

Australia Build to Rent Market Update

savills

Build-to-Rent Resilient to a Changing Market

The number of investors targeting Australian Build-to-Rent (BTR) has grown exponentially over the past 18 months, with over \$3.5bn raised and committed to the sector since January 2021. This is largely down to the positive demographic and economic changes, and thematic, underpinning the sector, and the resilience of the sector globally during Covid.

From a performance perspective BTR across more mature global markets has proven its investment credentials over the past two years:

- Rents quickly recovered post lockdowns and easing of restrictions
- Low voids, strong rent collection, minimal arrears and elevated renewals throughout
- Overall decreasing availability of rental product fuelling demand and sustaining occupancy
- Solid income growth

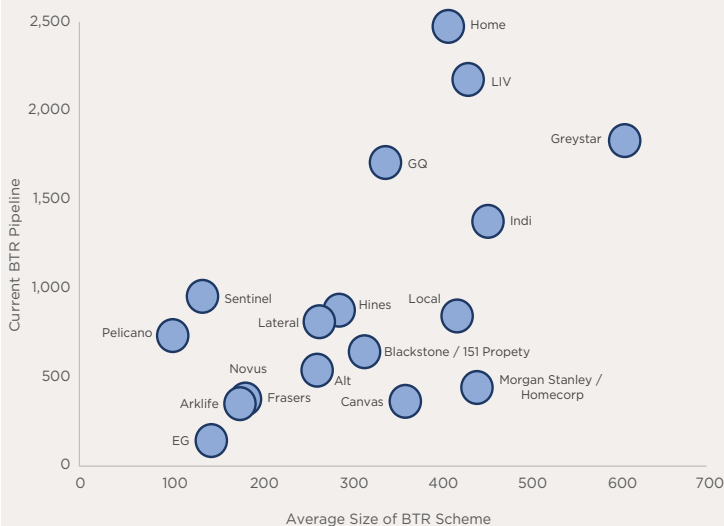
The performance evidence from global markets has had three knock on effects for the Australian market – the first is that it has given confidence to a much broader range of investors to enter the market; secondly, the institutions already active are accepting lower hurdle rates of return as the asset class is being priced according to a reduced risk profile; and thirdly, Australia continues to offer attractive yields compared to other more mature (North American and European) markets.

Despite the headwinds of an inflationary environment, residential is likely to be more sheltered from a forthcoming consumer spending squeeze (tenants will pay their rent before spending on more non-essential items). Rental accommodation has previously proven its resilience throughout periods of high interest rates and inflation, and evidence from increasingly competitive global markets highlights that best-in-class assets are achieving premiums with widespread yield compression.

15,400 Build-to-Rent Units Completed By End of 2024

Australia's institutional grade BTR stock now stands at 3,800 with a further 8,400 units under construction. The future pipeline currently stands at 22,500 units, including those at application stage. This brings the total size of the sector to 34,700 units completed or in development.

Chart 1. Market Segmentation and Diversification Amongst Operators and Investors Becoming Apparent



Source: Savills (*selected groups, reported projects)

Build-to-Rent as an Affordability Buffer

For policy makers, there is also a growing understanding that the delivery of BTR accommodation can help act as a balance to the enraging story of housing deficit, stimulate new housing development, and help counter rising rents. The speed in which BTR dwellings can be delivered to a market, as presales of individual dwellings are not required to commence construction, creates a ripple effect which helps to alleviate rising unaffordability. This is in addition to BTR being a pathway to enabling more affordable and social impact housing to enter the housing system, be it for those at risk of homelessness, sufferers of domestic abuse or for key workers, through ESG principals and strategies of investors and operators.

Rental Vacancy to Remain Low

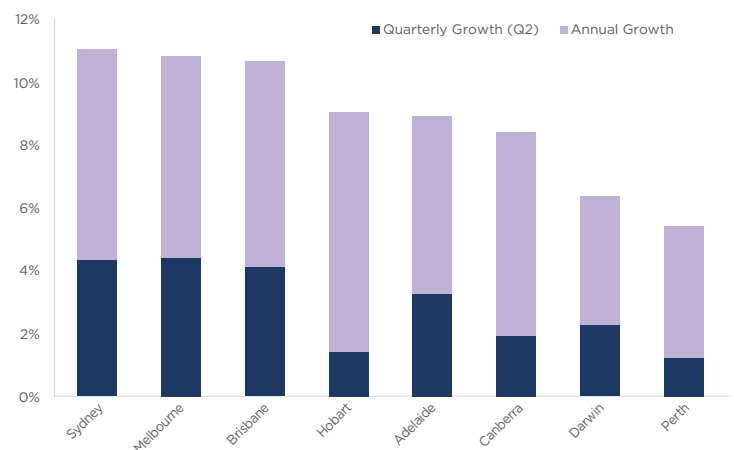
The 2021 Census has revealed that the average household has declined from 2.6 in 2016 to 2.5 in 2021. Much evidence has suggested that the decline has been recent. The shift to wanting more space has been a result of the pandemic, which has seen a decline in group households and a rise in lone person households. As such, the decline in average household size has increased demand for homes (by number), a key factor driving down rental vacancy rates (along with persistently low rental supply), even as the international border was closed, and population growth declined to zero.

Across Australia as a whole, a decline from 2.6 to 2.5 persons per household is the equivalent of requiring an additional 400,000 households to match increased demand. With projections for the formation of smaller households to continue, and immigration increasing, alongside the return of over 282,000 international students in the seven months since early December, record low vacancy rates are forecast to remain lower for longer.

