RESEARCH & CONSULTING

Knight Frank

BUILD-TO-RENT
INSIGHT
APRIL 2017

THE NEXT AUSTRALIAN RESIDENTIAL INVESTMENT WAVE

KEY FACTS

According to the 2011 Census there were **2,297,458 rented dwellings across Australia** (30% of all dwellings), up 14% from 2006.

In Australia **50% (1,248,650) of all rented dwellings are categorised as a separate house** and 29% as an apartment.

54% of all rented dwellings (1,247,951) in Australia are privately rented through a landlord or real estate agent (i.e. not through State Government, Housing Authority or charity).

418,993 (63%) of all Australian rental apartments are privately rented through a landlord or real estate agent.

Knight Frank projects the proportion of all rented dwellings will increase to total closer to 33% on release of the 2016 Australian Census data. **By 2021, this figure will reach upwards of 35% due to the increase in new investor targeted residential stock** due for completion over the next three years across the Eastern Seaboard.

PAUL SAVITZ
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BUILD-TO-RENT

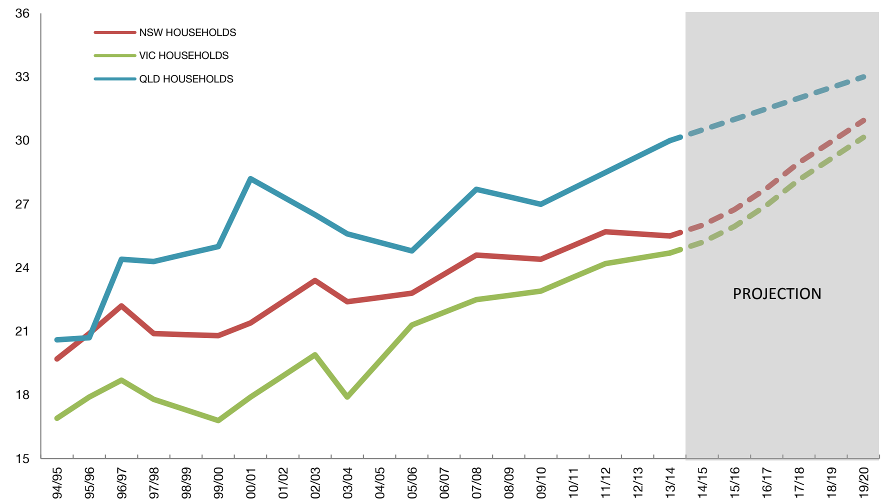
The success and growth of purpose built student accommodation as an institutional real estate investment class in Australia, evidenced by an increasing supply pipeline, is leading to the exploration and diversification into a new residential investment asset class.

Over the next five years it is expected that there will be the development of close to 40,000 new purpose built student accommodation (PBSA) beds across Australia, as both domestic and global institutions awaken to the potential of this maturing investment class. This follows two years of above historical supply, with 10,200 beds delivered to the market, the equivalent of 11% of total stock.

Following this growth in the purpose built student accommodation sector is interest and activity in the Australian residential private rented sector (PRS) or the Build-to -Rent (BTR) concept, as known in the UK, or the established Multifamily Housing sector, as termed in the US. As an example of the size of the market, the US multifamily sector saw sales volumes eclipse US$150bn for the second consecutive calendar year, as investors continued to acquire assets due to strong underlying fundamentals which have seen occupancy rates trend around 94% over the long term. For the UK, the institutional BTR sector bounced off the downturn during the most recent economic cycle post the GFC. As land values stabilised, development finance stalled and apartment sales slowed opportunities to pick up sites or partially completed buildings grew. In addition, a commitment from the UK Government to help deliver more affordable housing tenures, the establishment of a PRS Taskforce and the £1bn Build-to-Rent fund which provided loans and equity to build-to-rent developers, were all aimed at increasing investment into private rented housing, which aided growth of the BTR sector.

