SAVILLS
Research

Australia Build to Rent Market Update

Shortage of Rental Stock Provides Opportunities for Build to Rent Investment

Residential rental vacancies nationally are falling, or remaining extremely low, and on average, rents are rising. The following analysis charts the change in residential rental levels across metropolitan Local Government Authorities (LGAs) within the five major capital cities against the availability of rental stock in the last quarter of 2021 relative to the same period in 2019. The data indicates that nearly 70% of all LGAs have less apartments available for rent in Q4 2021 compared to two years prior, and are now in need of new rental supply. This undersupply of accommodation is fuelling current rental growth to levels far in excess of historic growth.

The private rental sector, or "mum and dad" investors, are partly responsible for falling rental supply, with a growing number of landlords exiting the market taking advantage of pent-up buyer demand and aggressive capital growth.

Across the major capital cities, the short–medium term outlook for new high density 'for sale' apartment development is far below levels of historic completions, which will result in heightened demand as population growth is encouraged. There is currently a stronger focus on smaller high quality residential projects that appeal to owner occupiers, particularly downsizers, as it remains a challenge to reach pre-sale funding hurdles for larger investor focussed schemes.

The decline in the Australian residential supply pipeline illustrates how the pre-sales requirements put on developers by financiers in Australia makes development very responsive to prevailing demand conditions, demand which had been falling since the retreat of domestic and foreign investors from the market. APRA's macro-prudential measures over the past few years to slow investor credit growth had been a sticking point for domestic investors, in addition to a rapidly compressing yield.

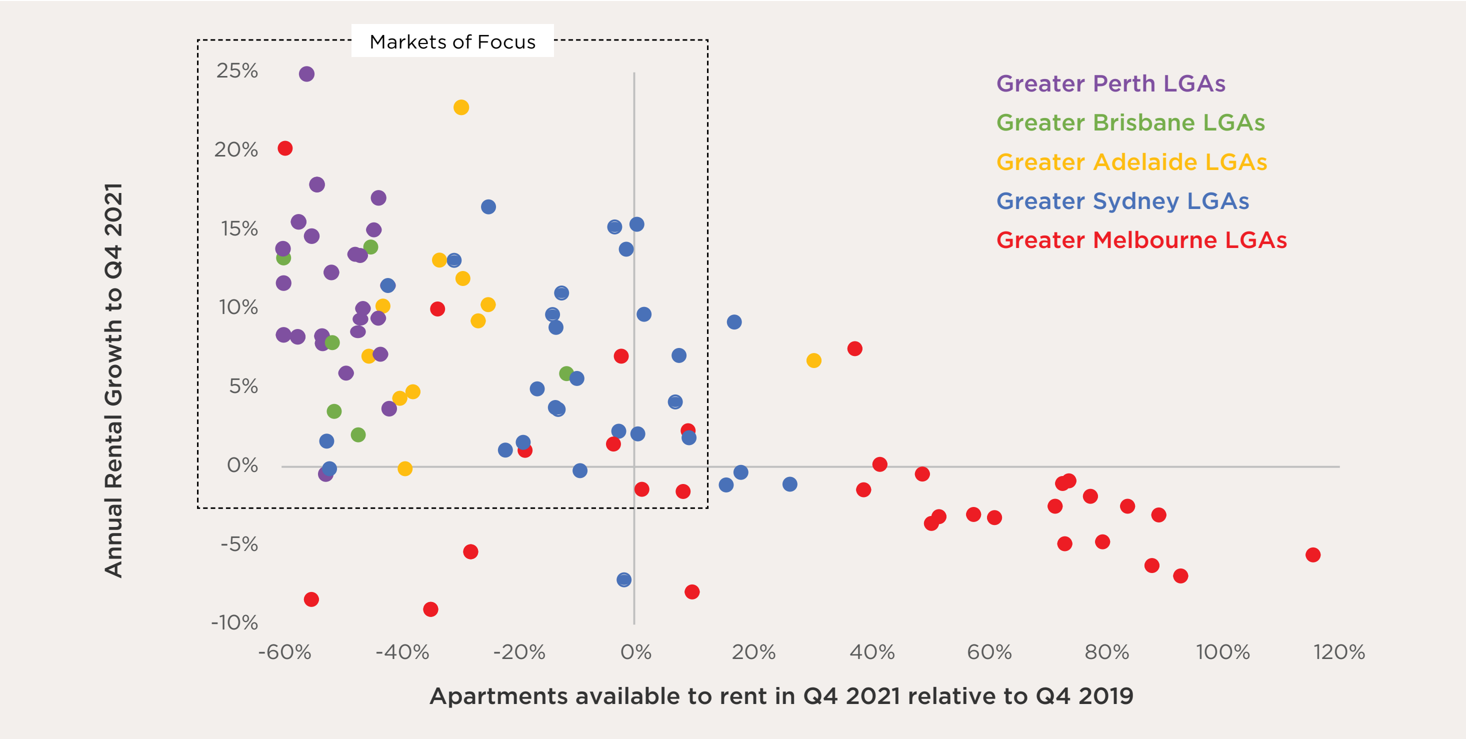
Significant decline in individual offshore investment is also responsible for the downward trend in apartment demand and subsequent fall in construction activity, particularly since this demand is almost entirely in new housing stock. State and Federal imposts on foreign investors and credit constraints contributed to the decline, but changes to Chinese capital restrictions likely had a much larger impact.

