REAL ESTATE INSTITUTE OF AUSTRALIA

BUILD TO RENT: A MARKET ANALYSIS

Understanding the role of the build to rent sector in achieving Australia's 1.2 million homes target

April 2024

100 YEARS OF SERVING THE REAL ESTATE INDUSTRY

REIA

Re-Leased

MESSAGE FROM THE PRESIDENT

Characterized by high demand and tight supply, we are currently facing continuous scrutiny and debate over the future of housing and renting for Australians today.

Along with the prevailing pressures caused by high interest rates and inflation, inadequate supply of housing stock continues to be the single biggest factor to the housing crisis that is further exacerbating the current cost of living.

Current vacancy rates across Melbourne, Brisbane and Sydney are all critically below the benchmark 3% where supply and demand are in balance. Dwelling approvals have been steadily falling since 2018 and supply constraints of building materials only add to the cost of building new housing stock.

In light of this, it is essential to innovate. REIA has long championed new policies that are aimed at encouraging the construction of affordable rental housing, which will not only address the current crisis but also contribute to the long-term stability of the housing market.

With this in mind, this REIA Build to Rent (BTR) Market Analysis examines the viability of the Build to Rent segment in delivering on Australia's 1.2 million homes target.

The evidence and data from our report have provided mixed results and points towards BTR playing a niche role at best for both our residential and commercial real estate practitioners; and ultimately property customers.

Yours faithfully,

Leanne Pilkington

President

Real Estate Institute of Australia

SPONSORS FORWARD

As the trusted technology partner of REIA, we are excited to continue our support for the community, driving innovation in property management, and making a positive impact on Australia's commercial real estate landscape.

Our collaboration with the REIA reflects our shared dedication to enhancing the industry through Project CRE. We are committed to fostering growth by advocating for the industry, sharing insights, providing education, and implementing transformative initiatives.

At Re-Leased, we are deeply committed to shaping the future of commercial real estate in ways that benefit people, properties, and the environment.

We take pride in our sponsorship of the REIA Build to Rent Report, which addresses the supply-demand imbalance and supports policies for affordable rental housing development. This report uncovers the implications for both residential and commercial real estate practitioners as well as tenants.

Yours faithfully,

Tom Wallace

Chief Executive Officer

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ACKNOWLEDGEMENT OF COUNTRY

REIA respectfully acknowledges the Traditional Owners of Country throughout Australia and recognises their continuing connection to land, water, and community. We pay our respect to them, their culture and their leaders, past, present and emerging.

DISCLAIMER

The REIA BTR Database (March 2024) tracks details of some 135 BTR projects in Sydney, Melbourne and Brisbane. While every effort has been made to track as many BTR projects as possible, the REIA makes no undertaking that every project being planned in these cities is included in the database. This is because some projects will be in very early stages of planning, or no public record of their planning or details is available. Projects can be added to the REIA database by emailing: reia@reia.com.au.

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3,800
Completed BTR Projects

