Environment, Planning and Sustainable Development Directorate and ACT Suburban Land Agency

# Build to Rent Feasibility Analysis

*Amended Report Following SLA Engagement*

PAXON GROUP

Corporate Finance
Management Consulting
Project Finance and Infrastructure

Perth • Sydney • Melbourne • Brisbane • Adelaide • Darwin | August 2021 – Version 1.

Environment, Planning and Sustainable Development Directorate

# Build to Rent Feasibility Analysis

# Stage 1: Research

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Perth • Sydney • Melbourne • Brisbane • Adelaide • Darwin | July 2021 –Final Report

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# 1 Executive Summary

Paxon Group (Paxon) has been engaged by Environment, Planning and Sustainable Development Directorate (EPSDD) to prepare a Build to Rent (BtR) Feasibility Report and associated financial model.

The report is being delivered over three stages as follows:

- Stage 1: Research
- Stage 2: Feasibility Analysis
- Stage 3: Expression of Interest (EOI) Considerations

This stage, Stage 1, provides in depth analysis of the interrelationship between market drivers and policy context specific to the ACT. In doing so, it identifies the issues and opportunities that could be explored by the ACT Government to facilitate the development of a market BtR asset class.

In addition, this paper considers the market constraints and opportunities available to the ACT Government to contribute to the supply of affordable rental housing, including through BtR developments.

### Background

The ACT Government is looking to the growing BtR sector to boost the amount of affordable and secure rental housing in the ACT, which has one of the tightest and most expensive rental markets in the country. Concurrently, the ACT Government is seeking to implement a range of initiatives to fast track infrastructure investment that improves access to the housing continuum as part of its response to the COVID-19 pandemic and its economic impacts.

The ACT Government has a long held commitment to intervene where the housing market fails to provide for people in its community, with key objectives of the ACT Housing Strategy (2018) to grow the supply of affordable private rental properties, as well as provide better protections and security of tenure for low income households. Its strong desire to find lasting solutions to the problem of affordable housing, as well as deliver on the Parliamentary Agreement commitment to the development of affordable rental housing, are key drivers of the Government's commissioning of this research.

### Benchmarking

The market BtR model, which focuses on increasing the supply of long term rental housing, is an established practice in both the UK and USA. However, it is very much in its infancy in Australia, mainly due to current property market conditions and the taxation landscape.

Other jurisdictions in Australia are currently introducing a number of new stimulants to encourage greater expansion of the model, including land tax concessions, planning policy reforms and rental payment subsidies. These measures, however, are largely untested and it is not yet known whether they will have any significant impact on the development of a sustainable BtR asset class.

## BtR Characteristics

BtR can be defined as a type of residential development that comprises purpose-built rental accommodation, which is held in single ownership and held as a long-term revenue-generating asset.[1] The asset characteristics make the product attractive to the renter, as well as being matched to the investor type, as detailed below.

To appeal to tenants, BtR developments tend to have:

- Higher levels of amenity and inclusion of premium onsite services;
- Situated in long term desired locations – inner city, close to facilities, transport and employment nodes; and
- Include a commercial and/or retail component.

Characteristics matched to the investor type, include:

- Single ownership, held long term;
- Traded as an operating asset with rents generally charged above market rent;
- Large scale ~ 100-300+ units;
- Unique design features, such as smaller apartment sizes, higher density and increased Plot Ratio[2]; and
- Tailored towards delivering long term sustainable yield, lower than that required by typical property developers (due to longer term nature of BtR project).

## Location Parameters

The location parameters of BtR developments are matched to the characteristics outlined above, and based on precedents in USA and UK developments, are typically developed on sites with strong renter appeal. Key location parameter considerations include:

- Access to transport and employment nodes;
- Located near anchor institutions, such as universities and hospitals;
- Larger land holdings appropriately zoned for medium to high density to allow land costs to be amortised across a larger number of units (to allow scale);
- High rental demand;
- Consumer sentiment for higher density living;
- High rental yield to ensure the income return is sufficient to accommodate debt;
- Good underlying economics, including stable employment and population with low market volatility; and
- Smaller household compositions conducive to living in smaller sized apartments, often with increased Plot Ratio.

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[1] BtR in Australia: Product Feasibility and potential affordable housing contribution, July 2019

[2] Plot Ratio means the gross floor area in a building divided by the area of the site

## Market Fundamentals

Key market fundamentals need to be present to support the development of a sustainable market BtR asset class. Analysis of key property market metrics for the ACT market with comparison to Sydney and Melbourne is provided below.

**Table 1: Market Metrics**

| Market Characteristics | Canberra | Sydney | Melbourne |
|---|---|---|---|
| **Rental Yield[3]** | 5.3% | 3.5% | 3.5% |
| **Rental Vacancy[4]** | 0.9% | 3.6% | 4.4% |
| **Median Weekly Unit Rent[5]** | $495 | $470 | $388 |
| **Weekly Household Income[6]** | $2,087 | $1,750 | $1,542 |
| **Unemployment Rate[7]** | 3.7% | 6.3% | 6.9% |

Analysis of the above key metrics show that the ACT property market is largely favourable compared to Sydney and Melbourne to support the development of market BtR. Canberra has strong rental yields, low vacancy rates, higher incomes and a stable workforce.

