LATEST NEWS FROM PDI: THE BUILD-TO-RENT MODEL IN AUSTRALIA

February 19, 2021

Here's the latest Property Development Insights newsletter about the Build-to-Rent Model in Australia, which we trust you will find informative.

Build-to-Rent to Infuse New Blood into the Property Market?

The homeownership aspiration has long been an unreachable dream for young Australians, but the launch of the Build to Rent (BTR) model is offering a fascinating alternative to the traditional housing market. With increasing developers, real estate funds and industry superannuation funds claiming the interests in this model, the BTR has become a prevailing topic in mainstream media.

What is Build-to-Rent Model?

In the traditional Build-to-Sell model, developers build the apartments or houses and sell the residential development to individuals to live in or lease out as an investment. In contrast to this common method, in BTR model, where all the apartments in residential development are owned by the developer and rented out to long term tenants. As a part of the burgeoning institutionalised residential market, BTR is preferable for institutional investors who desire steady and reliable income (not unlike UniLodge’s student accommodation focus).

As an asset class, BTR has been at the forefront of housing delivery in the UK in more recent years, with currently around 110,000 units being in the development pipeline (JLL, 2021). Although BTR in the UK has not realised the same market penetration as it in the United States, it is circa. 5 years in advance of Australia. The booming demand for BTR units development in the UK is driven by the economic stimulus, job creation, housing supply and affordability.

How Can the BTR Model Help the Australian Housing Market?

Australia currently accommodates one-third of the population in the private rental market, while among younger Australians in capital cities reflects a significantly higher amount, with 70% of the young workforces (24-35 yrs old) renting their home in Sydney. Among those renters, almost half are considered ‘long-term’, holding the lease for at least 10 years (PWC, 2021). To enable rental security and facilitate tenant conditions, the BTR model entices institutional investors including large developers, superannuation funds to build apartments to rent directly to families. The single ownership of BTR development, accompanied by consistent stable rental income, indicates that the owner prefers to keep tenants for as long as possible to guarantee the tenure security.

Generally, the large-scale residential developments can be provided by BTR in the locations where is well-connected, close to strategic centres and public transport. These areas with convenient access to amenities, schools and jobs can offer compelling opportunities for residents to develop.

Current Challenges facing the BTR in Australia

- Yields: BTR assets commonly generate a lower yield compared to most alternative asset types like industrial and office buildings. BTR is more attractive for long-term investors like pension funds. Whilst commercial properties rely on anchor tenant for income security, BTR assets have a range of tenants to minimise the key tenant risk.

- Financing Constraints: Banks require significant pre-sales before the construction funding. As BTR development has no pre-sales and is being rented to individual tenants, underwriting the long repayment period, results in low security for banks and funding challenges.

- The Culture of “Australian Dream”: The high rates of homeownership in Australia may against BTR model.

- GST: The GST embedded in development and construction costs for the BTR project is not creditable.

- Unclear Planning Policies: As BTR is yet identified as a typical type of development by the planning system, there are no clear regulations to guide this type of development, increasing the risk of rejection or long delays.

Advantages & Disadvantages of BTR

One of the advantages of BTR is the possibility to initiate a new property investing form in capital cities in Australia. For low entry requirements for individual investors, investing in funds and trusts which develop BTR project may provide a reliable source of return. As all units belong to one ownership, the building management and maintenance of the BTR project should be more efficient. In this circumstance, the quality of the building which is built to be owned is enhanced compared to the sold off.

For institutional investors, the BTR projects provide diversification and stabilised long-term returns, reducing the re-leasing risk and commission payments as compared to other commercial assets. Through large-scale development and management, the BTR project will benefit the labour market, from the design and construction sector and long terms employment from management, cleaning services, landscaping and maintenance.

However, based on experience in other countries, BTR projects are more likely to attract young individuals and couples who only need relative short occupancy. The considerations of the frequent changes in occupants and the cost of vacancy period are also needed.

BTR Future

With Australian housing prices forecast to increase significantly as the economy recovers post-COVID-19, and considerable pent-up demand for renting, the investment opportunities offered by the BTR model have not been exploited as a way of capturing strong retail and institution investor demand for alternative investment opportunities. During the COVID pandemic, BTR has performed strongly in economics in where it is well-established.

The welcome changes for developers and investors currently including NSW land tax cut and foreign owners stamp duty surcharge relief in certain BTR projects also facilitator an increase in the feasibility of this type of asset. Maybe it is time now for the developing BTR model to shine as an identical asset class in post-COVID Australia.