Can Build to Rent fly in Australia? – Interim research findings

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Presentation overview

1. Explaining emerging interest in BTR
2. The BTR physical product
3. Geographical settings
4. Resident profile and experience
5. BTR and affordable housing
6. Key players
7. Funding, financing and feasibility

Drivers of growing interest in BTR

- Main drivers: changing attitudes among developers and financial institutions (potential investors)
- Some active Govt interest – NSW Treasurer; Property NSW inquiry (unpublished) an indepth investigation
- Rental housing returns – risk-adjusted – increasingly attractive – 'yield compression' in other asset classes
- Longer-term trends: more LT tenants; lifestyle aspirations increasingly to the fore
- Shorter-term development: awareness of peaking demand for traditional developer BTS product
- Aspiration for BTR as vehicle for affordable housing

Domain

Experts predict build-to-rent revolution coming to Australia

Sydney Morning Herald

Build to rent emerging as $300b housing industry

news.com.au

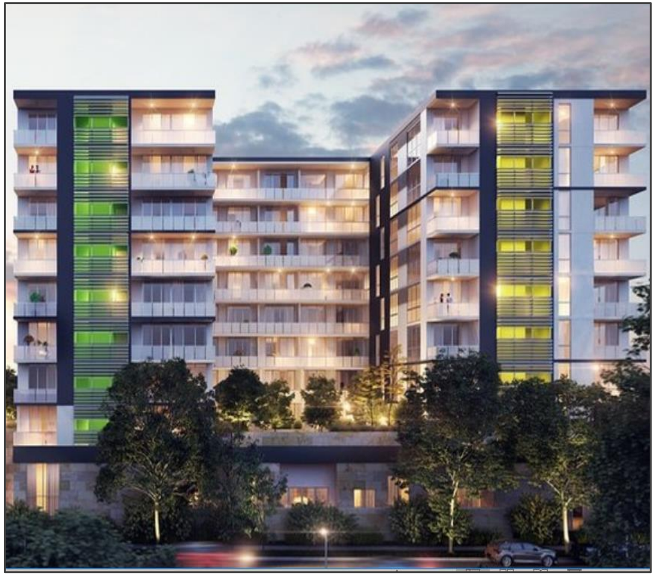
Build-to-rent developments could help long-term tenants

BTR: the physical product (1 of 3)

- BTR housing essentially:

  Designed for purpose apartment blocks to be held in single ownership for the long term

- PB student housing – BTR form already long-established:
  - Designed for rental purpose
  - Predicated on secure long-term income stream
  - Institutionally funded to be held in single ownership
  - 94,000 units built by 2017 Australia-wide (Knight Frank)
- Hundreds of NG Boarding House developments in Sydney (some overlap with student housing projects)
- 1,300 CHP-built affordable homes, NSW 2012-17



Hart's Landing, mixed tenure scheme, Penrith – Evolve Housing

BTR: the physical product (2 of 3)

- ‘At least 23 BTR projects under consideration’ - potentially 14,600 new rental apts (PCA, March 2018)
- Publicly announced ‘mainstream BTR’ schemes:
  - Grocon-built Gold Coast athletes village conversion (1,200 units)
  - Grocon Melbourne South Bank (up to 410 units)
  - Mirvac Olympic Park – under construction (258 units)
  - Mirvac – other eastern seaboard (reportedly three projects)
  - Salta Properties – Melbourne Docklands (260 units)
  - Salta Properties – Richmond, Melbourne (426 units).

Salta Properties – Richmond (CGI)

BTR: the physical product (3 of 3)

- Design components heavily influenced by US ‘multi-family’ model
- Common features include large scale, mixed use
- Possible new variant – shopping centre airspace setting
- Compared with standard ‘BTS’ product, planned ‘mainstream BTR’ buildings will have:
  - Greater % of total floorspace devoted to communal use; smaller apartment floorplans
  - High quality external public space – e.g. roof gardens
  - Materials and finishes designed for low maintenance
  - Higher environmental performance
  - More limited car parking

Geographical settings

- Initial ‘mainstream BTR’ projects prob. limited to favoured locations of Syd, Melb
- Partly reflects novelty of product and ‘play safe’ inclination of developers and investors
- CBD or CBD fringe locations plus inner ring suburban sites well-located for public transport
- Some players speculate that – as in the UK – geographical diversity will increase over time
- Perhaps initially to favoured locations in Brisbane and Canberra

Mirvac ‘Pavilions’ – Sydney Olympic Park (CGI)

Resident profile and experience

'For us, it's a mid-market product – for 'the masses'. It is not 'affordable' and it's not 'luxury" – BTR developer