Furthermore, the ACT property market has shown to be fairly resilient with no indication that it has been adversely affected by COVID-19 pandemic (although it is noted that the ACT Government has introduced a number of measures to soften the impact of COVID-19[8]). Together, these metrics indicate a good platform to support the development of a BtR asset class in the ACT.

## Constraints on Uptake of BtR

Despite the favourable property market conditions in Canberra, the BtR product has failed to develop in the ACT. The table below provides a summary of the factors that that are potentially limiting investor interest in BtR product in the ACT. Each of these factors are discussed in more detail in the body of the report.

**Table 2: Limiting Factors**

| Factor | Description |
|---|---|
| **Comparable Yield** | BtR as an asset class sits below the risk-return curve of other asset classes in Australia, which has been somewhat influenced by Commonwealth taxation policies. |

[3] https://sqmresearch.com.au/property-rental-yield.php?region=vic%3A%3AMelbourne&type=c&t=1

[4] https://sqmresearch.com.au/graph_vacancy.php?region=vic%3A%3AMelbourne&type=c&t=1

[5] Domain Rent Report, December quarter 2020: https://www.domain.com.au/research/rental-report/december-2020

[6] https://www.abs.gov.au/statistics/labour/earnings-and-work-hours/average-weekly-earnings-australia/may-2020#state-and-territory-earnings

[7] ABS 62020.2 Labour Force, Australia

[8] https://www.revenue.act.gov.au/covid-19-assistance#:~:text=Landlords%2C%20who%20reduce%20rent%20on,limit%20of%20%241%2C300%20per%20quarter.&text=If%20your%20application%20is%20approved%2C%20we%20will%20apply%20this%20contribution,to%20your%20land%20tax%20account.

| Factor | Description |
| --- | --- |
| **Land Availability** | The availability of sites for purchase by BtR developers that are suitably sized and located. In addition, typically lower yields means that BtR developers are often at a disadvantage to Build to Sell (BtS) developers in bidding for sites. |
| **Absorption Rates** | The limited ability of the ACT market to absorb large scale residential rental developments given the relatively small size of the market (for example, there are only around 900 dwellings available for rent at any given time). |
| **Size and Scale** | The size and scale of BtR developments required to encourage institutional investment and offset transaction costs. |
| **Tenant Appetite** | ACT has a significantly lower rate of net overseas migration; a key driver of tenant demand for BtR developments. |
| **Land Use Planning Constraints** | Planning policies that do not readily accommodate the unique features of BtR product. |
| **Less Favourable Planning and Taxation** | Taxation and planning treatment of BtR developments are often seen as less favourable than BtS, including:<br>• Land Tax and Rates (given dwellings are retained rather than sold to the market);<br>• Charging of commercial rates to mixed use developments that are not unit titled; and<br>• Lease Variation Charges when recycling stock. |
| **Amendments to Residential Tenancies Act 1997 (RTA)** | Recent changes to the RTA that impact the ability of BtR developers to increase rents by more than 10% above CPI. |
| **Cost of Debt** | Ability of BtR projects to achieve satisfactory gearing and debt cost. |

## Solutions to Constraints

Potential solutions that governments can use to overcome these barriers are detailed in the table below. It is noted that these approaches may not be applicable or currently allowable in the ACT under current planning guidelines and as such would require further work to determine suitability or support for such changes.

**Table 3: Solutions**

| Constraints | Solutions |
|---|---|
| **Land Availability** | • Releasing land with a lease restriction for the specified purpose of BtR developments;<br>• Provision of Government owned land for BtR developments;<br>• Provision of Government land with a Crown lease purpose clause of BtR with potential for covenants preventing unit-titling<br>• Providing Government land under a long term leasehold, with commitments for inclusion of BtR housing. Other jurisdictions have provided leasehold terms of up to 49 year, but it may be as long as 20 years depending on project economics;<br>• Zoning overlays that restrict use of land for purposes other than BtR, so that BtR becomes the highest and best use of land; and<br>• Variant of the Land Rent Scheme. |
| **Size and Scale** | • Aggregate sites – providing scale through a combination of smaller sites; and<br>• 'Salt and pepper' developments, whereby sites are spread throughout a local area. |
| **Absorption** | • Drip feed development into the market, or provide a mitigant for lower revenues due to delayed take-up of rental stock, by:<br>  o Delaying land purchase payment; and<br>  o Delaying taxes / duties. |
| **Taxation Treatment** | • Exemptions or concession on land tax, rates, stamp duties or lease variation charges; and<br>• Introduction of an apportionment mechanism for mixed use developments that are not unit titled to address equity issues. |
| **Planning Policy** | • Introduction of more flexible planning policies specific to BtR developments, such as:<br>  o Greater flexibility to increase plot ratio requirements to account for greater prevalence of shared facilities;<br>  o Greater flexibility to reduce minimum car parking requirements; and<br>  o Concessional planning allowances, such as greater density or height. |
| **Grants** | • Provide one-off cash grants through upfront capital contribution or rental subsidy / guarantee. |

Provision of land is often seen to be one of the most efficient forms of support from a government perspective to stimulate BtR market. This is because funding of the land purchase is generally the most challenging from a project feasibility perspective as it is required early in the development project cycle and is usually required before planning approval is received. Victoria has adopted this approach with its public housing renewal program, whereby market BtR developments are being built alongside social housing developments on public land.

