BUILD TO RENT

The key to unlocking the future liveability of Australia's cities

For nearly two decades, Australian cities have been consistently ranked among the world's most liveable. But the dial is shifting. Consumer priorities have changed, and our cities aren't responding quickly enough, particularly when it comes to housing. The new Australian dream has adapted to modern society, with consumers increasingly wanting accommodation that's close to work, offers high quality amenities and guarantees security of tenure. It's no longer just about owning a house and living in the suburbs.

Population growth represents a significant challenge. Almost 1.6 million additional homes will be needed by 2029* and even with conservative assumptions on rental demand, that translates to 500,000 more rental properties (Urbis).

In response, a new approach is required – one that addresses this emerging demand and in doing so retains our enviable liveability and economic productivity.

Governments and the market must provide consumers with a range of housing options to choose from – and quickly.

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*ABS Population Projections 2017-66. (2016). Australian Bureau of Statistics. http://stat.data.abs.gov.au/Index.aspx?DataSetCode=POP_PROJ_2011

URBIS

Allens › ‹ Linklaters

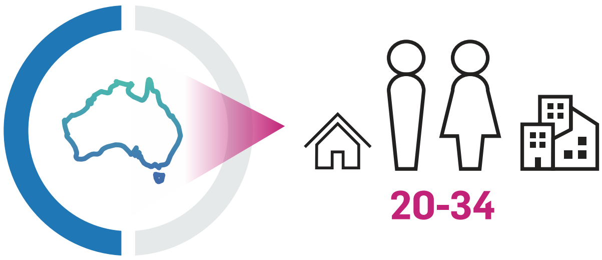
DELIVERING FOR THE DEMAND

A straight comparison between annual dwelling demand and the number of apartments approved in the inner-city areas of Sydney, Melbourne and Brisbane show since the beginning of 2018, fewer apartments are being approved to build. If this trend continues, supply shortages could have an impact on prices and rents through every segment of the market.

Across the Eastern Seaboard's inner-city markets, we only have 1.5 years' worth of housing demand in apartment supply that is under construction. There is a further 2.2 years of demand in the pipeline that is approved – but not yet selling. Selling remains the core issue holding up supply, and unless amendments are made to the approach, this number will continue to grow.

All areas are growing, in particular 20-34 and 55+

IN 2016, NEARLY HALF OF AUSTRALIANS AGED 20-34 RENTED



FROM 2006-16 DEMAND FROM RENTERS AGED:

20-34
grew from
1,532,300 *to*
2,115,600

35-49
grew from
993,500 *to*
1,312,800

50-64
grew from
519,300 *to*
796,100

DEMAND TABLE	2019	2029	Change 2019-29 (No.)
	Australia	Australia	Australia
Population	25,474,000	30,259,000	+4,785,900
Dwelling Demand	9,649,000	11,206,000	+1,557,000
Renter	2,981,000	3,463,000	+482,000

Source: ABS; Department of Employment, Skills, Small and Family Business; Urbis

BUILD-TO-RENT HOLDS THE KEY

Build-to-rent (BTR) is the quickest solution to increase choice and capacity at scale.

Incentivising BTR could bring forward the delivery of a pipeline of approved projects resulting in three years of housing supply in the inner city – *if* released for development. Currently, it takes three years to deliver a project post approval, substituting it for BTR will cut this timeframe down by at least one year on each project – helping bridge the supply gap on the horizon.

For Australian cities to thrive, an increased supply of high-quality rental accommodation is needed. These will house global talent for multi-national companies and promote local labour mobility while meeting the demand for greater choice of housing across a variety of price points in our growing cities. With an additional 285,000 key worker jobs forecast for the next 10 years, the need for quality housing that enables mobility has never been greater.