- Main target group: young professionals aspiring for better private rental offer (more security, better service)
- Possible interest from wealthy older downsizers (second home)
- Expected appeal of conveniently included ancillary services (fast broadband, keenly priced utility services)
- New thinking for the development industry: property as an income-generating service rather than property as a saleable asset

BTR and affordable housing (1 of 3)

- Claims on BTR contribution to ‘housing affordability’ objectives questionable
- BTR could provide a vehicle for affordable housing – but only through significant policy intervention *beyond ‘levelling the playing field’*
- Primary challenge: making mainstream BTR work, financially, as a market rent product – may require policy reform even to achieve that
- Developer awareness that ‘AH’ components normal in UK and USA but:

> *‘A project needs to be as viable with affordable housing as without… Overcom[ing] the detriment to return from discounted rents [requires] concession, incentive or bonus’.*

BTR and affordable housing (2 of 3)

'In NY there are a lot of tax rebates that go with the 20% [affordable rental] rule' (Developer)

- In Aus context, could include:
  - Reduced car parking; extra height or density
  - BTR design SEPP – greater design flexibility than for BTS
  - Concessions on council rates or S94 contributions
- Preferred form of affordable housing from developer perspective:
  - 'Discounted market rent' apartments pepper-potted thru project ('tenure blind' design)
  - Target market – low to moderate income earners; not social housing clientele

BTR and affordable housing (3 of 3)

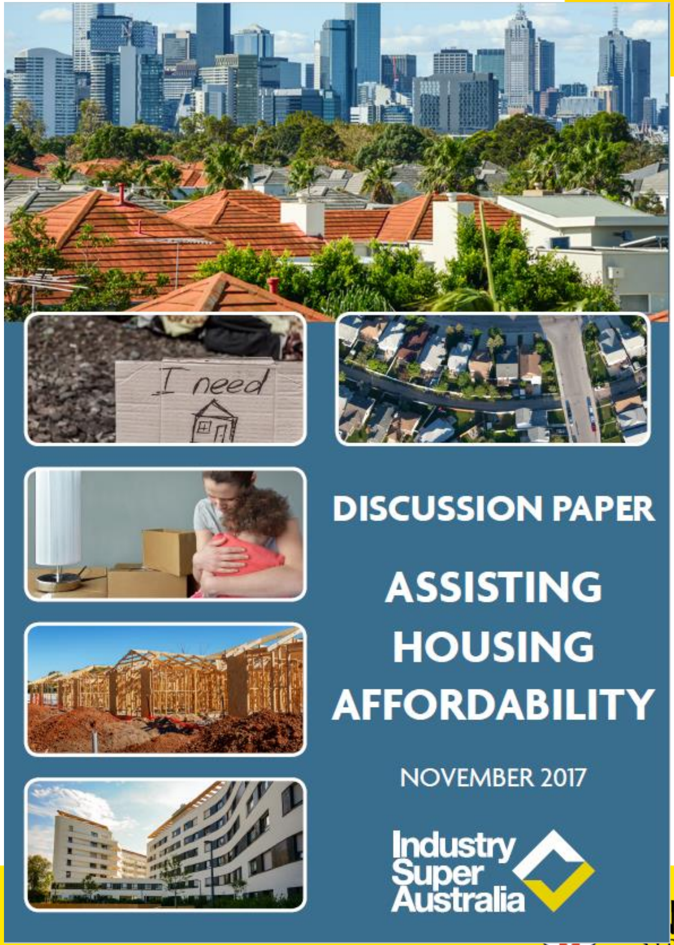
- ‘Business logic’ of standard developer/investor BTR model likely to prioritise:
  - Retention of buildings in single ownership
  - Unified property management
- May restrict CHP AH role in developer-led BTR schemes to tenancy management of scattered homes only
- Or CHPs might pitch for management of investor/ developer-owned market rent schemes (fee for service)
- CHP controlled AH-BTR project funded by institutional investment feasible only with substantial govt support (e.g. cheap/free land)

Key players (1 of 2)

- Developer motivation to engage with BTR incentivised by ‘listed company’ status – predictable revenue stream boosts share price
- Many expect overseas investors (pension funds, sovereign wealth interests) to be first movers – reflects prevailing Aus finance sector culture:
  - Higher yield expectations
  - General ‘conservatism’
- Potential importance of overseas investors sharpens debate around MITs and Withholding Tax rate [see later slide]

Key players (2 of 2)

- Completed BTR buildings likely to include schemes retained in developer ownership long-term
- Developers progressing above model building capacity for in-house BTR management service
- Certain Industry Supers; other finance sector stakeholders strongly favour AH-BTR schemes owned by CHPs or by Funds themselves