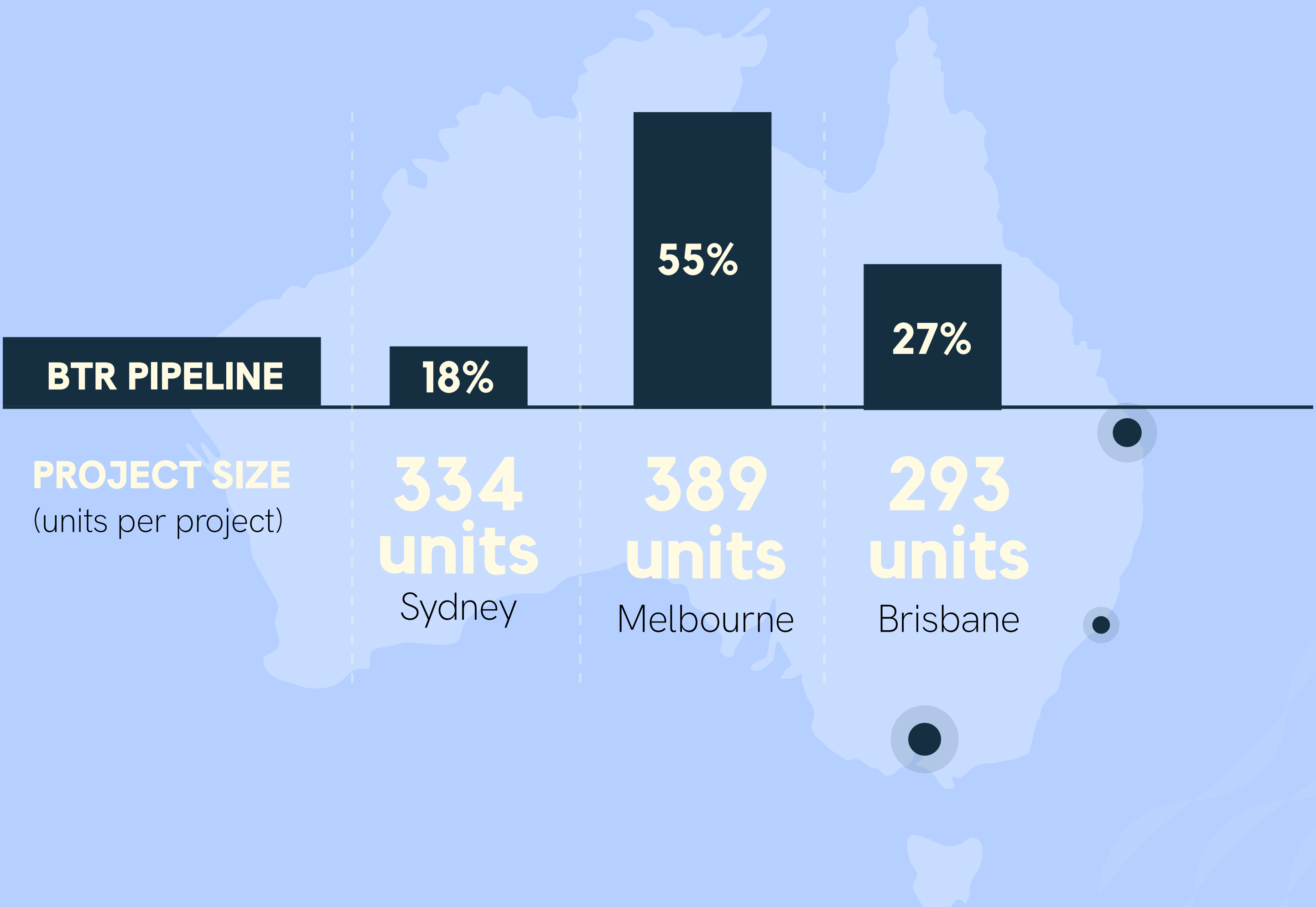
200
Average number of units by BTR site

44,139
Combined BTR pipeline

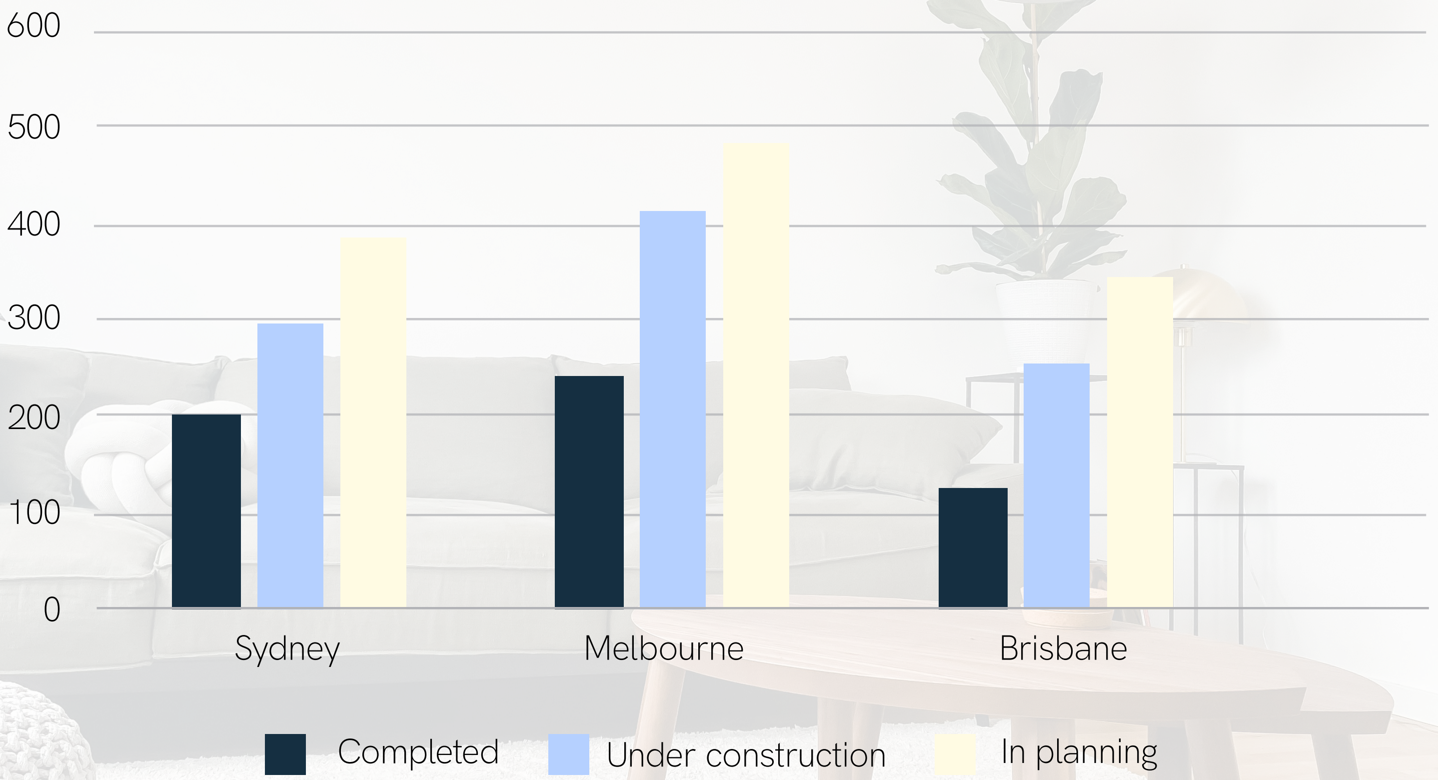
43%
Of touted projects that have no approval

