Agents Follow the Money as Build-to-Rent Ramps Up

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Commercial real estate agents are marketing development sites as build-to-rent opportunities, taking advantage of booming interest from institutional investors.

An increasingly unaffordable housing market coupled with tax and planning reform are heating up the sector, with some on-market campaigns dominated by build-to-rent bids.

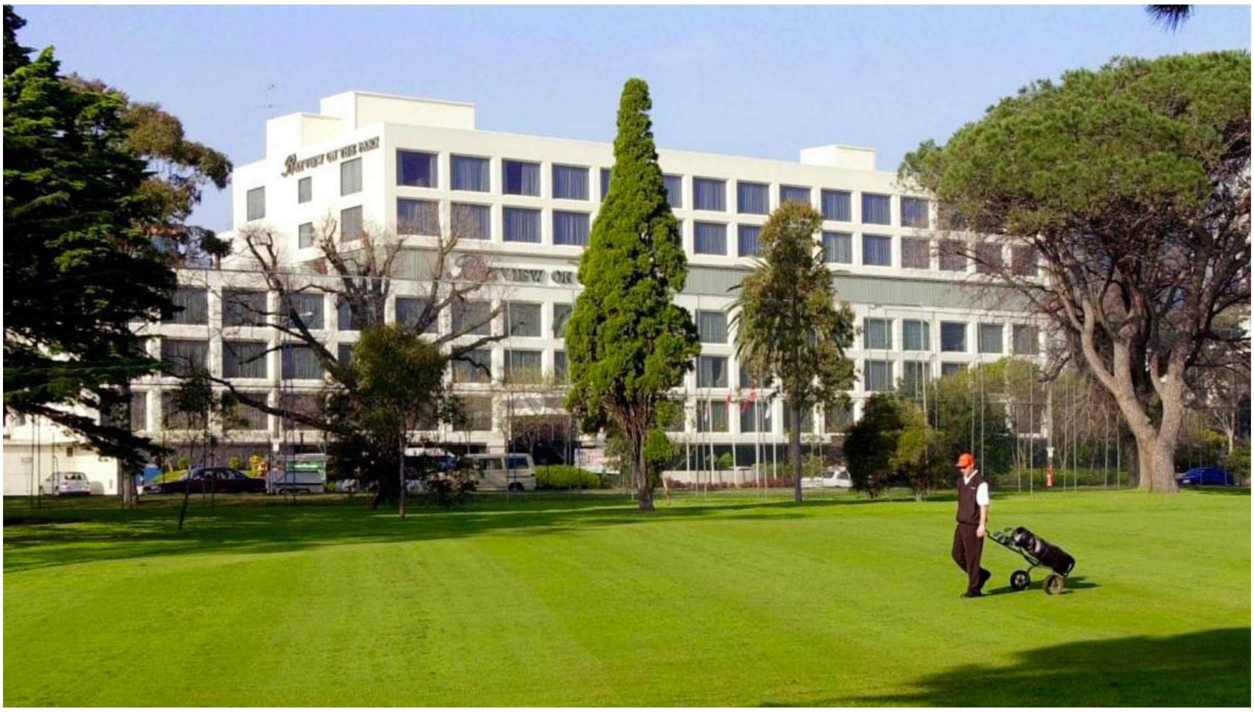
Director of alternative investments at JLL David Hill says that 75 per cent of bids on one recent deal focused on build-to-rent, backed by international investors as well as domestic super funds.

“Obviously, our job as agents is to broaden the appeal of an opportunity, to capture as many segments of the market as you can, and ultimately to derive the best outcome for the owners or the vendors,” Hill says.

“So we present sites, where possible, as having a multitude of potential uses. But what we’re finding is that the weight of interest is really coming from build-to-rent groups at the moment.”

Although the current boom’s early mover projects, initiated two years ago, are now coming online, Hill says that the majority of build-to-rent transactions have taken place in the past 12 months.

On the other side of the deal, build-to-rent developers are also reporting that agents are approaching them with tailored campaigns around suitable sites.



