Build-to-rent

From ‘nice-to-have’ to ‘must-have’

AUGUST 2023

Build-to-rent (***BTR***) is one of the most effective keys to alleviating Australia’s housing crisis. It can provide a significant amount of housing supply nationally and at speed, in an environment where demand is growing and supply is shrinking. But, to make it truly shine, we need the right settings in place.

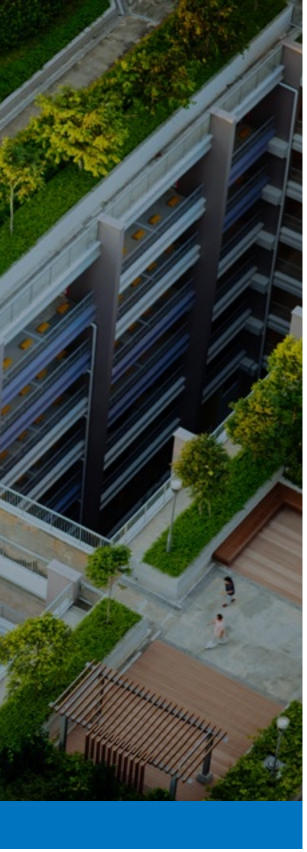
For years now, there has been a chorus calling for regulatory reform in the BTR space. This advocacy has been a tremendous example of the property industry coming together to ensure the right settings are in place for this important sector, which is still so new to the Australian market. As we explore in this report, we expect this advocacy and the resultant reforms will lead to continued investment and growth in the Australian BTR market, which is critical for our cities given the expected population growth and already historically tight rental vacancy rates.

However, we strongly caution against taking two steps forward and one step back with policies such as the previously proposed caps on rent. Not only will this hinder BTR’s potential, but it will also cause supply shortage (and, consequently, increase rents even more in the long term) at a time when we need solutions, not more problems.

Allens and Urbis are proud to be a part of this advocacy, and we continue to call for action to ensure the BTR sector can realise its full potential to create more liveable cities, drive economic growth and play a key role in alleviating the ongoing housing crisis.

In this report, we look at:

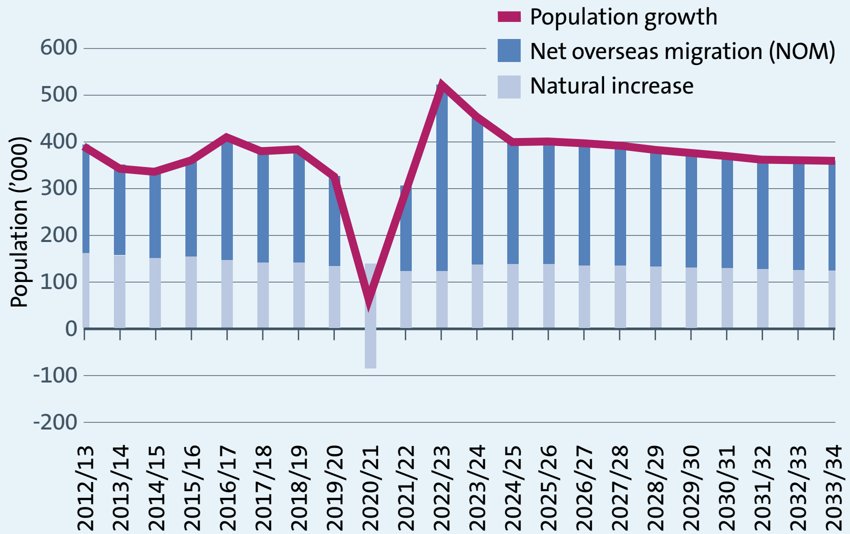
- **Where BTR was and where we are now:** exploring the significant developments that have happened in this space, including the recent announcements regarding the managed investment trust (***MIT***) withholding tax rate, which are making BTR a more viable sector.
- **The role of BTR in Australia’s housing crisis:** why more housing solutions are needed, and how BTR in particular will alleviate the pressures from Australia’s growing population.
- **Proposed policies and their potential impacts:** how short-sighted policies such as proposed rent caps could hinder BTRs potential, and the damaging effect this will have on housing supply.
- **Where to next for BTR?:** including likely development structures and the flow of capital into the sector.