52%
Of pipeline is owned by foreign investors

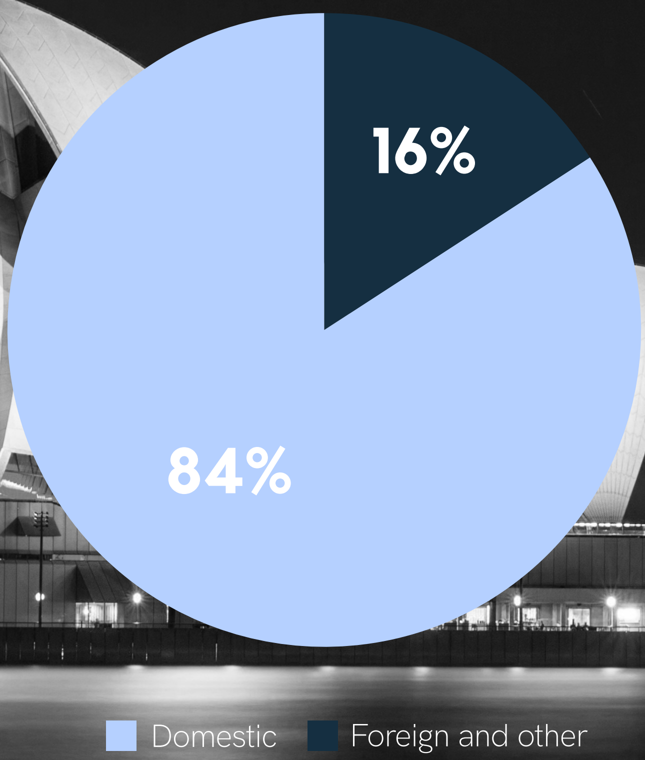
Where are the planned BTR projects



BTR Pipeline by major capital cities



Who owns the BTR sites

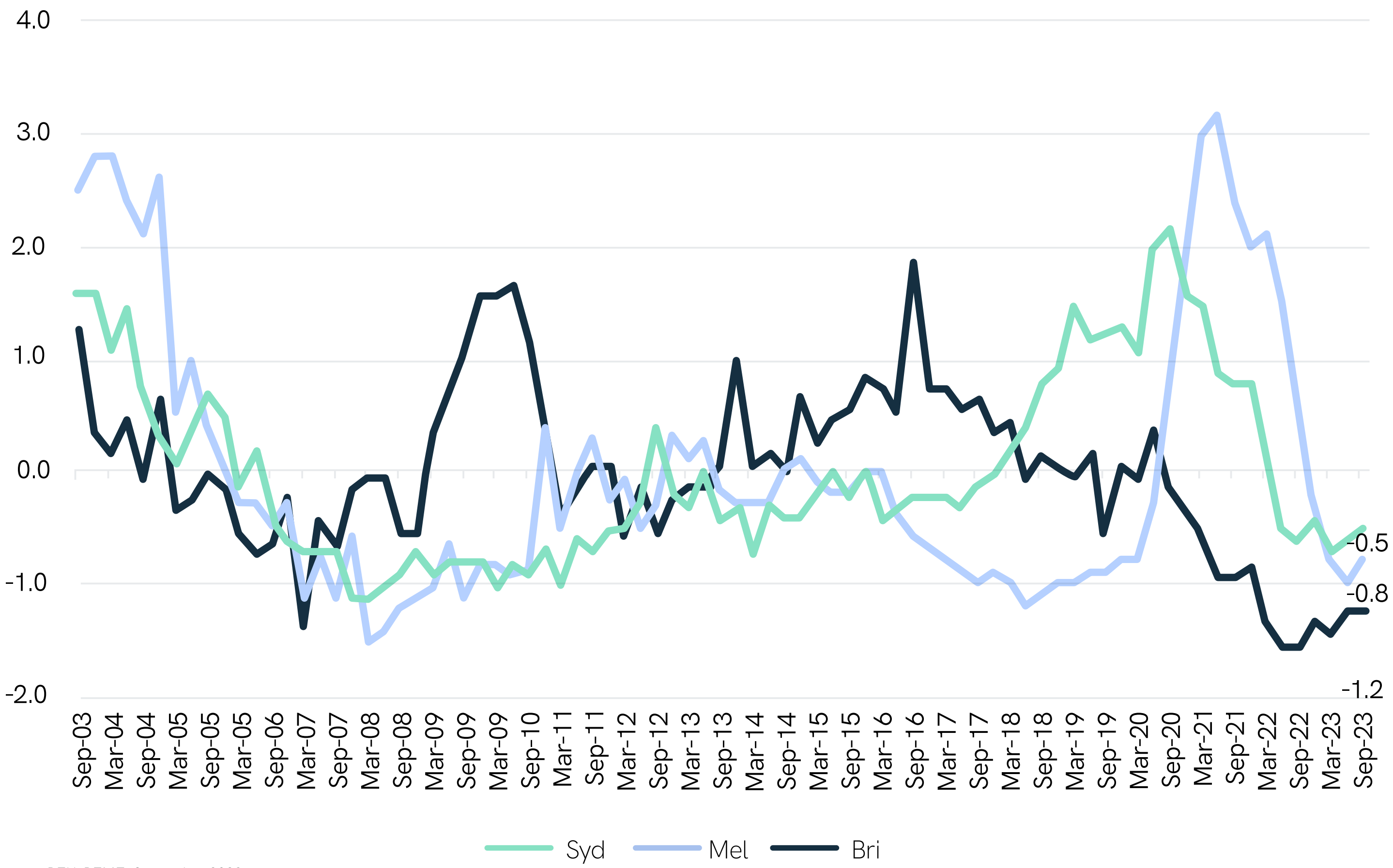


INTRODUCTION

The Australian rental market is in one of the tightest periods of supply we have ever experienced. This report focuses on the three largest residential markets in Australia – Sydney, Melbourne and Brisbane.

Soaring demand coupled with supply constraints has meant many prospective and current renters in most of our major cities have been unable to find quality accommodation in their preferred location close to work, family and transport. Demand outstripping supply has also contributed to rental increases, although high interest rates and maintenance costs play a major role here. Current vacancy rates in all three cities sit well below the 20 year average vacancy rate, with Brisbane in particular experiencing a prolonged period of below average vacancy rates.

RESIDENTIAL VACANCY RATES, DEVIATION FROM 20 YEAR AVERAGE



source: REIA REMF, September 2023

In this context, the Build To Rent (BTR) market has piqued the interest of many of Australia's largest institutional owners and developers. The BTR market is simply rental stock held in company ownership, usually in medium to large sized multi-dwelling apartment style buildings. In addition to local institutions, smaller local private developers and major offshore investors are also entering the market with new developments, in many cases in partnership with one another.

Historically, Australia's residential rental stock has been overwhelmingly owned by private investors. The major exception being social housing provided by predominately State Governments. However, the proportion of total new dwelling stock built in public ownership has been dropping substantially over the last 40 years. For example in the September 1984 quarter, 11.6 per cent of new dwelling stock completed in NSW was owned by public entities. This proportion had dropped to just 1.2 per cent by September 2023. As a result, the private rental market has overwhelmingly taken on the task of building new housing stock for both owner occupiers and renters.

PUBLIC OWNED DWELLINGS AS A PROPORTION OF TOTAL DWELLING COMPLETIONS

	NSW	VIC	QLD
Sept 1984*	11.6%	7.0%	5.4%
Sept 1993	10.4%	4.5%	3.4%
Sept 2003x	1.1%	1.6%	2.5%
Sept 2013	2.7%	1.9%	0.6%
Sept 2023	1.2%	1.4%	0.7%

source: ABS Building Activity, Australia, Sept 2023

** earliest available data*

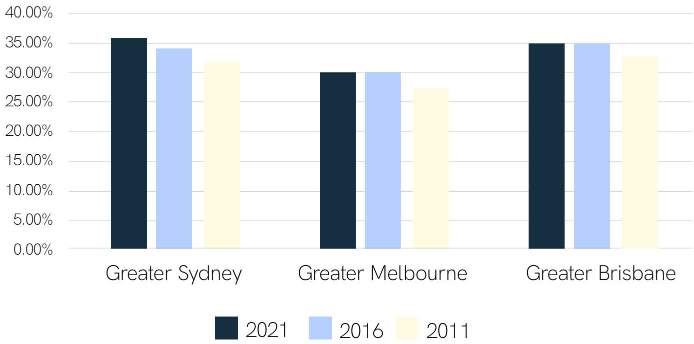
Supply constraints of building materials, due mostly to the pandemic and geo-political factors, has meant that the cost of building new housing stock has increased dramatically. In the 3 years to December 2023, the cost to build a new dwelling by an owner-occupier has increased by 33 per cent . In addition, the cost for a private investor to purchase a new dwelling to put on the rental market has also increased substantially due to rising construction costs and high interest rates. In this context, Australia is primed to see its BTR market grow, as these investors see the long term opportunity of relatively safe, long term income streams from residential tenants.

This report provides an overview of the current BTR market in Sydney, Melbourne and Brisbane, and gives an insight into its potential growth.

THE BUSINESS CASE FOR BTR

While the BTR market is well established in many markets overseas, particularly the USA and some European markets, the investment concept is just starting to gain traction in Australia.

Almost 36 per cent of Sydney dwellings were rented at the last census, compared to 31.6 per cent 10 years' earlier. This equates to an additional 176,709 dwellings rented in Sydney over the 10 years to 2021, or an average of 17,671 additional dwellings supplied to the rental market over the same time period.



ABS Census' 2011, 2016, 2021.