For Australia, the Covid pandemic is causing even more delayed or abandoned medium and high-density apartment projects. Annual completions, which lag approvals and starts, in September 2021 were already 30% down on September 2017 completions, which are expected to fall further into 2022 and 2023 to be around 40 - 45% below the peak.

Chart 2. Residential starts and completions significantly below long term levels

Source: Savills, ABS

Chart 1. Shortage of rental stock fuelling rental growth



The medium-term danger now for Australia is that it will take some time for the apartment development pipeline to reverse its downward trend. With still very strong levels of national population growth expected once borders reopen, a period of supply shortages over the next few years at the national level could reappear. This could result in pressure on renters in some parts of the country, in particular, increasing the house price unaffordability and rental unaffordability measures.

Build to Rent (BTR) is starting to find its place within the housing spectrum, the analysis presented highlights significant untapped markets of focus. There remains considerable scope for new rental supply to enter the residential market throughout the country.

Fast Population Growth in a Global Context

Migration to Australia during 2020 and 2021 fell starkly due to widespread travel bans and international border closures brought on by the global Covid pandemic. It is expected to bounce back rapidly in 2022.

The three largest capital cities recorded past (2001-2018) population growth of between 1.4% (Sydney) and 2.2% (Melbourne) per annum. As a benchmark, London grew by 1.2% per annum over the same period and Manchester by 1.5%, two markets which have seen a large proportion of the UK's recent BTR development.

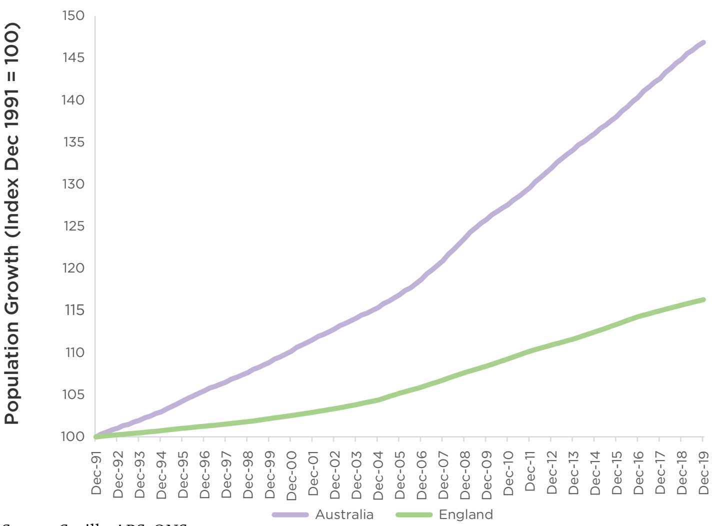
Moving forward, those two UK cities are expected to see their resident population increase by 0.5% and 0.4% per annum respectively. During the same period, 2018-2029, Melbourne, Brisbane and Sydney are expected to grow by 2.2%, 1.9% and 1.8% per annum, significantly outpacing growth of the UK cities.

According to the Treasury's mid-year economic update, released in December, net overseas migration is expected to climb to 180,000 people in 2022-23 (almost double the previous estimate). The 2024-25 forecast remains at 235,000 people. Prior to the pandemic (2019-20), net overseas migration had been around 190,000 people.

The policy shift highlighted by the Mid-Year Economic and Fiscal Outlook (MYEFO) shows the federal government's intention to steadily increase migration, as it seeks to energise economic growth and replace skill shortages as part of its recovery from the pandemic.