▲ The former Bayview on the Park hotel was acquired for more than $70 million by Aware Super for a build-to-rent project.

Managing director of build-to-rent specialists Arklife Scott Ponton says "anything that comes to the market that has a mixed-use or residential flavour to it, agents are looking at it from a build-to-rent perspective, as well as other, more traditional build-to-sell perspectives".

"We are seeing opportunities put to us as build-to-rent, when previously agents hadn't thought of that sort of thing."

"And we're going to see more of that."

Head of build-to-rent operator Home Christian Grahame agrees that agents have begun to recognise and highlight sites suitable for the sector.

"For Home, prioritising proximity to transport, the local community and amenity is key."

"Suitable sites for build-to-rent remain challenging to identify, but agents have recognised the sector as an emerging market and are positioning some site sale campaigns specifically for build-to-rent. Two recent campaigns in North Melbourne reflect this approach."

Operational efficiencies

Despite recent disruptions to migration patterns, and working-from-home trends, institutional investors are banking on the long-term growth and security of build-to-rent.

Funds are piling into the sector, with Gurner and Qualitas the latest to announce an oversubscribed international capital-raising for a build-to-rent platform called GQ, raising $1.2bn on a $1bn target.

▲ A rendering of developer Home's build-to-rent towers next to Marvel Stadium in Melbourne's Dockland.

Qualitas' global head of real estate Mark Fischer described the build-to-rent strategy as anchored on "assets generating defensive and resilient cashflows."

"[We] are seeing global institutional investors increasingly allocating capital to investment strategies supported by these themes.

"Across Australia, we are anticipating strong and growing demand for high-quality build-to-rent assets as population growth and declining home ownership drive the need for quality rental stock.

'Build-to-rent, at its heart, is a very long-term investment model," JLL's head of build-to-rent Paul Winstanley says.

"For institutional-grade build-to-rent, the investment case is looking at demographics over a long period of time. Obviously, the apartment pipeline is a lot more owner-occupier focused now, which has meant that there's less investment.

"So build-to-rent is the biggest opportunity, because ultimately, we need those properties."

Hill says that institutional appetite for build-to-rent projects sits in the 200 to 450 apartment zone, which is where economies of scale and operational efficiencies align. To assist buyers, his team is modelling specific build-to-rent demand factors on a city district level, and building detailed pitches when sites are strong.

“Build-to-rent sites are typically priced on a 10-year internal rate of return cashflow basis,” he says.

“So what that means is these groups are pricing the completed asset, and then working backwards via residual method to deduct down to a site value, to ensure that they’re hitting their return hurdles, and that’s typically a 10 per cent IRR.”

“We work very closely with these groups to build up the assumptions and the operational investment thesis, to then work backwards towards site value.”

▲ United Asia Group repositioned its build-to-sell approach to build-to-rent for a site at 346-350 Macaulay Road in Kensington, Melbourne it paid $30 million for in 2018.

Grahame says that agents who do their groundwork are putting themselves, and their buyers, at an advantage.

“Clear instructions to the agent and a well-prepared data room certainly make the process of evaluating a site and reaching a deal much more efficient,” Grahame says.

“Most major agencies or transaction managers understand that the institutional capital involved in build-to-rent is demanding a high standard of due diligence and governance in any sale process.”

Planning and tax reform welcome, but more needed

While developers have welcomed the recent NSW build-to-rent SEPP, and 50 per cent land tax concessions in NSW and Victoria, there's more work to be done to support the sector.

