. Exemption of additional foreign acquirer duty on future transfer	Refund on Foreign Transfer Duty eligible

Source: Urbis Spotlight on BTR May 2024

02 MARKET PERFORMANCE

RENTAL MARKET CONDITIONS

The rental market is extensive and diverse, requiring investment across the entire spectrum, from affordable to market-rate to luxury properties. Each segment plays a unique role and is driven by different factors. This diversity should be considered when evaluating BTR products and the market conditions that have influenced their development.

In this snapshot, we are focused on BTR assets in the form of institutional grade investments that are targeted toward the upper end of the rental market. This is the type of BTR that is often spoken of in the media and is the typology that has garnered the most interest and activity to date. These assets do contribute to housing supply within the spectrum.

Premium BTR assets at the high end of the market are thriving due to peak rental market conditions. Vacancy rates are significantly below the natural rate of 2-3%, driving rents to grow faster than average. This is occurring against a backdrop of rising home prices, increased but now stabilising incomes, and a shift in consumer mentality towards valuing 'freedom' and experiences over ownership. This shift is crucial for the success of premium BTR assets, which cater to the demand for high-quality rentals, with tenants willing and able to pay the premium rents these operators charge.

In the table below, we have captured the rents in live BTR assets, the differential to standard new apartment product rents, and provide context to the rental growth over time and vacancy within the market overall. It is clear from this data the market has become more favourable for BTR returns.

Metric – Q1/2024	SYD	MEL	BRI	PER
BTR Asset Rents (pw)	$880	$886	$890	$907
Differential to New Apartment Product	13%	32%	14%	21%
Historic Market Metrics – All Apartments				
Rent Growth – 1 yr	1.6%	10.2%	13.0%	16.1%
Rent Growth – 3 yrs p.a.	11.6%	17.6%	13.1%	13.0%
Rent Growth – 5 yrs p.a.	4.6%	4.0%	7.7%	10.8%
Vacancy Rate – Q1 24	1.2%	1.1%	1.0%	0.4%
Avg. Vacancy Rate – 10 yrs	2.3%	2.4%	2.3%	2.6%

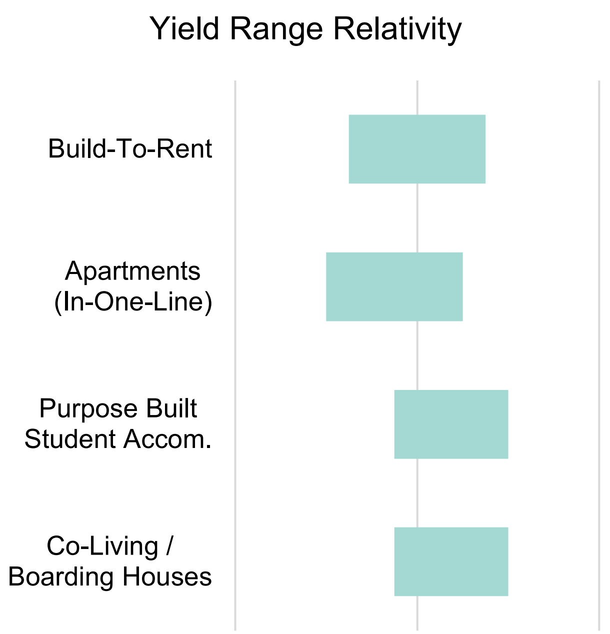
Source: Urbis Apartment Essentials, SQM Research; Urbis

RETURN ON INVESTMENT

BTR projects are supported by institutional capital. Globally, this is often from pension funds, sovereign wealth funds, listed and un-listed property funds. This puts these projects in the same category as Commercial Real Estate: office, retail, and industrial assets. Therefore, these institutional investors need to be able to achieve commensurate returns on a like-for-like basis while also adjusting for the level of risk inherent in each of these typologies. This is where BTR often wins out, because it is significantly lower risk from an operational point of view.

However, while the market conditions for a premium BTR offer have evolved with strength over the past five years, the conditions for securing capital from the institutional funds have gone from strong to weak. This has been driven by the sharp increases in the cash rate, which increases the risk-free return on money, which has occurred alongside an increase in geo-political risk, and construction uncertainty.