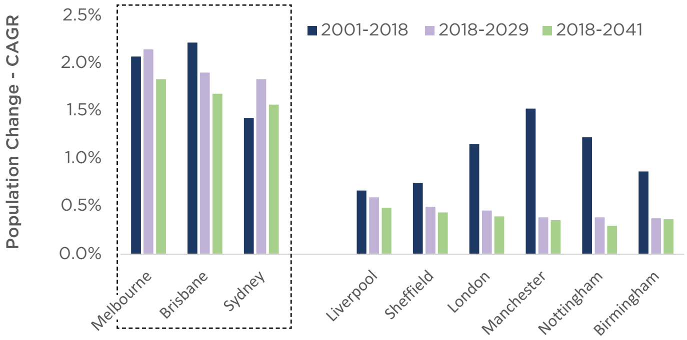
A recent ABS survey revealed that 69% of migrants 15 years and over arriving in Australia throughout the last 10 years held a post high school qualification. Those that came with a qualification, the majority (79%) held a bachelor degree or higher. These statistics highlight those skilled migrants moving to Australia often have a higher than average level of education and consequently income. Skilled immigrants are expected to be a considerable driver of near term BTR occupier demand.

Chart 3. Population growth in Australia has historically outpaced UK growth



Source: Savills, ABS, ONS

Chart 4. Australian capital cities population forecast to rapidly increase



Source: Savills, ABS, ONS

Institutional Capital is Backing BTR, Diversification has Appeared, Groups are Targeting Scale

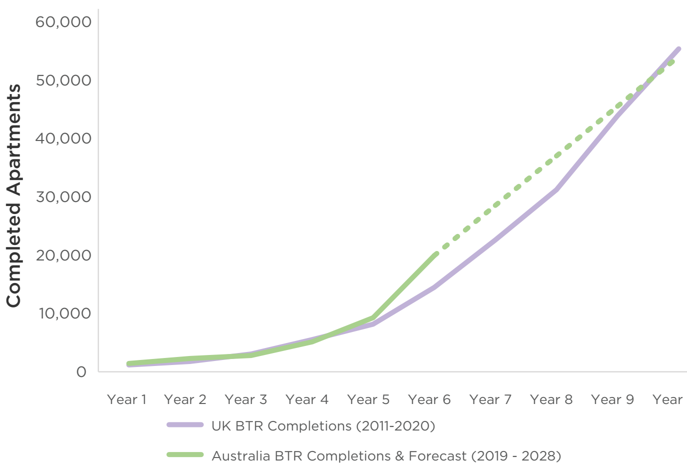
The similarities between the emergence of the sector in Australia and the UK are well documented. Policy makers showing support to the emergence of an operational residential sector, as investors look to more defensive, less cyclical asset classes. The contraction of the residential construction 'for sale' sector and the gravitation of experienced overseas BTR operators and investors from markets such as North America, Europe and Asia Pacific have provided the initial push.

In the first five years, from the emergence of the first UK BTR scheme in London 8,160 units were completed. Albeit without the full support of government policy that the UK market was fortunate to enjoy, the emergence of the Australian BTR sector will occur at a similar speed as the UK equivalent. Over 9,250 units will be complete over the same five-year milestone from initial scheme to end of 2023.

By the end of 2021, around 2,800 institutional grade BTR apartments have completed nationally, in addition, over 5,000 apartments are currently under construction, with 2,300 forecast to complete in 2022. More than 25,500 apartments are in the pipeline to be delivered in the next five years (2022 – 2026). The market remains heavily skewed towards Melbourne (Victoria) where over 60% of supply is located. Sydney continues to be the market with greatest barriers to entry including the cost of land and the planning environment.

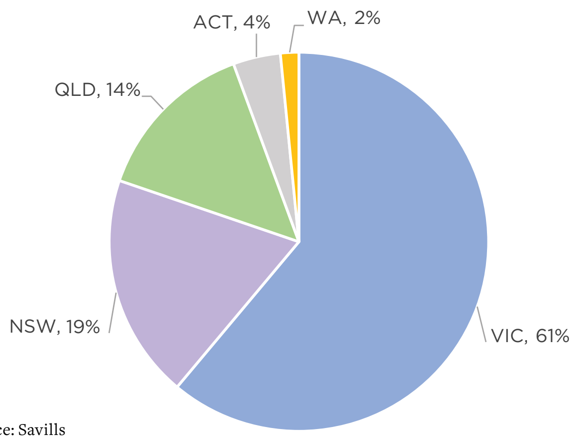
It is important to note that these projects are at varying stages of planning. Some are at an early stage of feasibility with no development application having been submitted. Others have submitted a development application and several schemes have development approval granted. Based on Savills analysis, 2024 will be the year the market sees the largest annual delivery (10,500+ apartments).