### Benefits and Risks of Market Intervention

The key benefits of governments intervening in the market place to support the development of a BtR asset, include:

- Increased rental supply;
- Diversification of housing typology / adds to the spectrum of rental housing options;
- Improved security of rental tenure with longer tenure leases and reduced turnover of stock;
- Opportunity to partner with the private sector to accelerate delivery of housing supply;
- Monetise government owned lands to meet housing targets;
- Opportunity to potentially include affordable housing (noting this will require additional government investment as BtR developments with affordable housing are unlikely to be viable); and
- Increases housing construction and supports jobs and investment as the economy recovers from the impact of COVID-19.

The key risks in intervening in the market place, include:

- Given the increase in rental supply, it may place downward pressure on rents which may:
  - Artificially deflate private property investment;
  - Place pressure on rental yields and reduce investor's returns;
- Bringing a new source of capital into the market, may adversely impact home ownership affordability given an increase in demand for land;
- Bringing newly built rental product into the market may impact demand for older styled rental properties; and
- Given historically lower yields than BtS, it generally requires some form of investment by taxpayers via government concessions and/or incentives; and
- Public perception of government investment in profit making entities.

### Affordable Renting Housing

Rental affordability is a prevalent theme and priority area of the ACT Housing Strategy (2018). This strategy document defines affordable housing as "*when a household spends less than 30% of their income on housing costs, and that household falls within the lowest 40% of household income*".

ACT has approximately 150,000 households which have been divided into five income quintiles. The ACT Government has identified those in Income Quintile 2 as a demographic in increasing need of affordable rental housing in the ACT.

## Housing Stress

A household is defined as being in housing stress *"when it pays more than 30% of its gross income in housing costs and its income is amongst the lowest 40% of all households."*[9]

The table below shows that those households in Income Quintile 2 paying the median weekly rent of $495 require a subsidy of up to $174 per week to avoid housing stress.

**Table 4: Income Quintile 2**

| Income Quintile 2 | |
|---|---|
| **Annual Income** | $55,000 - $100,000 |
| **Weekly Income** | $1,057 - $1,923 |
| **Affordable Rental Payment** | $321 - $579 |
| **Median Weekly Unit Rent** | $495 pw[10] |
| **Subsidy Required (Excess)** | $174 - ($84) |

The level of rental subsidy is based on the median weekly unit rent (December quarter). In Canberra's inner city suburbs, particularly suburbs like Civic and Acton, where rents are higher than the median, the required subsidy level would be much higher.

## Barriers to Delivery of Affordable Rental Product

Provision of affordable rental housing, being rental housing offered at a discount to market rent, is highly unlikely to be provided by the market, as this is a constraint on the income that can be earned from land and development.

Given project economics, there is generally a need for government investment to offset the financial impact of reduced rental payments. Throughout Australia, this support is typically provided through:

- Community Housing Providers (CHPs) or organisations with a defined purpose of housing provision;
- Sites which are zoned for affordable housing (noting this is currently not possible in the Territory Plan);
- Planning or development restriction requirements which mandate a portion of affordable housing in a development; or
- Land sale contract documents requiring delivery of affordable dwellings.

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[9] ACT Housing Strategy, October 2018, Glossary of Terms

[10] Domain Rent Report, December quarter 2020: https://www.domain.com.au/research/rental-report/december-2020

### Potential Solutions

Potential solutions available to the Territory to overcome the barriers to the provision of affordable rental housing, include:

- Option 1: ACT Government deliver on its own;
- Option 2: ACT Government incentivise the private sector to deliver a mixed tenure development that comprises an affordable housing component; and
- Option 3: ACT Government partner with CHPs.

These options will be further explored in Stage 2 of the BtR Feasibility Report.

# 2 Introduction

## 2.1 Scope of Works

Paxon Group (Paxon) has been engaged by Environment, Planning and Sustainable Development Directorate (EPSDD) to prepare a Build to Rent (BtR) Feasibility Report and associated financial model.

The report is being delivered over three stages as follows:

- Stage 1: Research
- Stage 2: Feasibility Analysis
- Stage 3: Expression of Interest (EOI) Considerations

This stage, Stage 1, seeks to address the lack of BtR research specifically for the ACT context and identify the challenges and opportunities in developing the BtR model.

## 2.2 Background

The ACT Government is looking to the growing BtR sector to boost the amount of affordable and secure rental housing in the ACT, which has one of the tightest and most expensive rental markets in the country. Concurrently, the ACT Government is seeking to implement a range of initiatives to fast track infrastructure investment that improves access to the housing continuum as part of its response to the COVID-19 pandemic and associate d economic impacts.

The BtR model, which focuses on increasing the supply of long term rental housing, is an established practice in both the UK and USA. Its uptake in Australia, however, has been slow with other jurisdictions in Australia currently introducing a number of new and largely untested stimulants to try to encourage greater expansion of the model.

This Feasibility Report, Stage 1: Research provides in depth analysis of the interrelationship between market drivers, policy context and the viability of BtR specific to the ACT. In doing so, it identifies the issues and opportunities that could be explored by the ACT Government to facilitate the development of a market BtR asset class.