Having confidence in achieving the investor's hurdle rate is key to securing funding. However, often to get these deals across the line, there is a need to provide security of delivery of projects and portfolios. Given the BTR market in Australia is still embryonic, we are yet to see any true sales of purpose built BTR projects to measure returns. As such, we think it appropriate to measure returns referencing the difference to returns of other asset classes. In this instance, measuring the delta to commercial property types is a good indicator, as is considering the spectrum of institutional grade living sector asset returns. We also note that BTR markets overseas typically achieve sharper yields given their maturity. This highlights the potential opportunity for keener yields for Australian BTR assets in the future.



Source: Urbis Spotlight on BTR May 2024

03 BUILDING THE PIPELINE

As the market conditions ripened and the environment for returns became more competitive, we saw Australia's first wave of institutional grade BTR projects come through in 2019 and subsequent years.

Setting this up in an environment marked by planning and policy uncertainty took considerable courage from BTR developers. These pioneers initiated our progress, but their operational success and the continued expansion of the pipeline are now crucial. Given the rapid changes in the funding environment in the second half of 2023, we are on the verge of failing to build much of what is currently planned and proposed.

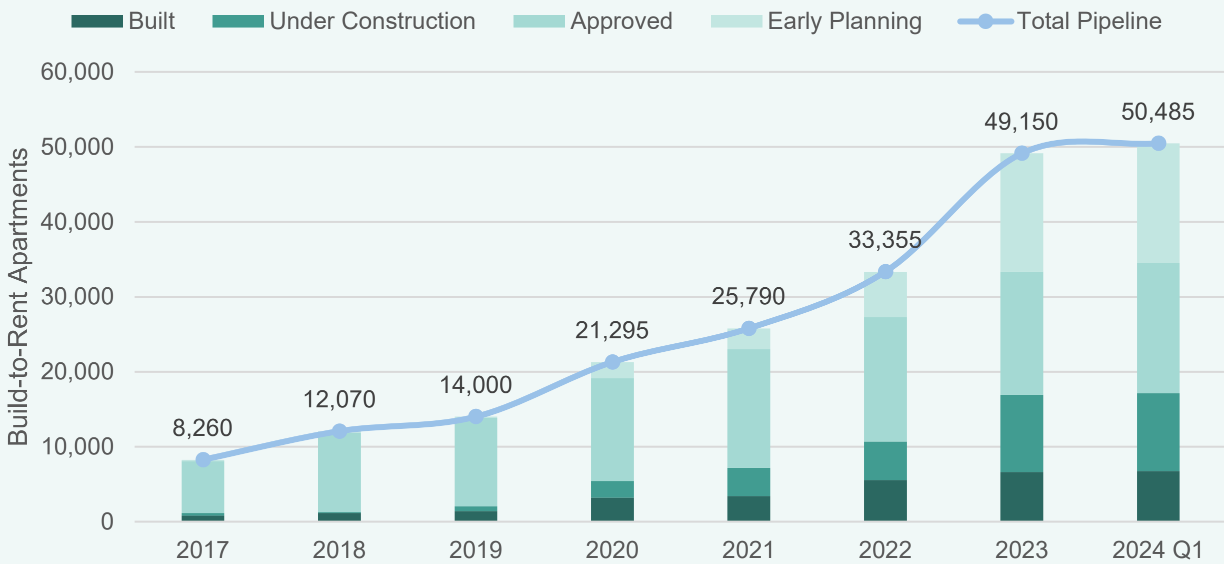
Greater incentives are necessary to boost confidence and ensure maturity, while also supporting existing assets that are currently operational and pre-policy. Achieving this won't happen overnight and will likely require another market cycle to fully establish.

This is clear when reviewing the pipeline of 156 BTR projects and over 50,000 apartments. Over 50% of these projects do not have any funding behind them yet. Therefore, they are much less likely to be delivered. Moreover, those with funding and that are under construction only total 10,355 in addition to the 6,764 already built.