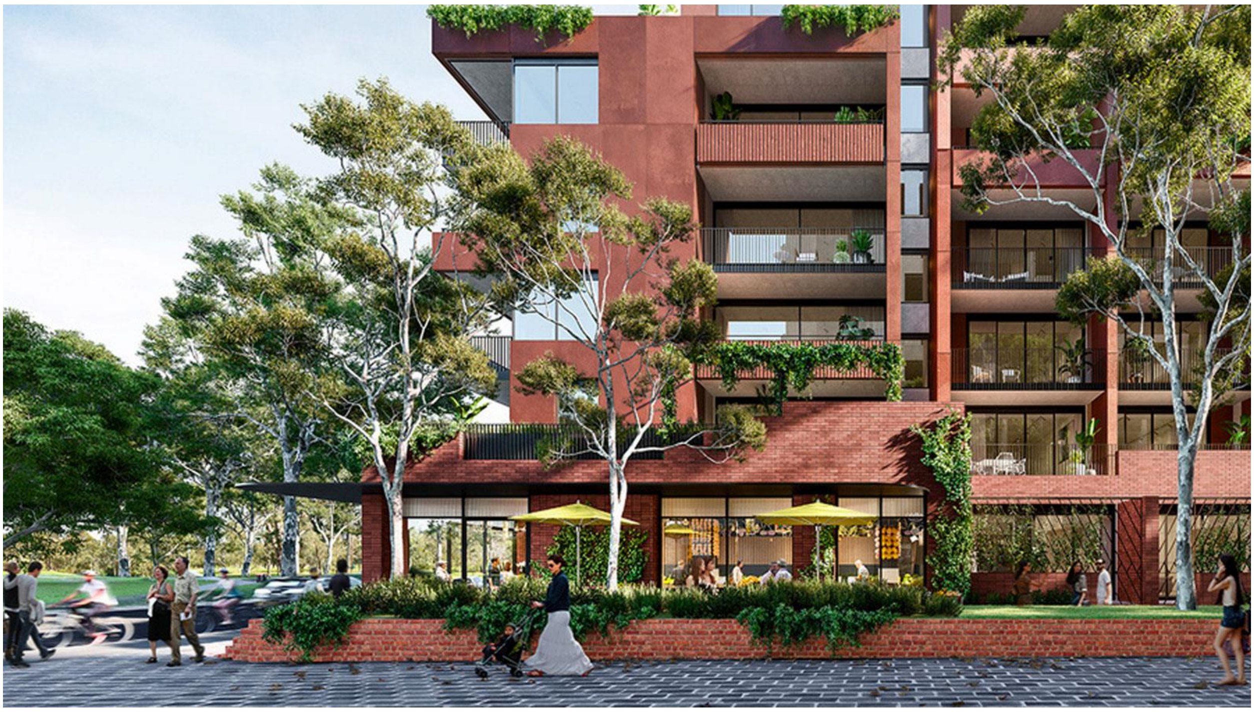
"The build-to-rent sector will continue to grow but the availability of large, appropriately permitted or zoned sites is a key challenge for build-to-rent in most capital cities, particularly Sydney," Grahame says.

"The complexities and uncertainty of planning systems, and increasing statutory and regulations are a disincentive for institutional investors. While Victoria and New South Wales should be commended for introducing supportive tax and some planning policies for build-to-rent, we'd like to see planning processes further simplified."

Hill concurs that planning remains a hurdle.

"Given the early stage of the sector here, we don't really have the planning framework to separate out and identify build-to-rent as its own use," Hill says.

"Because of that, essentially the only way to build a pipeline for build-to-rent is to acquire sites, either with residential permit approval or hotels, and go for change of use to accommodate build-to-rent. So we've seen most of the activity where build-to-rent groups will have confidence in the building envelope."



▲ Mirvac and Milieu are planned 527 build-to-rent units on a 1ha site in Melbourne's inner north.

Hill says that this might involve tweaks to internal configurations, with build-to-rent developers (and tenants) generally preferring a higher proportion of one- and two-bed apartments. But overly prescriptive planning codes can stifle the flexibility that underpins project success.

“Build-to-rent assets have to be best in class in the market that they’re trying to target. That could be affordable, the middle band, or premium, but they have to be best in class in design, because it’s an occupier long term,” he says.

“If it’s on the doorstep of employment, for example, it might cater to a market that’s more weighted towards studio or one-bed apartments versus two- or three-beds.

“Sites that are in different locations and might not have access to the same transport infrastructure might require components of parking, more two- or three-bed apartments, if it’s more of a suburban setting.”