Chart 5. BTR construction pipeline, Australia vs UK



Source: Savills

Chart 6. Australia pipeline weighted to Melbourne (Victoria)



Source: Savills

Dependent on the success and support of the BTR sector the first decade of growth could look extremely similar to the UK. Structural changes in demand, together with new purpose built supply coming to market, have opened the operational residential sector to more investors than ever before. As management platforms develop, investor comfort with operational real estate has increased.

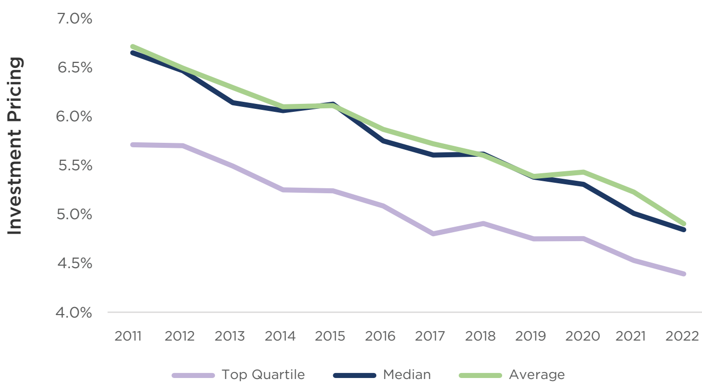
So far the Australian BTR market is small scale and fragmented, investors are seeking scale quick. Most groups are looking at building scale through the delivery of large 350+ apartment projects, stabilisation of schemes of that size will take time and will only be delivered in specific markets, smaller sub 250 unit schemes can open up new areas to BTR. Consolidation is expected in the future, as has happened in other sectors and other BTR markets globally.

Global BTR Transaction Yields Being Driven Down

As the global volume of BTR transactions, or Multifamily as known in North America, has increased, in addition to the increasing liquidity within the sector, and asset class maturity across a wider geographical spread, including increasing transaction volumes in Europe and Asia Pacific, BTR/Multifamily cap rates have trended downward.