In addition, this paper considers the market constraints and opportunities available to the ACT Government to contribute to the availability of affordable rental housing, including through BtR developments. The ACT Government has a long held commitment to intervene where the housing market fails to provide for people in its community, with key objectives of the ACT Housing Strategy (2018) to grow the supply of affordable private rental properties, as well as provide better protections and security of tenure for low income households. Its strong desire to find lasting solutions to the problem of affordable housing, as well as deliver on the Parliamentary Agreement commitment to the development of affordable rental housing, are key drivers of the Government's commissioning of this research.

## 2.3 Policy Objectives

Paxon understands that the ACT Government is keen to explore the BtR model as a pathway to meet the following two policy objectives:

1. Increase the supply of private rental accommodation; and
2. Increase the supply of secure long term affordable rental housing for households in Income Quintile 2.

A market BtR development, by definition, is not an affordable housing product and will not achieve the second policy objective. This is because the economic conditions and drivers for market BtR and affordable rental housing are very different.

Accordingly, this research paper separately discusses the market BtR product and a BtR model that incorporates affordable housing and identifies the respective barriers and potential solutions of each model to achieving the above policy objectives.

# 3 Benchmarking

The following section provides an overview of the status of BtR sector in Australia and internationally. It also discusses the range of levers currently being used by Australian jurisdictions to stimulate the sector and identifies the benefits and risks of market intervention.

## 3.1 BtR Models in Australia

The BtR asset class is very much in its infancy in Australia, mainly due to current property market conditions and the taxation landscape. However, as governments continue to introduce policy and support measures for BtR developments, the BtR market has been increasingly attracting interest from property developers across Australia and internationally.

Recent reports in the media suggest that Australia's BtR pipeline grew by a staggering 68 per cent through 2020, with over 40 projects incorporating 15,000 units.[11] Of these projects:

- 55 per cent are in Melbourne;
- 25 per cent in NSW; and
- 15 per cent in Queensland.

However, despite the strong pipeline of projects, there is a risk that many of the projects will not be able to secure financing with banks taking a very conservative approach to lending to the emerging BtR sector. The managing director of Greystar Australia, Chris Key, has been quoted as saying this may be as high as 50% of projects[12].

### 3.1.1 Market BtR Developments

The main players entering the Australian BtR market include:

- Mirvac – An Australian ASX listed property group whose business encompasses residential, office & industrial, retail and build to rent developments. Mirvac currently has over $23 billion of assets currently under management.
- Meriton – A private company that has designed, developed and built more than 75,000 apartments across the East coast of Australia. Meriton offers sales, leasing and property management services, as well as the luxury accommodation brand Meriton Suites with more than 19 locations nationwide. Meriton assets are estimated to be worth more than $7 billion.
- Grocon – An Australian privately owned development, construction and funds management company founded in 1948. Grocon has undertaken projects across commercial, office, residential, government, social housing, health, hotels and infrastructure, although it has recently gone into Administration casting some doubt on the future of its BtR projects.

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[11] https://www.afr.com/property/commercial/build-to-rent-pipeline-hits-record-high-local-investors-slow-to-react-20210212-p57234

[12] https://www.afr.com/property/commercial/build-to-rent-pipeline-hits-record-high-local-investors-slow-to-react-20210212-p57234

- Sentinel Property Group – An independently owned international real estate investment management firm, headquartered in New York and with corporate offices in Amsterdam and Melbourne. The firm currently has $7.3 billion of institutional quality real estate assets under management on behalf of 107 domestic and international clients.
- Greystar Real Estate Partners - An international real estate developer and manager based in the United States. It has $32 billion in assets under management and manages more than 500,000 units in the US.

Examples of the status of market BtR models throughout Australia are outlined in the table below. This identifies the status of BtR from those in operation to those in planning stages, noting it focuses on projects that incorporate sustainable BtR asset class / market / investment.

**Table 5: Status of BtR Models in Australia**

| Status | |
|---|---|
| **In Operation** | • Various Sydney sites, including 'Signia', Mascot (Meriton)<br>• Subiaco, Perth (Sentinel Real Estate)<br>• Olympic Park, Sydney (Mirvac) |
| **Under Construction** | • Parklands, Gold Coast (Grocon)<br>• Queen Victoria Market, Melbourne (Mirvac)<br>• 31-69 McLister Street, Spotswood (Suleman Group) |
| **Approved yet to commence** | • Southbank Melbourne (Grocon)<br>• St Leonards, Sydney (Grocon)<br>• Richmond, VIC (Salta) |
| **Proposed** | • South Melbourne (Gurner)<br>• Docklands (Salta)<br>• 7-23 Spencer Street, Melbourne (Mirvac)<br>• 395 Albert Street, Brunswick (Mirvac)<br>• Gold Coast (Homecorp Property Group)<br>• South Yarra, Melbourne (Greystar)<br>• Sydney's North West Corridor (Kanebridge Property)<br>• Oaks Stage 3, Woden (Amalgamated Property Group) |

Of note, there are incidences, primarily in Sydney, of private property developers providing BtR style developments. These developments, however, have an important distinction from market BtR developments in that they have arisen in response to changing market conditions where developers have set out to provide a traditional BtS development but with a fall in demand, they have found themselves unable to secure the required level of pre-sales to bank finance. In response to this liquidity event, and having already invested in the land, private developers have sought alternative uses of the site, seen as BtR.