SUPPLY SHORTAGE:
Despite the demand for rental properties, there is a shortage of quality rental housing stock in many Australian cities. Build-to-rent projects could help address this shortfall by providing purpose-built rental units, thereby alleviating some of the pressure on the rental market. Dwelling approvals for non-housing stock (i.e. apartments, units, townhouses), have been steadily falling since mid 2018, and are now at around the levels they were in the early 2010s. In order to lift vacancy rates and alleviate pressure on rents, more non-housing dwelling stock needs to be planned and approved, and institutional owners may be the ones to be able to lift these rates of approvals.

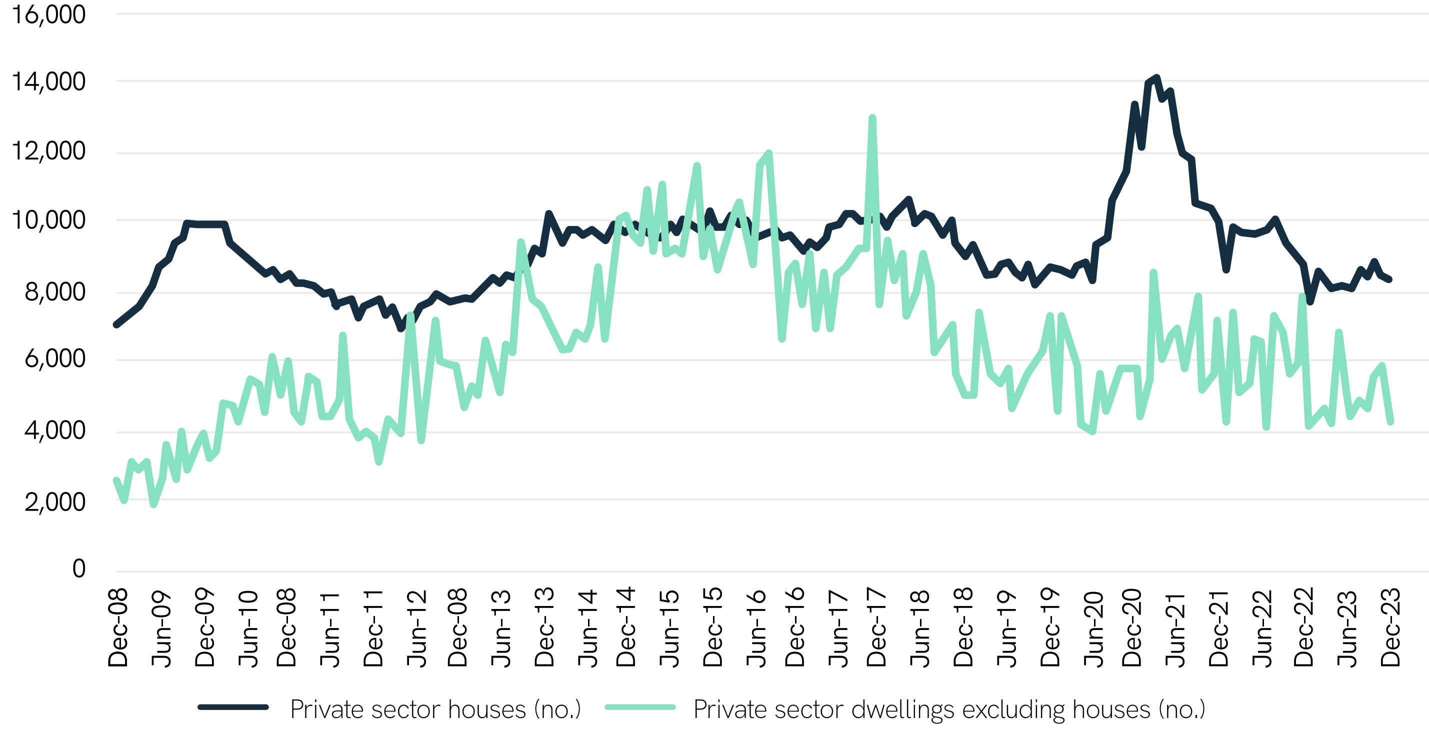
ABS, Consumer Price Index December 2023, 6401.0

GROWING DEMAND:

There is a rising demand for rental properties in Australia, particularly in urban areas where housing affordability is a challenge for many. Young professionals, families, and even retirees are increasingly opting for rental accommodation due to lifestyle choices, flexibility, and financial constraints. The proportion of dwellings that are rented has been rising steadily in all three cities over the last ten years, according to Census data.

Almost 36 per cent of Sydney dwellings were rented at the last census, compared to 31.6 per cent 10 years' earlier. This equates to an additional 176,709 dwellings rented in Sydney over the 10 years to 2021, or an average of 17,671 additional dwellings supplied to the rental market over the same time period.

Dwelling Approvals



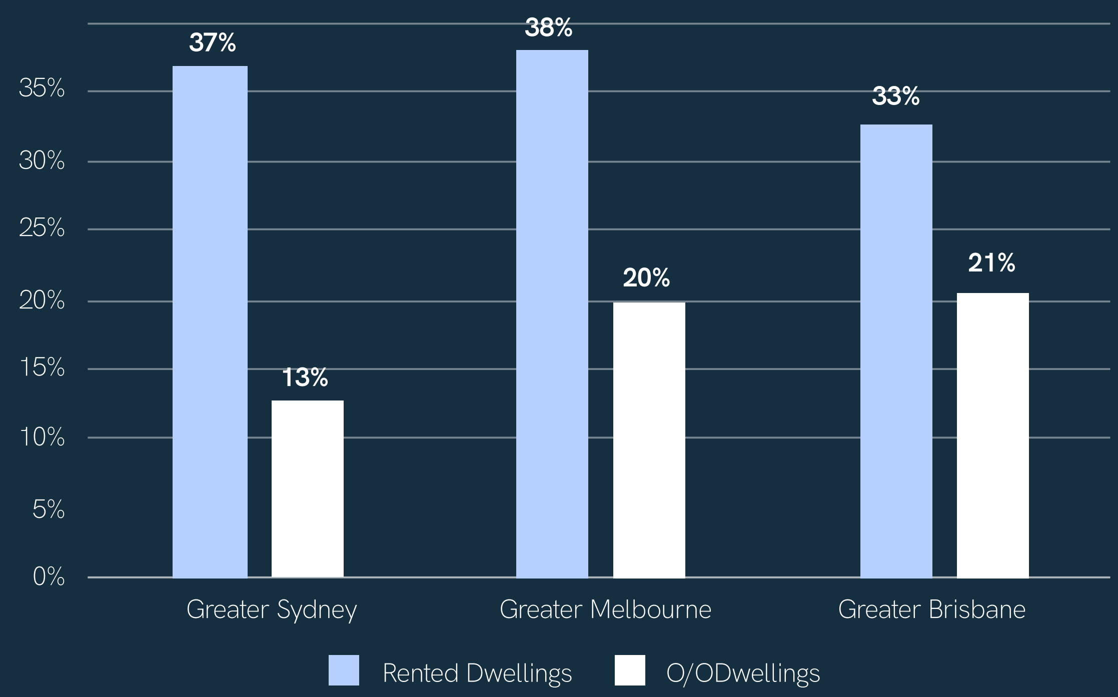
source: ABS, Dwelling Approvals, Dec 2023

CHANGING PREFERENCES:

Attitudes towards renting are shifting, with many Australians embracing the flexibility and convenience it offers. As homeownership becomes less attainable for some, either due to financial constraints or lifestyle preferences, renting is becoming a more appealing long-term option. Over the 10 years to 2021, the number of rented dwellings increased in each monitored city by a far greater percentage than owner occupied housing.