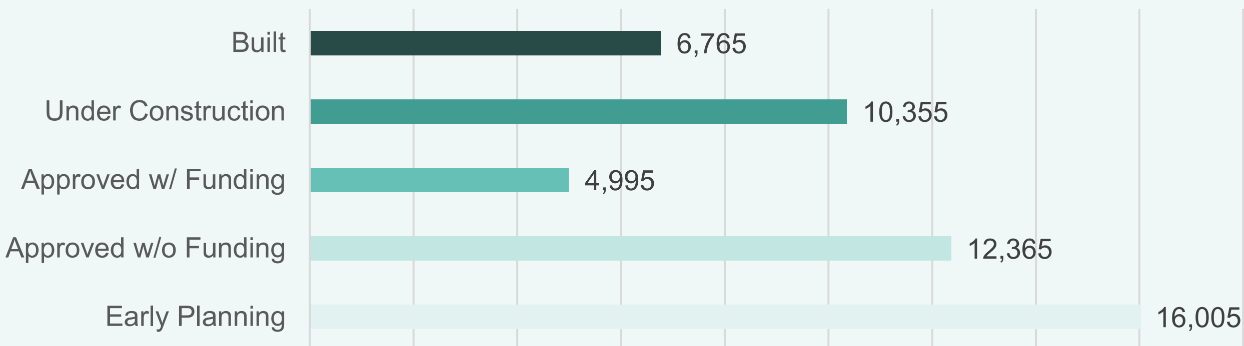
What is encouraging to see coming through in this pipeline nationally, is the diversity in target market and product offer. The largest projects are between 800 to 1,200 units, while the smallest are at the 50 minimum needed to classify for the tax incentives.

Depending on location, brand pitch, risk appetite, and overall development/funding model and stakeholders, we see the spectrum of offer coming through. This starts at the top with premium and luxury offerings, right through to supplying good quality product to those most in need of a home near to their workplace. Beyond this, the model is facilitating more affordable and social housing through Public Private Partnerships, projects which are in addition to the pipeline shown below.

AUSTRALIA'S TOTAL BTR PIPELINE



FIRMING UP THE PIPELINE



Source: Urbis Apartment Essentials; Urbis Spotlight on BTR May 2024

04 LOOKING FORWARD

CURRENT STATE

As detailed in this report, we are facing imbalanced market fundamentals, a challenging funding environment, and uncertain impacts from policies and planning legislation. Concurrently, we are experiencing a housing crisis, with vacancy rates at 1.1% and rising rents. However, it is evident that the market is now more diverse and varied than ever before.

While at a high level it appears BTR is booming and requires no additional clarity or support, the actual data presents a different picture. We need to be mindful of this when considering what more can be done to support this burgeoning housing sector.

It is important to understand and acknowledge that BTR is just one segment of the housing market. While we anticipate BTR will become significant in Australia, we do not expect it to dominate the market. In the UK, BTR comprises around 4% of rental stock, adding stability through professional operators of large-scale developments and creating opportunities to leverage institutional funds in the housing market. From a federal government perspective, BTR is a crucial component in addressing the housing shortage and achieving the National Housing Accord's goal of 1.2 million additional well-located homes by mid-2029 across Australia. Signatories to the Accord include all state and local governments as well as major superannuation funds.

Based on market forecasts, assuming continued policy stimulus, and a favorable funding environment, it is anticipated BTR could contribute between 10%-15% of new housing supply. More will need to be done to achieve this, along with corrections and balancing of the market cycle, which takes time.

ACTION NEEDED

We appreciate there is only so much government and policy makers can change. There are also several key market factors playing out, which will take time and are unlikely to receive much attention when it comes to reform.

It is our view, based on the current state, and the ambitions and potential to achieve an established BTR sector of scale, that the focus should be on improving certainty for investors via the following levers:

- Tax Reforms and Incentives, including:
  - GST treatment.
  - Further refinements to MIT legislation
  - Stamp duty surcharges.
  - Consistency of period for retaining as BTR.
- Streamlined and Certain Planning Pathway:
  - National consistency of definition.
  - Further planning policy ‘incentives.’

Currently, investors are evaluating projects based on their likelihood of success and the relevant policies affecting their portfolios. Factors such as weighing up the benefits (tax relief) and obligations (affordable housing) of the MIT legislation, navigating approvals from local councils and other authorities, all contribute to continued uncertainty and risk in project modeling. These uncertainties are significant given that BTR assets already offer relatively low returns, which should be proportional to the risks involved.

05 PARTNERING WITH YOU

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Unlock the full potential of your BTR investment with our expert advice. We understand the complexities of optimising your investment and are here to guide you through each step. Our national team brings deep market knowledge, comprehensive analysis, and clear, actionable advice to help you make the best decisions for your assets.

Whether you're managing a large portfolio or a small private investment, we deliver value and results with our multidisciplinary approach and market-leading expertise.

We have a national team of specialists helping clients optimise and deliver value in Housing every day. Contact one of our BTR specialists to explore this further and let us help you build your success.

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