### 3.1.2 ACT BtR Developments

A market BtR asset class has not developed in the ACT to the extent of Sydney and Melbourne. Amalgamated Property Group, however, has recently lodged a development application to construct a BtR project comprising 160 apartments as part of Stage 3 of The Oaks precinct, located in Phillip. Amalgamated will retain ownership of the development and operate the concierge. Residents will have access to the community amenity benefits of the Oaks precinct, including communal gardens, rooftop facilities, a wellness centre, a business centre, breakout zones and also indoor/outdoor dining areas have been designed to promote the community.

The Marquee, in Amaroo developed and owned by Empire Global, is another example of a BtR styled development. The development comprises 107 apartments and 3,000 square metres of commercial space. However, although the development has a single owner with all residential units leased, it does not have all the characteristics of a typical BtR development that charge above market rents in return for premium onsite services.

### 3.1.3 BtR Models with Affordable Housing

In addition to the above examples, there are also incidences of planned BtR models that provide an Affordable Housing component. These include:

- The NSW Land and Housing Corporation (LAHC) BtR project at 600-660 Elizabeth Street Redfern, aimed at delivering more social housing in the inner city as part of the Communities Plus program;
- Frasers Property development at 210 Brunswick Street Fortitude Valley, Queensland which will deliver 144 new affordable housing options to Brisbane as part of a 354-apartment development through Queensland Government's BtR Pilot Project; and
- A Mirvac residential building at 60 Skyring Terrace, Newstead, Queensland which is also part of the Queensland Government's BtR Pilot Project and will provide 99 new affordable housing options as part of its 390 apartments.

## 3.2 Overseas Markets

An overview of the BtR sector in the United States and United Kingdom is provided below.

### 3.2.1 United States

BtR is commonly known as 'multifamily housing' in the US. Multifamily housing is a US term for residential buildings containing five or more rental apartments It is a long-established and steadily expanding component of the American housing system. Multifamily housing developments are constructed or acquired by real estate companies or other financial institutions, primarily as income-generating assets to be held in single ownership for the long-term.

Over the past 10 years, popularity in multifamily housing has soared due to the low-risk, stable returns offered. The sector comprises of approximately 14.5 million units across the 62 largest metro markets in the US, accounting for one in six of America's rental homes. Multifamily housing is aimed at capturing tenants across all income levels, meaning that all people can access housing of their choice. Around 300,000 units are developed annually across the country.

The overall success of multifamily housing in the US is partly driven by the country's financial system, with its competitive nature allowing banks to operate dedicated multifamily arms to finance and grow that sector. Additionally, private capital has also driven the industry in recent years.

The US multifamily housing industry involves several large players. MAA, a Tennessee-based Real Estate Investment Trust, is the largest owner of multifamily housing, with some 100,000 units on its balance sheet. In terms of management, Greystar, who has a proposal under consideration in Melbourne, is the largest manager entity reporting 418,000 dwellings under its control in 2018.

#### 3.2.2 United Kingdom

The BtR market in the UK has seen a revival since 2012, mainly due to government-policy initiatives aimed to grow the sector. BtR developments have been growing strongly across the UK, with the number of homes completed and under construction rising 46 per cent in 2018 compared to 2017. Across the UK, the BtR sector now boasts over 117,000 homes complete, under construction and in planning.

In the UK, BtR developments cover a wide spectrum of properties ranging from relatively basic to extremely luxurious. Core demand for BtR properties has come from millennials who have been unable to enter home ownership.

US and Canadian companies are currently major BtR asset-holders in the UK, bringing their experience of the North American multifamily housing sector to the country. Additionally, UK-based pension funds and insurance companies who are active in the market, as well as a growing number of established not-for-profit housing association providers. Currently, the largest BtR project in the UK is Wembley Park, a 7,600- unit development which is valued at over £3 billion and expected to house 15,000 residents when completed in 2025-26.

## 3.3 Levers being Used by State Governments

Governments across Australia have recently announced a raft of policy and support measures to encourage the uptake of BtR developments. Levers being used include land tax concessions, planning policy reforms and rental payment subsidies.

The following section provides an overview of the stimulants being used by other jurisdictions.

### 3.3.1 New South Wales

In July 2020, the Berejiklian Government announced a package of taxation and planning reforms designed to support the growth of the BtR sector, with the Government finalising the changes on 12 February 2021. These tax and planning policies changes include:

- A 50 per cent reduction in land tax applied to BtR developments until 2040;
- An exemption from the Foreign Investor Surcharge on Land Tax and Stamp Duty;
- Planning provisions that[13]:
  - allow for development of BTR housing anywhere that residential flat buildings are permitted, as well as in the B3 Commercial Core, B4 Mixed Use zones and B8 Metropolitan Centre zones;
  - introduce minimum car parking rates and apply councils' maximum car parking rates where relevant;
  - apply council height and Floor Space Ratio (FSR) standards;
  - prevent residential subdivision for 15 years in all zones, except the B3 zone where the BTR housing development cannot be subdivided into separate lots, in perpetuity;
  - require a consent authority to be satisfied that a BTR housing development in the B3 zone will be readily capable of conversion to commercial premises;
  - support the flexible application of the Apartment Design Guide, requiring consideration of the amenity provided by common spaces and shared facilities; and
  - introduce a State Significant Development (SSD) pathway for BTR housing developments that have a Capital Investment value (CIV) of more than $100 million for the Greater Sydney Region (except in the City of Sydney) and more than $50 million for development on other land.