The biggest increase in rented dwellings by percentage was Melbourne, at 38 per cent, followed by Sydney at 37 per cent and Brisbane at 33 per cent. In contrast, increases in owner occupied housing increased by a far smaller proportion in each city. With vacancy rates currently at record low levels, this data highlights just how strong the demand is for new rental supply in each city.

Increase in dwellings by occupancy type, 2011 to 2021



source: ABS Census 2011 & 2021 ** both owner-occupied with a mortgage and without*

STABLE RETURNS:
BTR properties can offer stable and predictable returns for investors. The type of investors that are active in the BTR space both here and overseas will likely compare returns and fundamentals to other commercial asset classes, such as office, industrial and retail properties. While fluctuations in residential vacancy rates do occur, the long term average vacancy rate is far lower than that of office property. Generous incentives have also become ingrained in commercial property leases in Australia, with incentives offered to tenants as high as 40 per cent of the lease value not uncommon in office leasing deals in the current market.

QUALITY STANDARDS & REDUCED MARKET FRICTION:
BTR developments often prioritise quality and tenant satisfaction, offering modern amenities, communal spaces, and professional property management services. This focus on tenant experience can attract tenants and support long-term occupancy rates, enhancing the viability of BTR investments.

Providing residential rental stock to the market that will be available on a largely uninterrupted basis will also help reduce market 'friction'. This occurs mainly when a landlord wishes to sell their property, forcing the existing tenant to find a new rental (or other living arrangement) and also taking the house out of the rental market, either temporarily or permanently. In Australia, the median timeframe that an investor holds a residential investment is 8.9 years. Whilst BTR properties will be bought and sold from time to time like all other commercial property, there will be little to no impact on the existing tenants, and they can continue to occupy the property as normal, just as other commercial tenants do when the property they have a lease in is sold.

CASE STUDY: BTR IN THE UK

According to commercial real estate agency Savills UK, 2023 was the second highest year on record for investment in BTR projects in the UK, with £4.5 billion invested in projects around the country. This was only down marginally from 2022, when £4.6 billion was invested . The UK BTR market has grown substantially since 2016, when a number of government initiatives were enacted to incentise institutional investors to contribute to housing stock on the country. As it stands, BTR stock surpassed a significant milestone of over 100,300 completed homes as at December 2023, with a further 53,800 homes under construction. The future pipeline currently stands at 112,800 homes, including those in the pre-application stage. This brings the total size of the sector to 267,000 homes completed or in the potential pipeline.

The UK is already moving on to the next iteration of institutionally owned housing stock, Build to Rent Houses. These are otherwise known as Single Family Housing, and are single dwellings built typically outside of London in areas such as the North West, Liverpool, Manchester, the Midlands and South East. In 2023, 42 per cent of total BTR investment was in the BTR Housing category, a massive increase on the previous year when it was only 8 per cent. Given the long term preference of families to live in houses rather than apartments in Australia (particularly in regional areas) this may be the next trend to watch in Australia once the BTR apartment market is established.

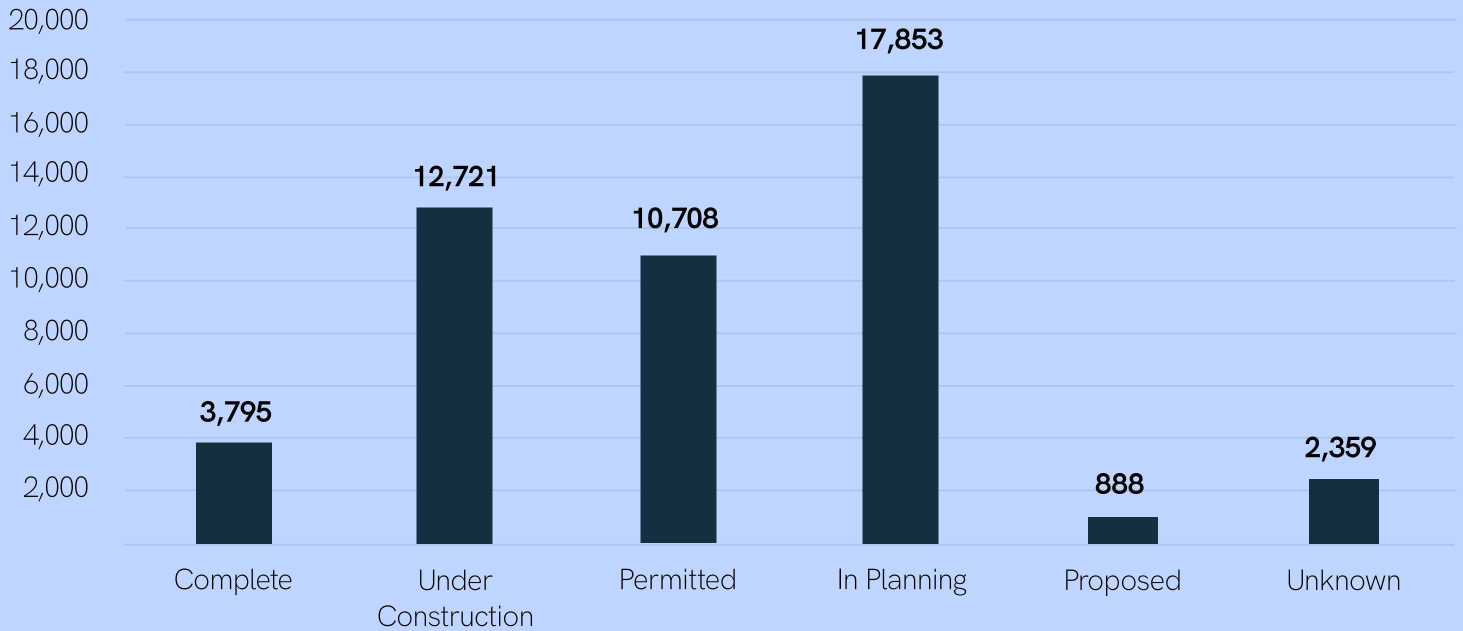
AUSTRALIAN BTR MARKET OVERVIEW

The Australian BTR market is very much in its infancy, with just under 3,800 BTR units currently completed in the Sydney, Melbourne and Brisbane markets. Melbourne has by far the largest amount of existing stock, accounting for just under 70 per cent of all completed units. The average number of units in completed BTR developments is 200.