Oversized Rental Growth Performance to Persist

Residential rents across Capital Cities have moved in different directions and at different speeds over the past 10 years. More recently, rents have increased above trend after a period of easing. According to CoreLogic, this sustained period of strong rental growth has seen national dwellings record the highest annual growth in rental values (9.5%) since 2008. Factors driving the upswing include increased government stimulus throughout the pandemic, accumulated household savings through lockdown periods, the swift economic recovery seen as restrictions eased, rapid declines in vacant rentals, the opening of the international border and a contraction in housebuilding. Most recently, inflation and rising interest rates are contributing to oversized rental growth.

Chart 2. Oversized Rental Growth Occurring Across All Markets



Source: CoreLogic, Domain, Savills

Rental Accommodation a Hedge Against Inflation

The inflation rate is one of those factors which has a direct relation to interest rates. Residential rental property prices tend to move in line with inflation and for that reason rental property is a great hedge against inflation.

The Reserve Bank of Australia (RBA) attempts to influence the rate of inflation by setting and adjusting the cash rate. Interest rates and inflation tend to be inversely correlated. In general, as interest rates are reduced, more people can borrow more money. The result is that consumers have more money to spend, and in theory causes the economy to grow and prices (inflation) to increase.

The opposite holds true for rising interest rates. As interest rates are increased, consumers tend to save because returns from savings are higher, or they have less money to spend due to higher mortgages. With less disposable income being spent, the economy slows, and prices (inflation) decrease. As the interest rate determines the price of holding or loaning money, when interest rates are low, individuals and businesses tend to demand more loans. With interest rates increasing demand for residential mortgages has slowed, and house prices have begun to decline.

However, the resilience of the wider economy in recent months is most evident in the labour market. Employment has grown significantly, and the unemployment rate is at multi-decade lows. Job vacancies and advertisements are at high levels and further declines in unemployment and underemployment are expected.

Many banks and forecasters expect headline inflation to be approaching a peak, but to remain well above central banks' targets into 2023. As reported in the last RBA inflation report, while stronger than expected, it showed price growth picking up in services closely linked to reopening of the economy. The consensus holds that as such bottlenecks and pent-up demand fade, inflation should moderate, but rent, could be the big exception to that.

With renters making up one-third of the housing market, such strong inflation could spark intense rental price rises. Elevated inflation expectations can drive real inflation higher, as businesses tend to raise prices and workers ask for higher wages when they expect price growth to accelerate. In a tight labour market, employees are demanding higher wages as compensation for higher living costs. Growth in the Wage Price Index is forecast to pick up to 3.0% by the end of 2022. Wage growth is then forecast to strengthen further as the unemployment rate maintains at recent lows, to be 3.9% by the end of 2024. This wage growth would be the fastest pace since 2011, the expectation is for oversized rental growth to continue for the medium term as supply side issues remain.

The ABS CPI results differ widely from other private data providers which are all reporting strong rental growth in the year to June. The reason likely relates to the fact that the ABS measures rents currently being paid across the market whereas other private providers measure newly signed rents. Therefore, the ABS CPI measure of rental growth is badly lagging, and if this assumption is true then the ABS CPI rental measure will continue to rise which will add to inflationary pressures.

Chart 3. Strong Wage Growth a Stimulus for Rent Increases



Source: Australian Bureau of Statistics, Savills

Yields Remain Attractive Compared to Maturing Markets

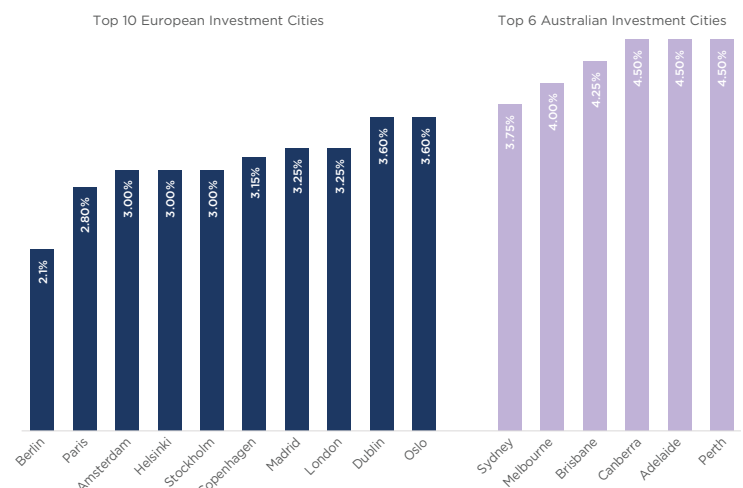
The yield stability currently being referenced across Australian Build-to-Rent reinforces how investors are attracted to the sector for the long-term income streams it generates. It also suggests they view recent challenges to global mobility caused by border closures as temporary, not structural.

As Build-to-Rent matures as an asset class globally, we have seen the type of capital targeting the sector change. The balance of BTR investors has shifted toward lower cost-of-capital investors such as pension funds and sovereign wealth, a step already taken in Australia.

We consider that the influence of increasing interest rates through 2022 will have a limited impact on yields and discount rates moving into 2023, as the level of capital allocation to BTR for Australia places downward pressure due to the strong thematic, and outweighs any negativity surrounding rising construction and debt costs.

Investors are also being attracted to operational assets such as BTR in the current inflationary environment as the granularity of the revenue streams across multiple tenants allows landlords to recoup inflation cost pressure through increasing rents on a regular basis, rather than fixed mechanical increases as would be seen in a long-term commercial office lease.

Chart 4. Australia Offers Attractive Yields Compared to European Benchmarks



Source: Savills (Q2 2022 Prime Multifamily Net Yield)



Savills Team

Please contact us for further information

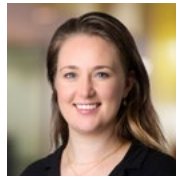
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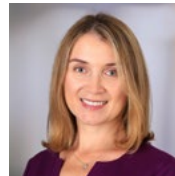
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