THE BENEFITS TO ALL STAKEHOLDERS ARE CLEAR

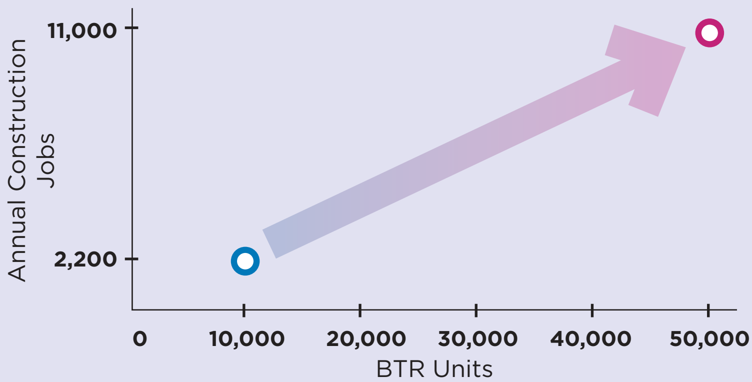
TENANTS	OWNERS	GOVERNMENT
High-quality accommodation with attractive amenities	Stable, long-term income	Enhanced labour mobility
Long-term tenancy options	Long-term viability thanks to higher construction quality	Eases housing crisis pressure
Reduced fear of eviction	Strong demand and scarcity of new supply	Onsite job creation and multiplier effects
Improved (and centralised) management	Counter-cyclical defensive investment	Reduced daily congestion-based inefficiencies
Proximity to work, particularly for essential services personnel		Can be scaled quickly, and delivered throughout cycles
Flexibility to relocate		Improved construction standards
		Decreased risks associated with poor construction quality

BTR IS A LEVER FOR ECONOMIC STIMULUS

Conservative estimates indicate that stimulating BTR delivery to a scale of 10,000 units ($2bn in construction investment) could support an average of 2,200 jobs per year linked to the construction phase alone.

Growing that to 50,000 units, or around 1/3 of the inner-city apartment pipeline on the eastern seaboard could support 11,000 jobs per year in the construction phase, as well as an average of $1.5bn in Gross Value Added (Urbis).

If incentives were to further shorten the timeframe of delivery or amplify volume of units the economic benefits would increase.



Source: REMPLAN

GOVERNMENTS CAN UNLOCK ITS POTENTIAL

With some key changes, governments can turn a ripple into a wave.

While BTR is gaining traction, it's still trying to prove its viability. Government policy does not currently support its emergence in any Australian jurisdiction.

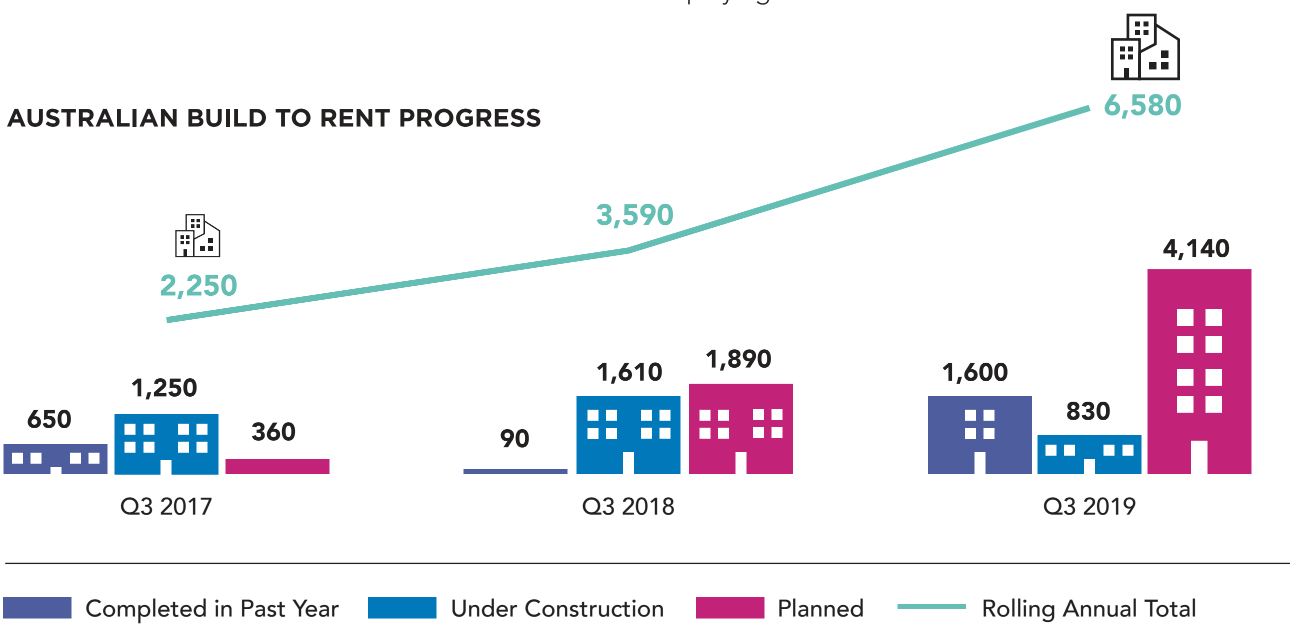
There is a risk that government policies that burden the BTR market with minimum social and/or affordable housing requirements during the sector's embryonic stage, will inhibit it from becoming an established asset class.
With further support from governments, the sector has the potential to become large enough to improve liveability and affordability.