However, the pipeline of projects either under construction, planning approved or proposed is enormous compared to current stock levels. There are 44,139 units at various stages of the development journey, with 29 per cent of these under construction. A further 24 per cent have planning approval, and 42 per cent are in the process of seeking planning approval.

Savills, UK Build To Rent Market Update - Q4 2023

Australia's Build to Rent Market, by Stage



source: REIA BTR Database, March 2024

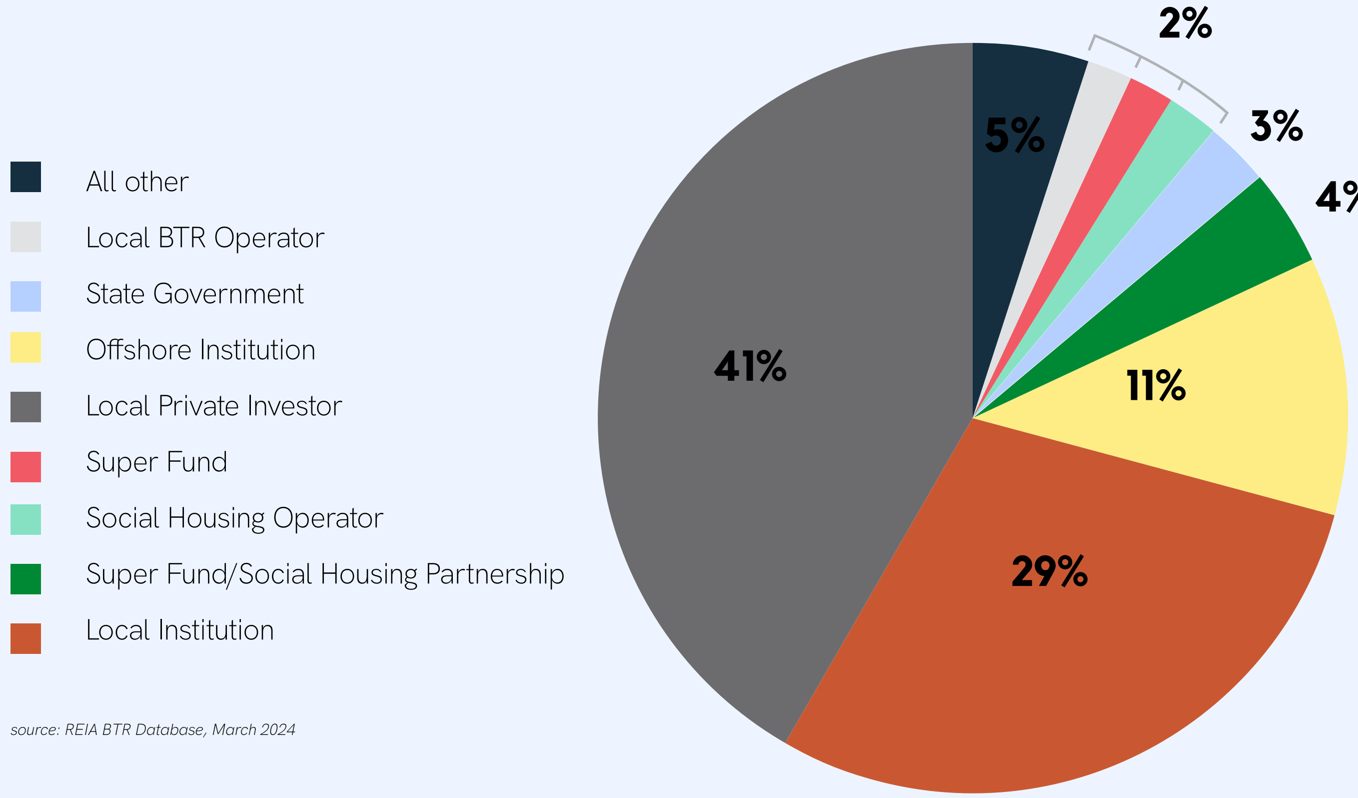
BTR OWNERSHIP BREAKDOWN

BTR Ownership Breakdown Local private investors/ developers account for the majority of the BTR pipeline ownership, at 41 per cent, although it should be noted some of these owners will be backed by institutional money. Both local and offshore institutions account for a further 40 per cent of the pipeline ownership.