BTR is pivotal to Australia's housing future

Over the next four years, the population of the eastern seaboard is set to increase by 1,500,000 (more than the size of Adelaide) as a result of net overseas migration. Clearly, BTR has moved from a 'nice-to-have' market that could fill a demand for premium rentals, to a 'must-have' product that's critical to alleviating Australia's housing crisis and ensuring the future liveability of our cities.

Migration to test Australia's property markets – 4 million new residents over the next decade



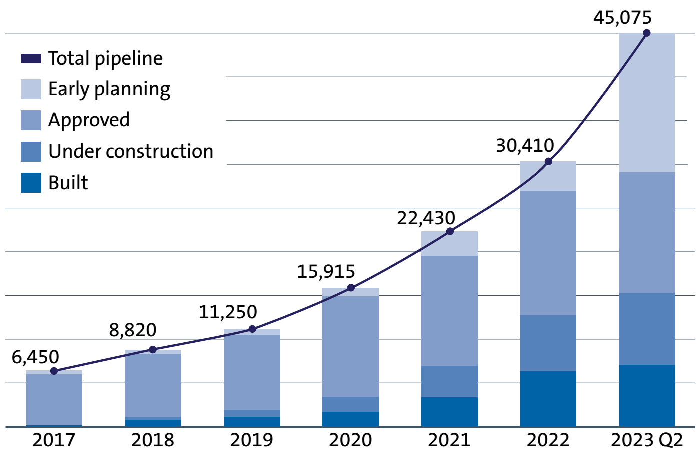
Source: Centre for Population; Urbis

Growing BTR pipeline

BTR is one of the levers that can assist with this population growth. The national BTR pipeline has picked up pace in the first half of 2023 to reach a cumulative total of 45,000 units, which is anticipated to equate to approximately $16bn in investment in new rental housing supply.

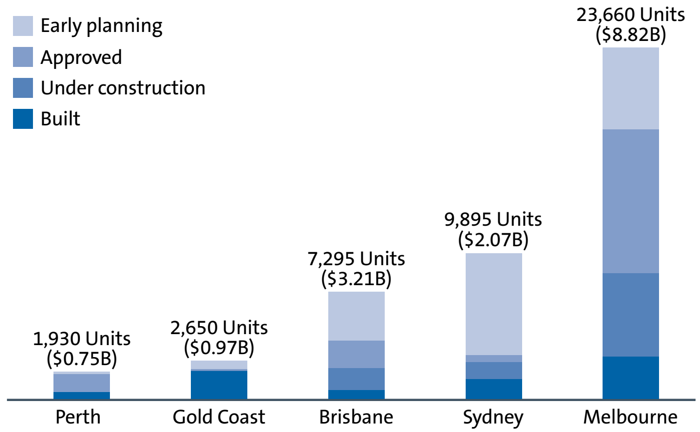
To date, Melbourne has attracted about half of this pipeline investment. As the fastest growing and soon-to-be largest city in Australia (by population), increasing housing supply here makes sense. However, the housing supply issue is a national problem. We need the right policies to encourage more supply across Australia to ensure each city has a growing BTR pipeline.