Until recently, only State Government and/ or social housing landlords in Australia built rental homes for people on low incomes. For those ineligible for affordable housing or for those unable or unwilling to enter the owner occupier market there has been a reliance on small-scale, largely unregulated “amateur mum and dad landlords” who either rent out their own former homes or accumulated portfolios of properties. The professional, large scale institutions now focussing on this new investment asset class are looking to build and construct, keeping these dwellings for

FIGURE 1
Private Rented Households, Eastern Seaboard States (% of total)
Renting from a private landlord only (FY)



Source: Knight Frank Research, ABS
Projections based on assumptions and modelling of take up of new residential stock by investor purchasers

the long term, and harvesting the income from rents, in the same way as the new wave of PBSA institutions are operating.

Proportion of Privately Rented Households

Renting in Australia is not a new concept, or a model of investment which needs convincing. Since 1994/95 the proportion of all residential households in NSW, Victoria and Queensland that are rented privately from a landlord increased by 6%, 8% and 9% respectively to 2013/14. Across these three Eastern states, between 25% and 30% of all households are renting privately from a landlord. This figure excludes those who rent from a social landlord or housing association.

An increase in residential apartment construction, a favourable investor lending and tax environment, historically low interest rates, the rise of the overseas buyer, and the rapid increase in dwelling price are a collection of reasons, which combined, are increasing the proportion of rented housing across Australia. The current economic climate and housing market environment suggests that the proportion of privately rented households will only increase. Knight Frank Research projects that NSW, Vic and Qld will have approximately 31%, 30% and 33% of all households privately rented from a landlord by 2019/20.

Flexibility of tenure, whereby for example, a young professional can live close to the amenity of the CBD, or within walking, a short run, or a cycle of their place of work, has, and will continue to increase the demand for rented accommodation. As will the need to house families in more suburban locations close to schools, child care facilities and medical centres, who struggle to raise a deposit to purchase a dwelling in their desired neighbourhood, thus providing the ability to live in a convenient location, with the security of a long secure lease.

Institutional Growth

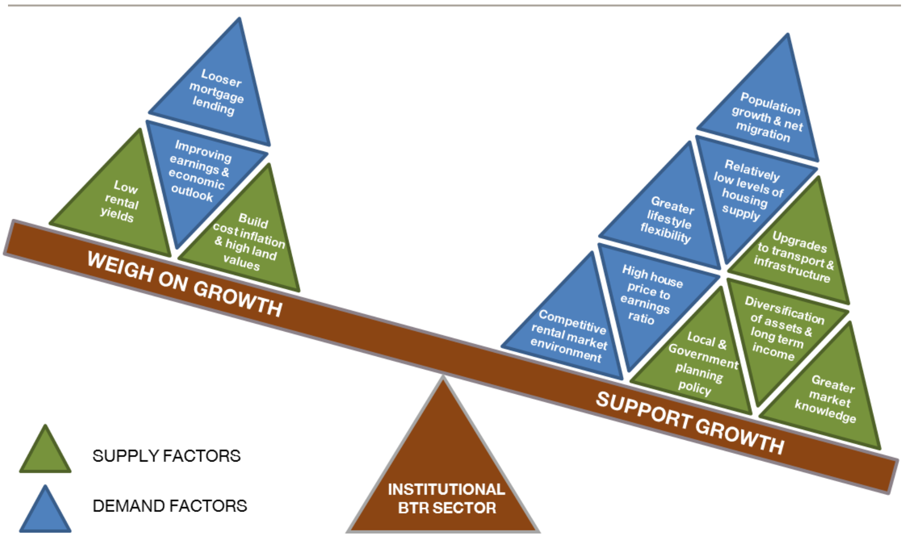
Institutions, often backed by pension/ super funds, which use the rental income to pay pensions, are actively looking at the BTR sector, although barriers exist just like in the student accommodation market. Availability of suitable sites, viability against other uses, low rental yields, and high build costs are all factors weighing on the growth of the sector. However, strong population growth across the Eastern Seaboard will keep groups such as the newly formed Macquarie Capital/Greystar partnership interested, as they look to tap into a sector which harbours constant occupier demand and provides predictable profits.