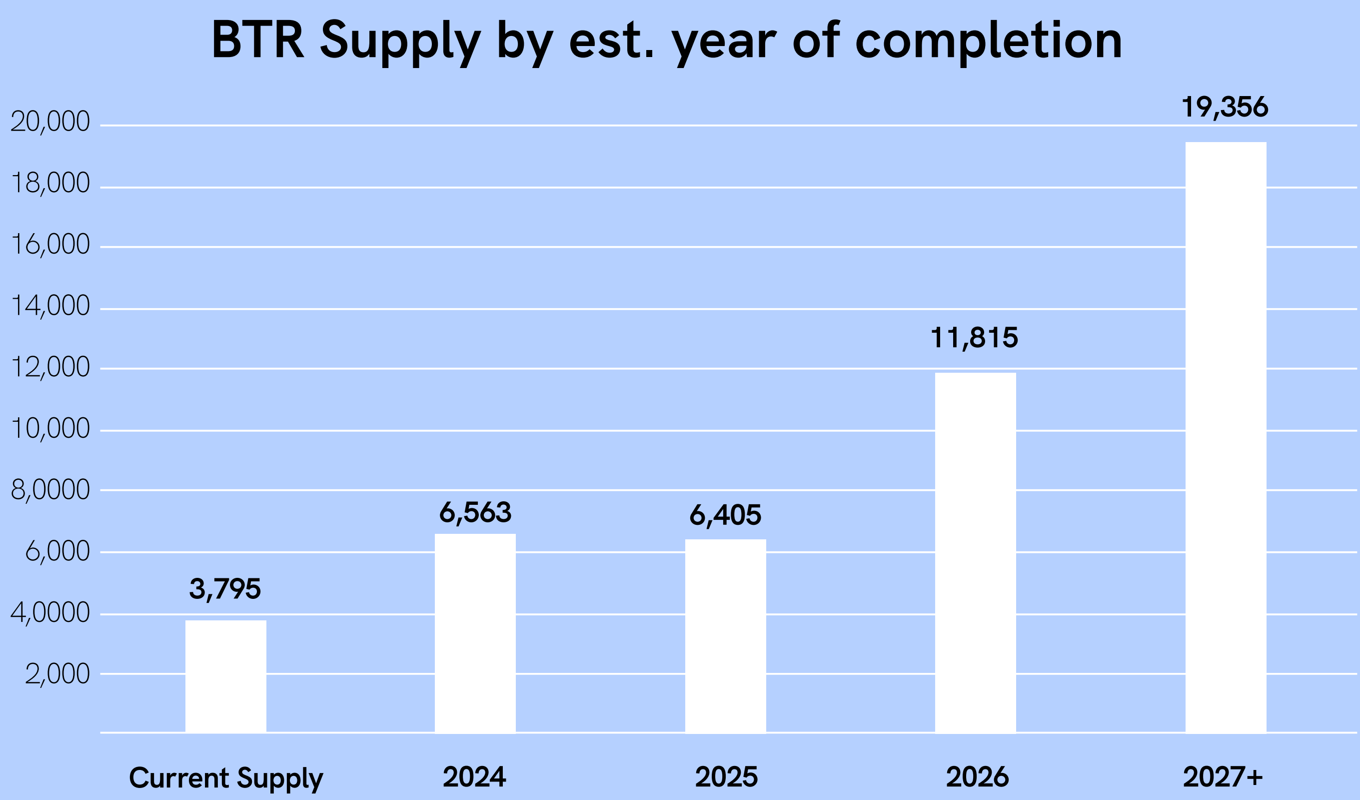
BTR PIPELINE BY YEAR

While the supply pipeline is very large in comparison to existing stock, just over 43 per cent of the pipeline stock has no confirmed time frame. This will be mostly due to both high construction and financing costs, which impacts even large institutional and private developers. Once interest rates start to ease – and this is likely to begin in the second half of the 2024 calendar year – more projects will enter the construction phase, and the time frame of completions will become clearer.

BTR ownership (inc. pipeline)by owner type



source: REIA BTR Database, March 2024



source: REIA BTR Database, March 2024

BTR PIPELINE BY CITY

In addition to having the most completed stock, Melbourne has by far the largest number of BTR projects in the pipeline. Just over 54 per cent of the total supply pipeline is located in Melbourne. Sydney has a large number of projects in the planning stage, at 8,923 units, and only 1,773 units currently under construction.

	Brisbane	Melbourne	Sydney
Complete	766	2,625	404
Under Construction	1,816	9,132	1,773
Permitted	2,054	7,041	1,223
In Planning	4,162	5,800	8,923
Proposed		888	
Unknown		636	691
Total	8,798	26,672	13,014

source: REIA BTR Database, March 2024

BTR PIPELINE BY AVERAGE SIZE OF PROJECT

Melbourne has the largest average sized projects, at 389, closely followed by Sydney at 334 units per project, while Brisbane's average project size is 293 units. For all cities, the projects in the pipeline are mostly larger than the existing projects, as developers try and build scale and gain more confidence in the sector.

	Brisbane	Melbourne	Sydney
Complete	128	239	202
Under Construction	259	415	296
Permitted	411	391	204
In Planning	347	483	388
Proposed		444	
Unknown		318	346
Total	293	389	334

source: REIA BTR Database, March 2024

AUSTRALIAN RENTAL GROWTH EXPECTATIONS

One of the key factors in determining the viability of BTR investments in the long term is understanding what rental growth might look like going forward. By analysing our long term residential rental data time series (REMF September 2023) we can get a good understanding of what rental growth may look like in each city going forward.

The best proxy data for BTR units is the 2 bedroom unit rental time series, which the REIA has been collecting data on since 1988. Rental growth in each city has changed fairly dramatically over the decades, depending on the local supply dynamics, as well as the prevailing cash rate at the time. Vacancy rates have consistently been relatively low, especially compared to other commercial property asset classes, and the expectation is demand for rental properties going forward will be strong given Australia's continuing international migration program.

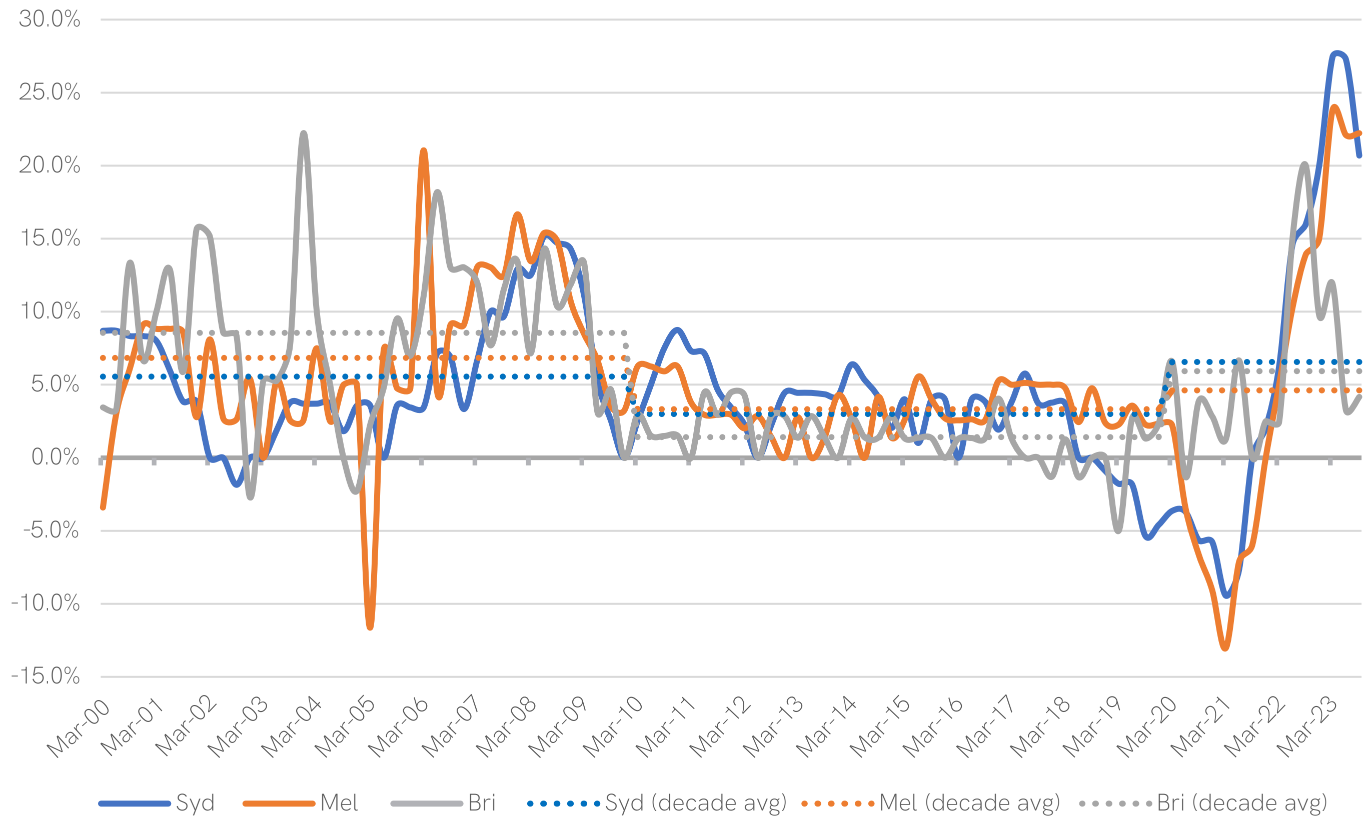
	Sydney	**Melbourne**	**Brisbane**
2000s	5.6%	6.8%	8.6%
2010s	3.0%	3.3%	1.4%
2020s (to date)	6.6%	4.6%	5.9%