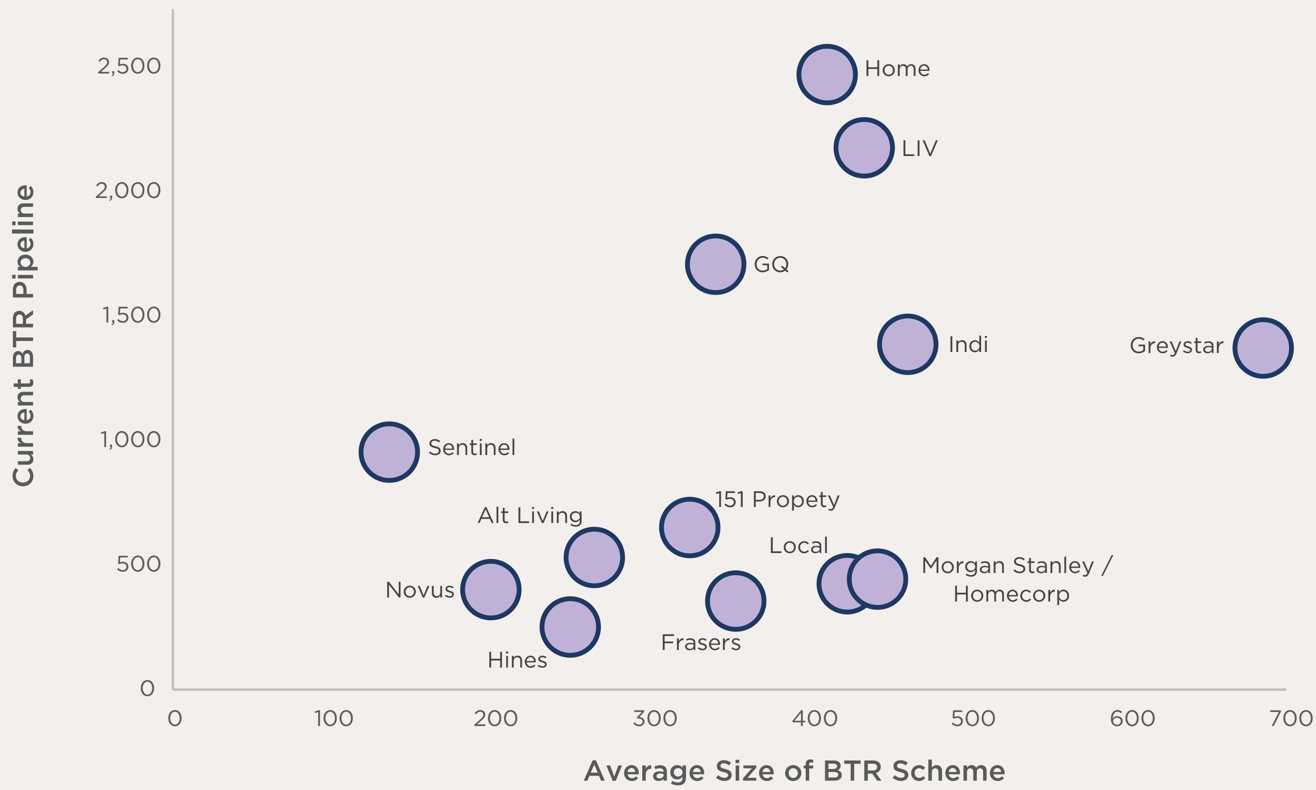
The strong performance of the sector over the past 18 months throughout more mature markets of the US and UK has further furnished its counter-cyclical credentials, driving increased investor appetite and a wave of new entrants. A deeper knowledge of the sector operationally and greater pool of investors chasing lower risk investments, to diversify real estate portfolios, has triggered the average global capitalisation rate to fall by 160 bps over the past 10 years to 4.9% as at the first quarter of 2022, the top quartile global cap rate recording 4.4%, a fall of 130 bps over the past decade. Newly developed highly amenatised BTR/Multifamily would be more akin to the Top Quartile pricing.

Chart 8. Increasing transaction volumes and greater liquidity placing downward pressure on yields



Source: Savills, Real Capital Analytics (All apartments excluding Age Restricted, Student and Subsidised Housing)

Chart 7. Growth in BTR operators and investors chasing scale through development



Source: Savills *selected groups, reported projects

Increased competition from investors will continue to place downward pressure on yields for the best assets. This will especially be the case for income-producing, stabilised assets. A common theme over recent years has been a lack of these opportunities. When they do come to market they attract significant competition. Looking to other core real estate sectors globally and in Australia, the industrial sector shows how strong investor demand and positive sentiment can drive yield compression.

The potential fly in the ointment is inflation. At present, forecasts are for the current strong inflation to be temporary. But, if it turns out to be persistent, then the RBA will have to act, leading to a rise in bond yields. This will put upward pressure on yields across real estate. But as BTR continues to mature as an asset class, we expect greater liquidity and economies of scale will put downward pressure on the sector's risk premium. This means that even if yields don't fall, they will likely remain stable even as the risk-free rate rises.

AUSTRALIA YIELDS	2015	2016	2017	2018	2019	2020	2021
10-Year Bond Rate	2.75%	2.40%	2.60%	2.60%	1.40%	0.90%	1.50%
Office (Premium/A Grade) #	6.20%	5.60%	5.25%	4.95%	4.85%	4.65%	4.60%
Retail (Regional) ##	6.45%	6.05%	5.65%	5.30%	5.05%	5.25%	5.40%
Industrial ###	7.25%	6.80%	6.45%	5.95%	5.70%	5.15%	4.35%
Sydney PBSA*	7.20%	7.00%	6.75%	6.25%	5.75%	5.25%	5.00%
Melbourne PBSA*	7.25%	7.15%	7.00%	6.75%	6.00%	5.25%	5.25%
Brisbane PBSA*	7.50%	7.50%	7.50%	7.50%	7.00%	6.65%	6.00%
Sydney BTRˆ						4.00%	4.00%
Melbourne BTRˆ						4.25%	4.15%
Brisbane BTRˆ						4.75%	4.50%

#Syd and Mel av. ##NSW and VIC av. Regional Shopping Centre ### Syd and Mel av. *Median Prime PBSA stabilised off-campus direct let single assets (NIY), ˆprime stabilised BTR

Source: Savills

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