In addition to the announcements listed above, the NSW Government has devoted an 1.1-hectare parcel of land in the inner Sydney suburb of Redfern for BtR under its Communities Plus program.

### 3.3.2 Victoria

BtR initiatives undertaken by the Victorian Government may be conceptualised into two stages:

- Understanding the barriers to establishing a BtR industry in Victoria; and
- Working with the private sector to develop BtR projects.

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[13] https://www.planning.nsw.gov.au/Policy-and-Legislation/Housing/Diverse-and-affordable-housing/Housing-SEPP/Build-to-rent-housing

In 2018, the Victorian Government launched three initiatives to facilitate BtR in Victoria; establishing an Industry Working Group to advise on growing the BtR Sector, establishing an Advisory Committee and developing a model agreement subject to their legislation. The Build to Rent Standing Advisory Committee provides advice on planning policies and reviews and assesses proposed BtR projects, including permit applications and agreements.

To increase the supply of affordable housing and to stimulate the State economy, Victoria's budget for 2020-21 includes initiatives to promote private developers undertaking build to rent projects. One initiative halves the land tax on BtR developments until 2040, mirroring a policy in NSW. It is estimated that the tax cut will add 5% yield on cost for BtR projects, which is a significant uplift given the typically low yields of these projects.[14] The change means that the tax on BtR projects is now comparable to build to sell projects. Along with the tax cut, BtR Developments will be exempt from the Absentee Owner Surcharge.

The Victorian Government is also working with developers to build private BtR housing alongside social housing developments on public land. The government provides the land under a ground-lease, expected to be around 25 years. A Community Housing Provider is expected to manage the social housing, with the developer retaining ownership of the private development. Sites expected to be developed under this model include public housing estates in Flemington, Prahran, Brighton, North Melbourne, Northcote and Preston.

### 3.3.3 Queensland

The Queensland Government launched a $70 million build-to-rent pilot project in 2018 in which it will partner with the private sector to deliver long-term rental properties and affordable housing close to Brisbane's CBD. The program involves the state partnering with the private sector to deliver low-rental homes and provide affordable key-worker housing options to the inner city. Developers were invited to build properties on privately-owned land, which involved the state government then subsidising rental payments by 25% for a portion of the apartments. Frasers Property Australia and Mirvac have been selected to develop the first two affordable housing projects in Brisbane under the program.

It is understood that this pilot project arose from an unsolicited market proposal to the Queensland Government. The Government determined that the proposal did not present a clear justification as to why it should be considered under an exclusive arrangement as opposed to procurement through a competitive process, and subsequently went through an EOI process to solicit proposals.

The Queensland Government recently announced it will expand the pilot project with two new tender processes released seeking proponents capable of delivering a BtR development with affordable housing components on the State owned site of the former Children's Court, 50 Quay Street and privately owned inner Brisbane site.

[14] https://www.afr.com/property/commercial/build-to-rent-developers-set-for-a-boost-with-new-victorian-tax-break-20201125-p56hsc#:~:text=As%20part%20of%20a%20package,NSW%20in%20July%20this%20year.

# 4 Market BtR Model

The following sections provide an overview of the unique characteristics of the market BtR model that drive the location parameters which make certain areas suited to BtR. It also describes the key market fundamentals, including in the ACT context.

## 4.1 Characteristics of Market BtR

BtR can be defined as a type of residential development that comprises purpose-built rental accommodation, which is held in single ownership and held as a long-term revenue-generating asset.[15] The asset characteristics make the product attractive to the renter, as well as being matched to the investor type, as detailed below.

### Characteristics to appeal to Tenants

To appeal to tenants, BtR developments tend to have:

- Higher levels of amenity and inclusion of premium onsite services, including greater volume and variety of shared facilities and services;
- Situated in long term desired locations – inner city, close to facilities, transport and employment nodes. This often includes location near public transport nodes to reduce car parking requirements; and
- Include a commercial and/or retail component which increases ground level activation and provides additional resident amenity.

### Characteristics matched to Investor Type

As outlined above, investors in BtR developments tend to be large funds with an interest in holding property long term. Characteristics matched to the investor type include:

- Single ownership, held long term;
- Traded as an operating asset with rents generally charged above market rent;
- Large scale ~ 100-300+ units, as this creates a scale of investment which justifies the diligence and project costs associated with such developments;
- Unique design features, such as smaller apartment sizes, higher density and increased Plot Ratio; and
- Tailored towards delivering long term sustainable yield, lower than that required by typical property developers (due to longer term nature of BtR project).

## 4.2 Location Parameters

Based on the characteristics above, it is possible to define the parameters which determine locations more suited to adoption of the BtR model. The location parameters of BtR developments are matched to the characteristics outlined above, and based on precedent in USA and UK developments, are typically developed on sites with strong appeal to renters.

15 BtR in Australia: Product Feasibility and potential affordable housing contribution, July 2019

Key location parameter considerations include:

- Access to transport and employment nodes;
- Located near anchor institutions, such as universities and hospitals;
- Larger land holdings appropriately zoned for medium to high density to allow land costs to be amortised across a larger number of units (to allow scale);
- High rental demand;
- Consumer sentiment for higher density living;
- High rental yield to ensure the income return is sufficient to accommodate debt;
- Good underlying economics, including stable employment and population with low market volatility; and
- Smaller household compositions conducive to living in smaller sized apartments, often with increased Plot Ratio.