Projected population growth of 1.22 million over the five years from 2016 to 2020, at an annual rate of 1.6%, and rising housing purchase costs across the three aforementioned states, will feed the demand for additional rental accommodation going forward, and will give rise to an institutional residential investment class here in Australia. However, as professionally delivered and managed product increases, differentiation of brand, design and price point will become important, coupled with an understanding of treating a tenant as a customer or consumer, comparable to the hotel or PBSA market.

FIGURE 2

Push and Pull Factors Influencing the Growth of the Institutional BTR Sector

Australia



Source: Knight Frank Research

DEFINITIONS

BUILD-TO-RENT

'Built', or 'Build-to-Rent' (BTR) is the new terminology which is being used by stakeholders in the UK to distinguish between the more traditional Private Rented Sector (PRS) accommodation and newly constructed institutional private rental accommodation where the whole block is owned/operated by an institution rather than individuals who bought an investment property to lease it out and ensure their pension income.

PRS

The Private Rented Sector, 'PRS' is essentially the term for the whole of the private rental sector, commonly used in the UK. Anything that is not 'social rent' (subsidised rental property provided by council or charity where rent is about 80% or less of the market rent) is in the Private Rented Sector (PRS). Individual buy-to-let landlords, institutions i.e. owner/ operators, employers' rented properties – are all dwellings which would fall into this category.

MULTIFAMILY HOUSING

In the US the residential sector is defined by the size of the property i.e. is it a house ('single family residential unit') or a block of flats ('multifamily residential units'). Traditionally home ownership in the US focused on family houses and multifamily was seen as an alternative where lower income households could live without ownership. Today, there are single family homes for rent as well as apartments that are owned.

A VIEW FROM THE UK

Over the last few years there has been a surge of interest in the UK residential investment market (PRS and Build-to-Rent). The sector is seen as key to accelerating the rate at which new homes are delivered across the UK, and has created many headlines in the industry press while receiving significant political support.

Today 5.12 million people live within the UK private residential rental sector. If current trends continue this will rise to more than 6.4 million over the next five years. Most of the demand in the private rented sector is from young, economically active people concentrated in urban centres. These people view themselves as being relatively transient and renting affords them the flexibility to upgrade, downgrade or move according to their circumstances.

Tenants are increasingly adopting a "rent now, buy later" mind set. A high proportion of tenants are expressing that they are happy with their current circumstance but aspire to buy later on, irrespective of whether or not they are currently saving for a deposit.

Large scale investors from the UK and overseas have been attracted to the sector by the combination of outstanding capital growth (particularly in London) and sound rental fundamentals (increasing demand and relatively low supply). In particular there is an increasing understanding that the income offered by the residential rental market is both secure and shows long term appreciation, a rare and valuable commodity in an increasingly turbulent world.

As well as providing a secure long-term investment, Build-to-Rent can also afford developers a number of benefits, ranging from accelerating their development programme through to providing a complete funding solution. With income now a key value driver, it is imperative that developers design their projects with a view to maximising gross rent and minimising operational costs. This type of product is currently rare in the UK and in order to satisfy the demand dwellings must be built from scratch, creating brand new institutional-grade assets specifically designed for the rental market.

A VALUATION PERSPECTIVE

From a value perspective, in order to generate acceptable benchmark returns, it is likely that funds/owners will need to develop and roll the product into a vehicle at a lower development margin (closer to return on cost) than would typically be acceptable to residential developers. As such, it would be expected that groups that have development arms and existing sites will be in a favoured position to move into this sector.

The sector is more aligned to going concern investments such as student accommodation and serviced apartments. Whilst it appears common in the UK for owners to have operating arms to manage their own product, local owners/funds may initially seek to limit exposure to operating performance by structuring long term head leases or management agreements. It would also be expected that whilst indexation of any head lease will be lower than more traditional sectors, underlying cash flow and total returns will be aided by longer lease terms (18 months on average in UK versus serviced apartments of closer to 3 months), more limited downtime and lower overheads relative to the hospitality sector. Important in the early stages will be establishing appropriately supported trading forecasts and the structure of any head leases/ managements agreements.

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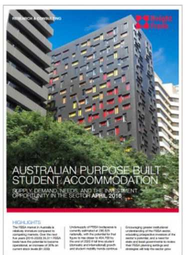

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