National BTR pipeline

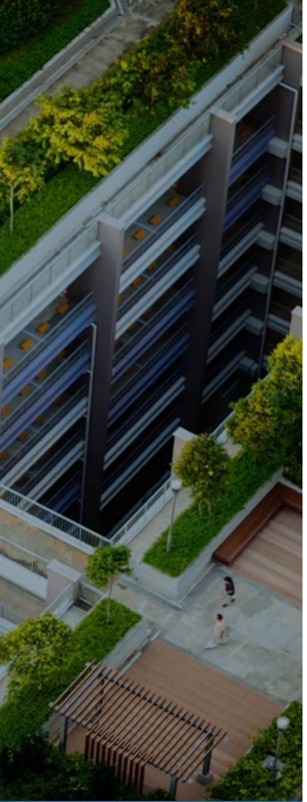


Source: Urbis Apartment Essentials

Main BTR pipeline investment destinations to date



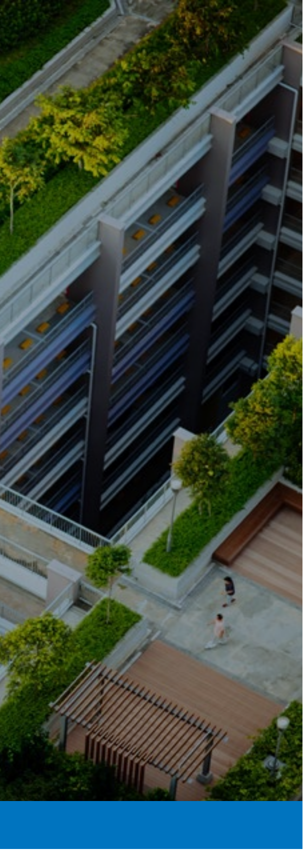
Source: Urbis Apartment Essentials



BTR's progress

BTR has made significant progress lately. The recent tax reforms and this year's Budget announcements (with consultation on implementation to come), demonstrate how far this sector has advanced. It is an opportune time to recognise where we have come from, assess the progress that's been made and to look ahead to where the sector may go.

	Where have we come from?	Where are we now?
Land tax	Previously, there was an unequal playing field where state revenue offices could collect little or no land tax from build-to-sell (***BTS***) projects, since the individual apartments owned by individual landlords may fall below the land tax threshold. By contrast, BTR towers, with a single landlord, are well above the land tax threshold (and likely to be at the highest rate, particularly if foreign owner surcharges apply).	NSW, Victoria and Qld have all legislated for a 50% land tax discount for eligible BTR assets.
MIT withholding tax rate	Returns were taxed at 30%, instead of the concessional rate of 15% for returns from commercial, retail and industrial real estate.	Concessional rate of 15% has been granted for returns for eligible BTR assets.
GST	GST embedded in acquisition and development costs is not creditable for BTR but is creditable for BTS.	No change, and likely to remain this way for the foreseeable future.
Depreciation	Rate for capital works tax deduction was 2.5%.	Rate for capital works tax deduction is now 4%.



Where to now?

Problems still at play

Homebuilding levels aren't matching huge population growth

Despite the substantial increase in Australia's population in recent years, home construction has not kept pace. With the country's current population currently at 26 million—a growth of over 30% in the last two decades—there has been a surge in the demand for new homes. However, national construction activity has remained largely constant, raising substantial implications for growth and housing availability. We need to expand development to match population growth.

Major supply problems need major consideration

The current supply of housing in Australia is diminishing. This reduction is being met with major economic challenges in the field of development, precisely as demand is soaring. Without thoughtful intervention, there are potential risks that span the entire housing spectrum, stemming from insufficient supply at all levels.

National housing shortfall

The National Housing Finance and Investment Corporation (***NHFIC***) estimates that 1.9 million additional dwellings are required over the next decade. This would require investment somewhere in the order of $660-830bn. Beyond this investment requirement, the NHFIC identifies a need to unlock a further 68,000 additional dwellings in the planning system to meet excess demand compared to new dwelling approvals.

Housing investment requirement 2022-33 by major city

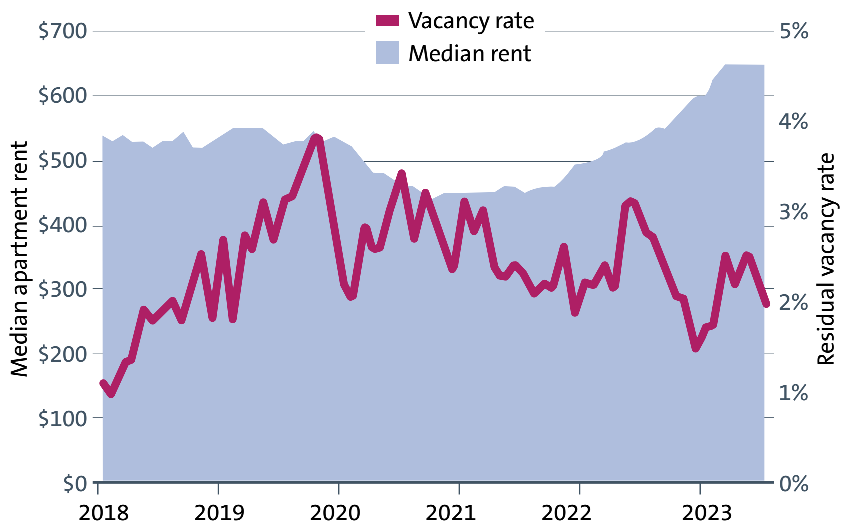
	Sydney	Melbourne	Brisbane	Perth	National
Additional dwellings required (2022-33)	308,600	411,300	206,500	189,300	**1,898,400**
Additional investment required	$107.7bn – $135.5bn	$143.5bn – $180.6bn	$72bn – $90.7bn	$66bn – $83.1bn	**$662.3bn – $833.7bn**