> BTR supporters in Australia aren't necessarily seeking more favourable concessions than other asset classes – they're simply seeking a level playing field.

Adjusting tax and planning policies will have the greatest impact on growing the BTR industry.
Tax reform in the UK, including providing land tax concessions, was the lever that kick-started BTR's rapid growth.

BTR supporters in Australia aren't necessarily seeking more favourable concessions than other asset classes – they're simply seeking a level playing field.

AUSTRALIAN BUILD TO RENT PROGRESS



**Firm projects only (excludes projects in early planning that could come forward once a formal application or approval is in place)*

Source: Cordell, Local Councils; Urbis

MANAGED INVESTMENT TRUSTS

BTR should be given a level playing field - it should be reclassified as 'commercial residential' and allow foreign investors' returns to be taxed at a concessional rate of 15%.

Income from residential real estate housing is currently denied the concessional 15% rate applicable to income from most other real estate asset classes for eligible foreign investors in Managed Investment Trusts (MITs).

Overseas-based BTR investors through MITs are taxed at 30% in comparison to the 15% tax rate for local superannuation funds and eligible foreign overseas investors in other asset classes. The reasons behind the increased withholding tax rate for MIT investments in residential housing included that, further incentives should not be given for foreign investment in a residential property market that was already overheated.

The policy failed to recognise that foreign investment in BTR will not have an inflationary impact on the housing market. In fact, as we outline below, it is likely to have the opposite effect. It also failed to identify that purpose-built BTR accommodation has strong similarities to other forms of commercial property investment.

These include office and industrial, where local and overseas investors are motivated by the possibility of earning long-term, stable rental income, and foreign investors are incentivised to do so by the concessional MIT rate. Comparable assets such as hotels and student accommodation are classified as 'commercial residential premises' by the government and qualify for the MIT concessional rate.

This is a significant impediment to the BTR industry, as it makes BTR less attractive for foreign capital – a key driver of the Australian property industry. This is a concern for the broader Australian economy as the property industry is one of the nation's biggest employers, and reduced activity in the industry has a major multiplier effect on a national scale.

Adjusting the MIT rules to provide a level playing field for BTR has the potential to stimulate and stabilise residential property development, which will benefit the broader economy.

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LAND TAX

Under the current law, and on an asset by asset basis, states stand to gain more land tax revenue for BTR projects than Build-to-Sell (BTS).

Under the traditional BTS model, states can collect little or no land tax since the individual apartments owned by individual landlords may fall below the land tax threshold. By contrast, residential towers developed as BTR, with a single landlord, will be well above the land tax threshold (and likely be at the highest rate, particularly if foreign owner surcharges apply).

Given all the policy benefits associated with having more BTR, as well as the potential for significantly higher land tax revenue and the fact BTR will create substantial employment throughout residential development cycles, state governments should strongly consider providing land tax concessions for BTR projects, if only to level the playing field with similar BTS assets.

To make BTR more attractive to foreign investors, foreign land tax surcharges should be removed for BTR investment. Rather than offering favourable conditions, this would merely bring BTR in line with other, more commercial residential assets, including in those jurisdictions which already characterise hotels and student accommodation differently to residential housing. It would help unlock BTR's full potential in Australia.