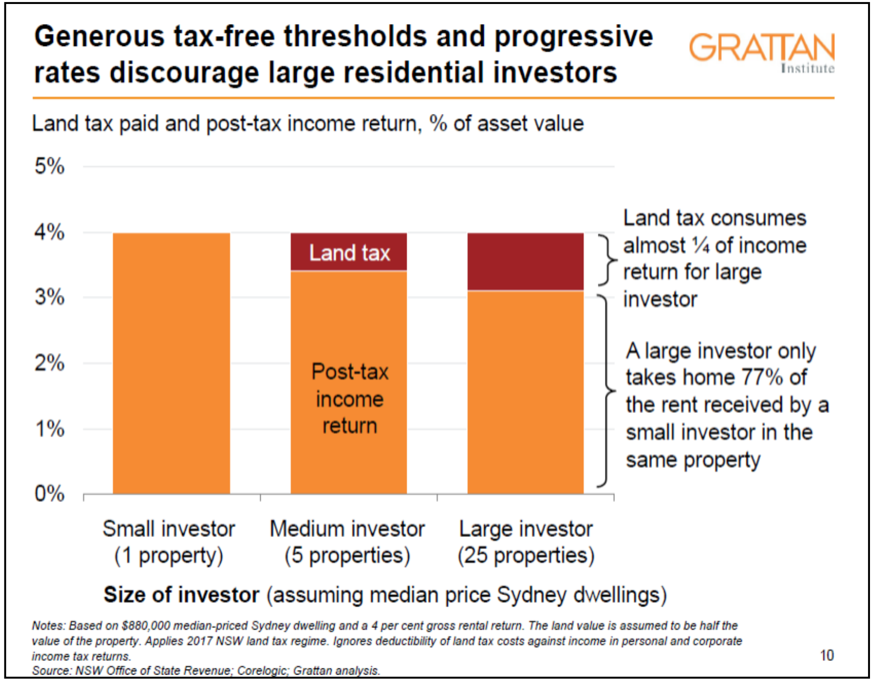


Funding, financing and feasibility (1 of 4)

- Projected BTR returns increasingly competitive in recent years because:
  - Low risk, counter-cyclical qualities of rental housing asset class – increasingly recognised
  - Falling returns for other asset classes have narrowed historic gap
- Rising land costs (esp in Syd/Melb) have moderated above improvement
- In current market, BTS ‘more profitable’ than BTR – therefore BTS developers tend to be able to outbid for sites
- For most informed stakeholders mainstream BTR financial feasibility remains v marginal under current economic conditions and tax structures

Funding, financing and feasibility (2 of 4)

- Widely-held developer concerns at BTR project feasibility impacts of current tax settings
- ‘Tilted playing field’ vis a vis individual rental investors results from:
  - ‘Progressive’ structure of State Land Tax regimes discriminates against BTR
  - Grattan estimate: LT liability (NSW) equates to 23% of rental return for large investor vs. 0% for small landlord



Source: Grattan Institute

Funding, financing and feasibility (3 of 4)

- Managed Investment Trust vehicle for overseas investment in Australia functional for retail and commercial development
- But 2017 foreshadowed proscription of MIT residential property holdings (except AH) – argued by industry as significant barrier to overseas entities – e.g. sovereign wealth; pension funds
- Especially given BTR emphasis on long-term hold for rental income (not capital growth), industry argues 2017 MIT 'clarification' misplaced
- Similarly, stamp duty surcharges for overseas investors recently imposed by state govts are problematic

Funding, financing and feasibility (4 of 4)

- *[BTR] makes complete sense in Australia; Australia has an even more attractive set of fundamentals – more stable but more upward trending than other markets. Low vacancy, high population growth’* – Developer
- Some stakeholders argue BTR conditional on significant ‘tax reform’ moves to address above issues; some proceeding in expectation of such change
- Others see the overarching barrier as that of ‘novelty’:

Property people are some of the most conservative people around. If they are not sure how it’s going to be valued, or what their return is, they don’t like it. But once somebody does it, everybody piles in... I know it will happen here – it just needs somebody to do it first’ – Industry expert

Can BTR fly in Australia?

- Developer-led BTR is an emerging product in Australia
- BTR ‘asset class’ status is going to take time – govts, industry and investors need to align much more closely for that to happen
- As BTR becomes established, prospects of increased geographical and product diversity
- Affordable housing in BTR will occur to any significant level only through much stronger govt support

Next steps for the research

- Research now embarking on second main phase – BTR project-level case study work
- Will inform financial feasibility modelling to better understand relative importance of sensitivities – e.g. relating to:
  - Changes in tax settings, business conditions, operational efficiencies etc.
  - Inclusion of affordable housing
- Final report completion target: September