Source: NHFIC; Urbis, Allens, ABS

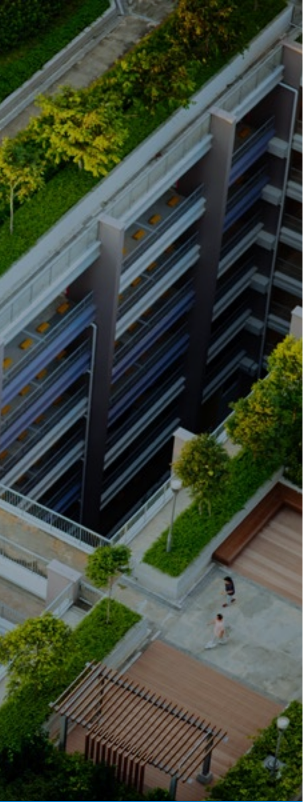
Decreased activity and surging demand driving up rents

This shortfall is already having profound impacts and is being felt most acutely in the eastern seaboard's inner-city rental markets, where an ongoing lack of supply and surging demand are driving up rents. Nationally, new dwelling completions have decreased by 19% since December 2017. With demand remaining strong, this has resulted in a 24% increase in the median apartment rent.

Median apartment rent & vacancy - Melbourne, Sydney, Brisbane, Perth, ACT (GCCSA)



Source: Urbis Apartment Essential



Where to now?

Proposed policies could stall much-needed supply

We must avoid short-sighted policies that may be politically popular but damaging for long-term supply. If, as the Victorian Government worryingly proposed (and the Greens, at a state and federal level, continue to push), rent caps were to be put in place, a significant number of developers and investors would pull out of the BTR market. It would also stall major projects while there was uncertainty as to whether or not rent caps would be implemented. Their exit would cause major disruptions to the supply of dwellings right when an increase in dwelling numbers is the key to tackling the housing crisis. While the door has been closed on rent caps for now, it hasn't been slammed shut and questions will continue to be asked on whether such policies should be introduced.

If we look both nationally and globally to places where they have enforced rent caps, we see that outcomes don't improve—they deteriorate. Research by the National Bureau of Economic Research (***NBER***) in San Francisco found that landlords affected by rent control reduced rental housing supply by 15%, causing a 5.1% city-wide rent increase.[1] Rent caps often result in a tighter market and increased rental prices.

We caution strongly against this proposal as it will impact housing supply, deter investment and ultimately put upward pressure on rents.

Overcoming problems and driving solutions

BTR could supply a large volume of stock

The BTR sector continues to emerge as an important contributor to rental markets. To date, the sector has delivered 7,135+ apartments over the past five years, with a further 38,300 apartments in the pipeline. While BTR is still in its infancy in Australia, as it evolves there will be potential to add a substantial volume of stock to the market.

This will be vital to providing homes to a whole variety of households, while also reducing the push-down effect that is crowding more people out of the private rental market into other forms of affordable or social housing. Ultimately, it aims to address the issue of housing scarcity.

1 See: The effects of rent control expansion on tenants, landlords and inequality evidence from San Francisco | National Bureau of Economic Research

Fund-through arrangements will continue to dominate

As we predicted in our 2019 BTR paper, fund-through arrangements have become a dominant trend in the BTR sector. We expect this to continue in 2023 as private developers with quality sites develop projects on a fund-through basis for long-term BTR investors. The model:

- allows developers to develop and sell stock in the current market that they otherwise couldn't
- allows investors to acquire new assets with minimal development risk
- is stamp duty efficient.

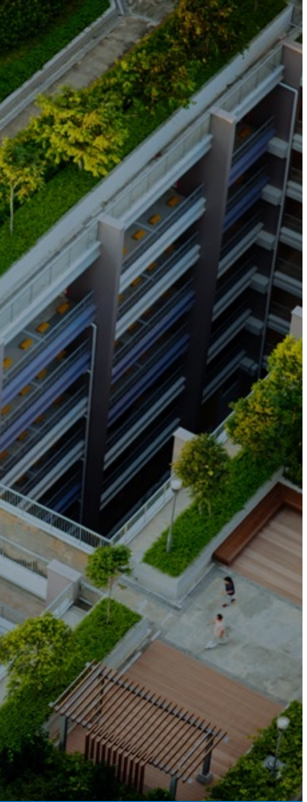
BTR towers to form part of mixed-use precincts

We expect an increasing number of BTR projects will form part of mixed-use precincts. Not only is this due to a lack of available land, but it also provides a community atmosphere and an important level of amenity for tenants. However, in our experience, complex issues regarding strata titling, shared services and the use of common spaces will need to be carefully negotiated.