PLANNING POLICY

The planning policies in each state can be used to ensure the BTR sector reaches its full potential in Australia.

Currently no Australian jurisdiction has specifically defined what a BTR asset is. It falls under the general concept of 'residential accommodation'. For BTR developers committed to holding assets for the long-term, defining BTR may provide an opportunity to optimise the overall community and economic benefits from BTR by adopting tailored planning policies to encourage high quality design outcomes. For example:

- requirements for minimum apartment sizes and layouts, and private open space could be re-framed for BTR assets that have high levels of amenity and service for occupants, in the common areas of the building; and
- greater density for BTR development could be incentivised over residential developments in priority areas, such as communities where key workers are in rental stress, given the role BTR can play in improving Australia's affordability and liveability.

A thriving BTR market will improve affordable housing capacity in Australia.

To achieve change in planning policy, BTR developers should consider the impact they can have on affordable housing. Some developers may be able to partner with an affordable housing provider to deliver a percentage of affordable units or units at a discount market rent, servicing key workers. As referenced earlier, there is also a discussion to be had regarding the quality of communal spaces within these developments and clearly articulating the service provided to residents. Possibly, too, restrictions could be placed on title to ensure the asset must be maintained as BTR for a certain minimum period.

In cases where affordable housing is offered, we believe BTR operators should still be able to operate the entire asset, including any affordable housing component. Not only would this ensure a more consistent experience for all occupiers, and provide maximum flexibility to operators, it would also alleviate any concerns BTR operators may have that the affordable housing component becomes marginalised within the building.

A component of affordable housing should not be an automatic assumption by planning authorities, as there are indirect benefits which flow from encouraging BTR. Here is how we see it unfolding:

- **The first wave:** In essence, this is the portion of the market who are looking to 'make renting more enjoyable', more secure and provide a better level of service to tenants. As seen overseas, early adopters of BTR units are predominantly middle-to-high income professionals and young families seeking convenience, community and a higher quality rental experience.
- **The second wave:** Where the indirect affordability gains become apparent is in BTR's 'second wave'. With enhanced BTR supply you begin to move people up the rental demand diamond into BTR – leaving greater capacity at the more affordable end.
- **The third wave:** As a result of the first two waves, BTR creates a layered rental market with more price points than at present. By increasing supply, it relieves pressure on social and affordable housing schemes and provides choice to those unable, uninterested or unwilling to invest in home ownership.