Based on these parameters, the following heat map illustrates those locations in the ACT seen to be more conducive to BtR developments.

**Figure 1: Map of Potential Locations for BtR**

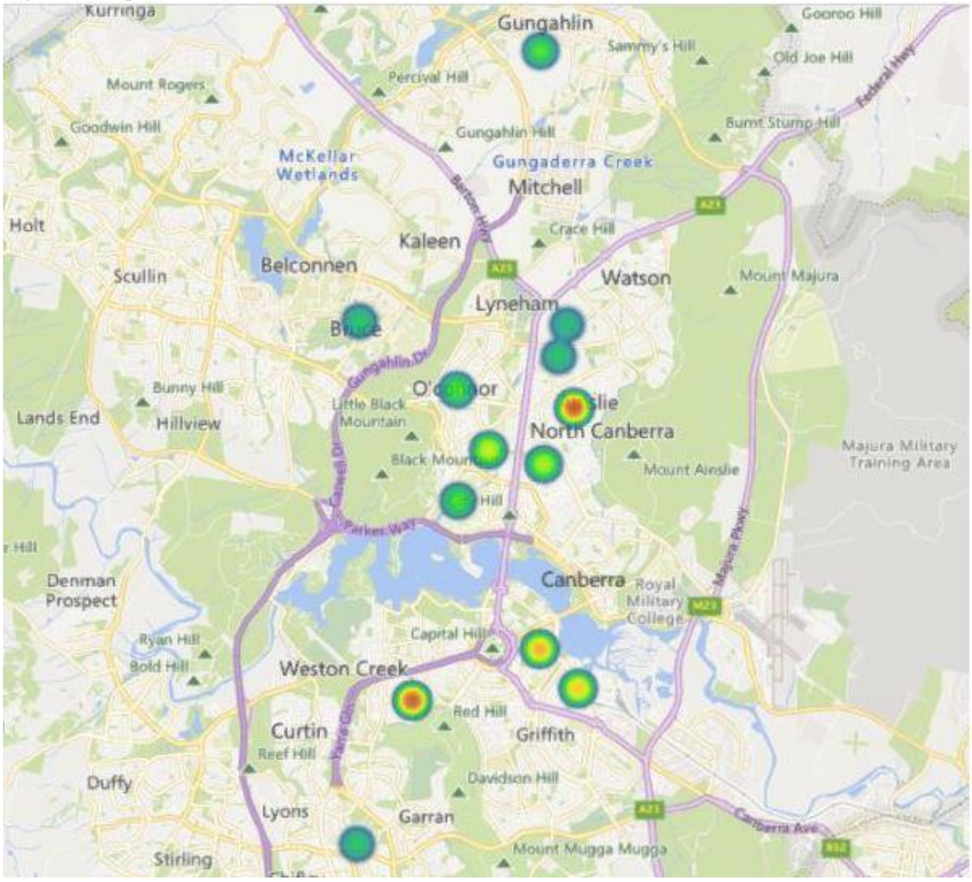



Figure 1 highlights urban locations that are situated in close proximity to transport infrastructure with higher median weekly rents and lower unemployment rates; key location parameters of BtR developments.

## 4.3 Market Fundamentals

In addition to the location parameters identified above, there are characteristics of the real estate market and demographics which also drive viability of the BtR model in some locations. Key market fundamentals for market BtR developments are described in the table below.

Table 6: Market Metrics

| Market Characteristics | Description |
|---|---|
| **High Rental Yield** | High rental yields are required to attract investors. |
| **High Rental Occupancy** | High rental occupancy generally indicates strong demand for rental accommodation, which limits vacancy and turnover of tenants in a BtR development. |
| **Propensity to High Density** | Propensity to high density is important as it is a driver of land cost, reducing the per dwelling cost of land. |
| **Strong Incomes** | Strong incomes are required to support the capacity of tenants to pay higher than market rents, which are generally charged at BtR developments in alignment with the greater facility and service offerings. |
| **Stable Employment** | Stable employment is a driver of tenants' ability to pay above market rents. |
| **Stable Population Growth** | Stable population growth is a key driver of economic growth and underpins long term demand for rental housing stock. |
| **Smaller Household Size** | BtR product is attractive to smaller household sizes given reduced apartment sizes, and tendency for higher density in BtR developments. |

Typically, these characteristics need to be present to support the development of a sustainable market BtR asset class in a localised area.

## 4.4 ACT Context

A number of relevant demographic and property metrics have been identified which align with the market fundamentals outlined above. This section compares these metrics across the greater Canberra, Sydney and Melbourne statistical areas relevant to the uptake of BtR developments, to identify whether there are demographic or economic factors which would make Canberra more or less suited to BtR development than major Australian cities where a BtR class is emerging. Where this data is not available for individual cities, state level data has been used.

### 4.4.1 Rental Yield

The table below shows the rental yield for houses and units for November 2020.[16] Rental yield is the net rental income divided by the median price and does not take capital growth into account.