It is worth noting the role BTR will have in unlocking more than just housing investment. It will be a catalyst for other forms of productive renewal in our cities.

MIT changes to unleash a new wave of capital

Over the past 18 months, we have seen a strong flow of capital into the sector in Australia, with a large number of new funds being established. With the concessional withholding tax rate of 15% now applying to eligible BTR assets, and with economic fundamentals in Australia perfectly positioned for the residential rental market, we expect this flow of capital to pick up pace, with offshore investors that may have been initially reluctant now having the confidence to jump into the Australian BTR market. However, proposals such as rent caps could erode all the good work achieved by these policies.



Where to from here?

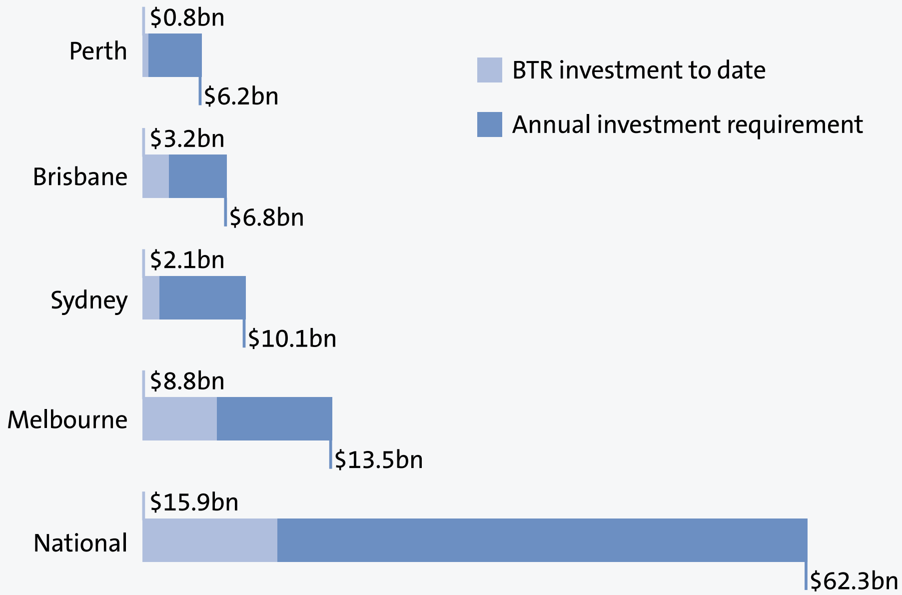
BTR is now a crucial tool in tackling Australia's housing crisis. It is critical that we continue to build on the strong foundations that have been laid, keep investments flowing and avoid a 'two steps forward, one step back' trajectory.

Even relatively conservative numbers put the requirement for annual dwelling investment at around $62bn each year to meet housing demand growth over the next decade. To date, the cumulative pipeline of BTR housing that's been committed to equates to around $16bn.

This clearly reinforces the scale of the broader challenge ahead for Australia. BTR is on an upswing on the back of recent efforts to support growth. However, the volume of investment in BTR to date would need to quadruple to supply even one year of Australia's housing demand growth.

In the global race for housing investment, it is imperative there are no brakes applied to BTR, whether at a state or national level.

Cumulative BTR investment compared to annual and total national housing investment required



Source: NHIFIC, Urbis, Allens, ABS

Annual housing investment requirement and cumulative BTR pipeline to date

	Sydney	Melbourne	Brisbane	Perth	National
Annual additional dwellings required (2022-33)	25,717	34,275	17,208	15,775	**158,200**
Annual additional investment required	$9.bn – $11.3bn	$12.bn – $15.1bn	$6.bn – $7.6bn	$5.5bn – $6.9bn	**$55.2bn** – **$69.5bn**
BTR pipeline to date	**9,895**	**23,660**	**7,295**	**1,930**	**45,430**
BTR investment to date	$2.07bn	$8.82bn	$3.21bn	$0.75bn	**$15.85bn**

Source: NHIFIC, Urbis, Allens, ABS

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