HOLISTIC VIEW OF THE RENTAL DEMAND DIAMOND

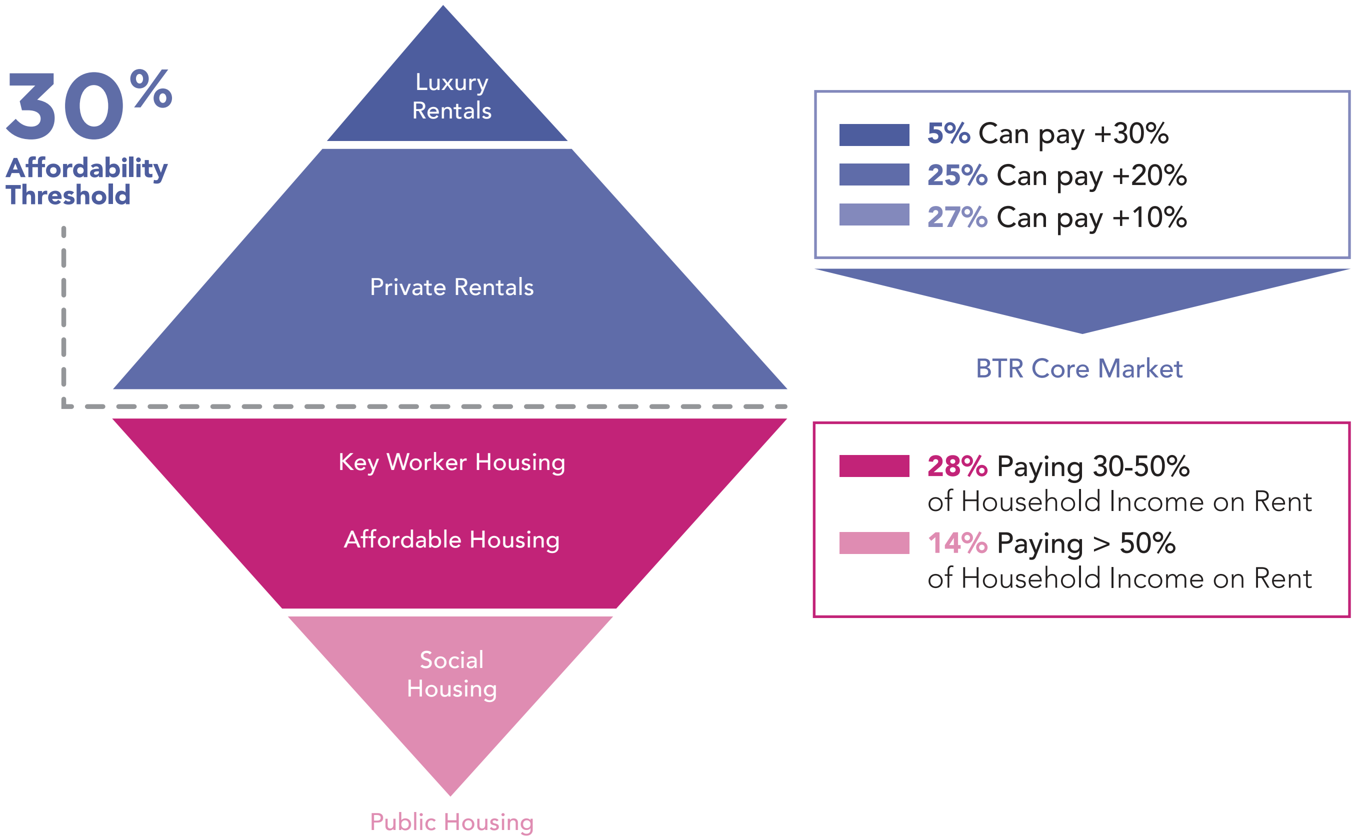
The broadest part of the rental market can afford to pay more rent and may be willing to do so with a superior service offering. This is where the first movers in BTR are focussing their efforts and their success will be key to understanding future scale and direction of this emerging asset class.

Different groups are pitching their view of what BTR is, should, or could be at different points of the market spectrum.

Some are hoping to find a potential delivery vehicle for much needed affordable housing. Others are focussing on the higher service-oriented private market that can afford to pay more for superior service and the convenience and security of purpose-designed and managed rental accommodation.

The current rental market has both a depth and breadth of requirements. There is a spectrum, and the extent to which either end benefits from BTR supply remains subject to many factors (e.g. investor appetite, customer appeal, development costs, labour costs, supportable rents, rental growth, and planning and tax incentives).

What is agreed, is that BTR represents a viable and fast route to increase housing capacity, which flows through to affordability and assisting to prevent a downwards trend through the spectrum into social housing and ultimately relieving the strain on public housing.



A ripple of momentum has started in this sector and if government policies can give it the level playing field it deserves, we will see the ripple turn into a wave.

ENSURING OUR FUTURE PROSPERITY

BTR holds the key to ensuring the liveability of our future cities. It's a positive catalyst that can support gains against a housing shortage, cater to the demands of modern consumers, provide an attractive long-term investment and restore the faith in our construction industry.

WANT TO KNOW MORE?

We'd love to talk to you about the role for Build-to-Rent in unlocking the future liveability of Australia's cities.

To speak to one of our team, please contact:

Tim Chislett
Allens
Managing Associate
T +61 3 9613 8190
M +61 412 397 392
tim.chislett@allens.com.au

Michael Graves
Allens
Partner
T +61 3 9613 8814
M +61 407 235 221
michael.graves@allens.com.au

Mark Dawson
Urbis
Director
T +61 3 8663 4905
M +61 402 494 733
mdawson@urbis.com.au