source: REIA REMF 6, Quarterly median rents of 2 bedroom units

International migration has had a major impact on rents since the pandemic began in early 2020. The first impact was a significant drop in rentals as most foreign residents on temporary visas were forced to return home. However, since migrants were welcomed back to Australia again in 2022, the opposite has occurred, as vacant rental properties were quickly snapped up by migrants and also locals returning to capital cities.

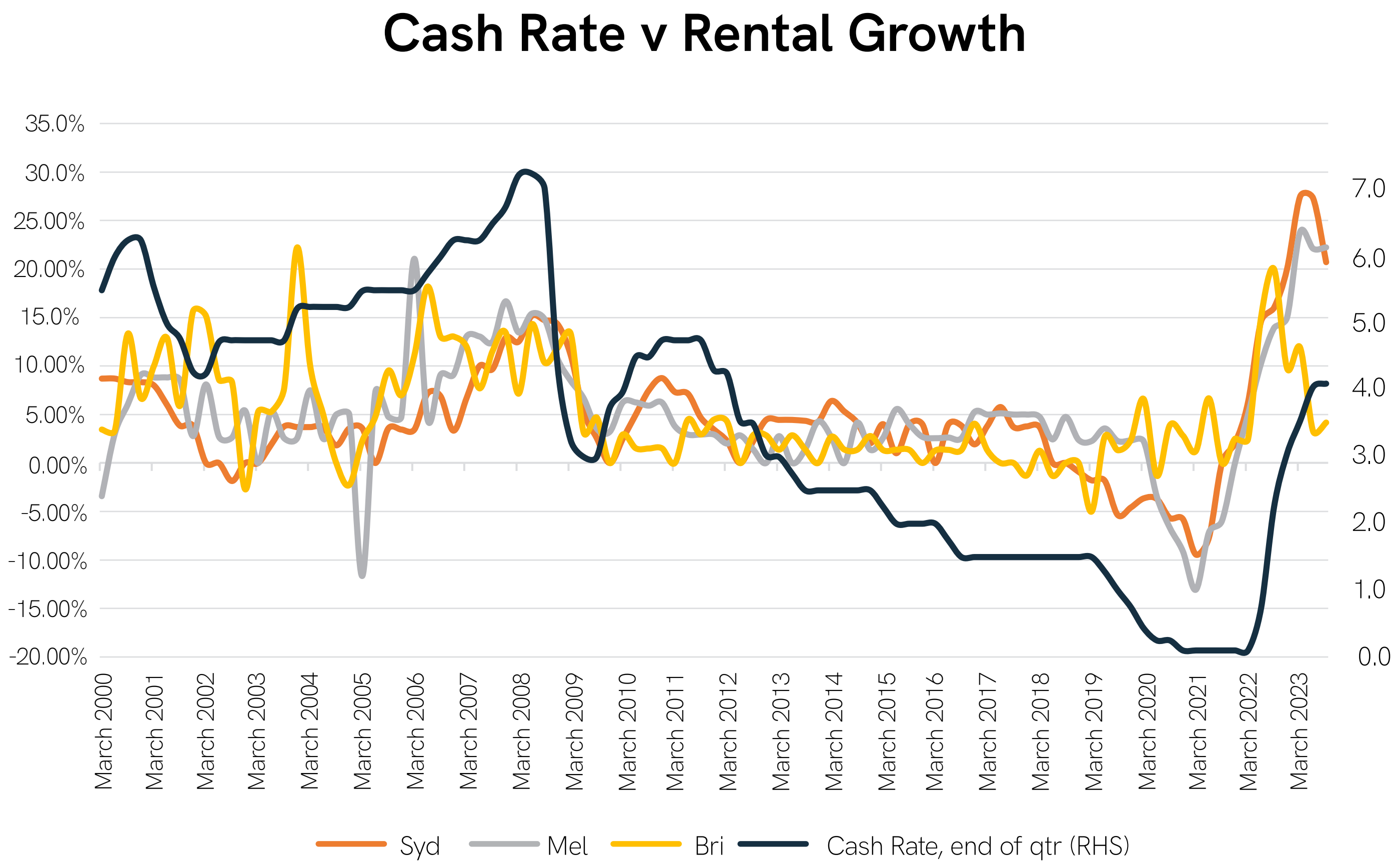
The issue has also been exacerbated by some investors being forced to sell their property both during and after the pandemic, as a lack of rent (during the pandemic) and rising interest rates (after) has had a major impact on the financial feasibility of owning a residential rental property. In some states, such as Victoria, higher land taxes on investor owned property is also seriously impacting supply, and will flow through to higher rents.

Annual Rental Growth, 2 bdr apartment



source: REIA REMF 6, Quarterly median rents of 2 bedroom units

Supply and demand are key drivers of rental growth in the major commercial asset classes of office, industrial and retail. While supply and demand is a key factor in determining rental growth in individual markets, the prevailing cash rate does play an important role. There is a clear relationship (see chart below) between the cash rate and rental growth.



source: REIA REMF 6, Quarterly median rents of 2 bedroom units, RBA

Once the cash rate starts to ease – likely in the second half of 2024 – will then see some moderation in rental growth in each city.

IMPACT ON THE EXISTING RENTAL MARKET

The residential investment market is still very much dominated by private owners, and it is important to acknowledge that that will remain the case in Australia. According to the 2021 census, there are just over 1.5 million dwellings that are rented in the Greater Sydney, Melbourne and Brisbane localities. This means that the current BTR pipeline represents just 3 per cent of the existing rental stock.

While the pipeline is expected to get larger over the next few years, the private residential investor market will remain by far the dominant provider of residential rentals for the foreseeable future. The BTR market will, however, play an increasing role in supplementing the private rental market.

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