Table 7: Rental Yield for Houses and Units, November 2020

| Location | Rental Yields | |
|---|---|---|
| | Houses % | Units % |
| **Canberra** | 4.0 | 5.3 |
| **Sydney** | 2.4 | 3.5 |
| **Melbourne** | 2.6 | 3.5 |

The above table shows that Canberra has markedly higher yields for both houses and units than Sydney and Melbourne, supporting BtR style investment.

### 4.4.2 Rental Vacancies

The table below shows rental vacancies for October 2020.[17]

Table 8: Rental Vacancy Rates, October 2020

| Location | Rental Vacancy Rates (%) |
|---|---|
| **Canberra** | 0.9 |
| **Sydney** | 3.6 |
| **Melbourne** | 4.4 |

Canberra's vacancy rate has been trending downwards over the last five years. Canberra recorded a vacancy rate of 0.9 per cent in October 2020, significantly lower than Sydney and Melbourne. A vacancy rate of less than 3 per cent (the industry benchmark rate) generally indicates strong demand for rental accommodation, suggesting potential demand for BtR style product in the Canberra market should it be made available.

[16] https://sqmresearch.com.au/property-rental-yield.php?region=vic%3A%3AMelbourne&type=c&t=1
[17] https://sqmresearch.com.au/graph_vacancy.php?region=vic%3A%3AMelbourne&type=c&t=1

### 4.4.3 Median Weekly Rent

The table below shows the median weekly unit houses and units for the December quarter 2020[18]

Table 9: Median Weekly Rent for Units and Houses (December Qtr 2020)

| Location | Median Units Rent | Median House Rent |
|---|---|---|
| **Canberra** | $495 | $600 |
| **Sydney** | $470 | $550 |
| **Melbourne** | $388 | $440 |

Canberra house and unit rents hit new record highs by the end of 2020. The median weekly house rent has increased by $20 and median weekly unit rents by $15 over both the quarter and the year to $600 and $495 a week respectively. Canberra remains the most expensive capital to rent a house and is now the most expensive city to rent a unit. This is the first time in a decade Canberra has the highest unit rents of all the capitals.

The table below shows a breakdown of the median weekly rent for units by the number of bedrooms. Note this is based on data from the June quarter, given data was not available in this format for the December quarter:[19]

Table 10: Median Weekly Unit Rents, 1, 2 & 3 Bedroom (June Qtr 2020)

| Location | 1-bedroom | 2-bedrooms | 3-bedrooms |
|---|---|---|---|
| **Canberra** | $425 | $500 | $580 |
| **Sydney** | $460 | $520 | $695 |
| **Melbourne** | $360 | $450 | $520 |

Over the past six months, Melbourne and Sydney recorded steep declines in weekly rent for units, due to a combination in the drop of foreign student numbers, overseas migration and tourism as a result of COVID-19. Overall, Canberra was the only city to record an increase in the median weekly rent for units.

### 4.4.4 Returns on Rental Property

In the June quarter 2020, the annual return for a three-bedroom house in Canberra declined by 3.7 percentage points to 5.5 per cent, while the annual yield increased by 0.1 of a percentage point to 3.3 per cent.

The annual return for a two bedroom other dwelling in Canberra increased by 3.3 percentage points to 6.7 per cent in the quarter, while the annual yield declined by 0.2 of a percentage points to 4.2 per cent. These yields, particularly for two bedroom units, are consistent with those seen in areas supporting BtR development, as they are aligned with likely investor expectations.

[18] Domain Rent Report, December quarter 2020: https://www.domain.com.au/research/rental-report/december-2020

[19] Domain Rent Report, June quarter 20202: https://www.domain.com.au/news/one-bedroom-unit-rents-take-biggest-hit-during-covid-19-downturn-new-data-shows-970051/

### 4.4.5 Income

The table below shows the average personal weekly earnings for May 2020.[20]

Table 11: Average Personal Weekly Earnings, May 2020

| Jurisdiction | $/Week | % of ACT |
|---|---|---|
| **ACT** | 1,861.40 | - |
| **New South Wales** | 1,748.90 | 94% |
| **Victoria** | 1,709.00 | 92% |

The table shows that the ACT has the highest average personal weekly earnings. Household income, however, is a more useful metric in the context of housing costs as it reflects the household's ability to support housing payments.

The table below shows median weekly household incomes, noting that this data is less recent than the personal earnings data in the table above.[21] However, this data is at a capital rather than State level.

Table 12: Median Weekly Household Incomes, 2016

| Location | $/Week | % of Canberra Median |
|---|---|---|
| **Canberra** | 2,087 | - |
| **Sydney** | 1,750 | 84% |
| **Melbourne** | 1,542 | 74% |

The table shows that Canberra has the highest median household income, in line with the personal income data, approximately 15% higher than Sydney. This suggests the ability to support higher than market rental payments by a reasonable portion of the population.

### 4.4.6 Rental Costs as a Percentage of Gross Household Income

The table below shows rental costs as a percentage of gross household income for the capital cities.[22]

Table 13: Rental Costs as % of Gross Household Income, 2017-18

| | Private % | Housing Authority % | Total % |
|---|---|---|---|
| **Canberra** | 18.6 | 22.0 | **18.3** |
| **Sydney** | 21.7 | 23.8 | **21.9** |
| **Melbourne** | 20.3 | 22.5 | **20.3** |

[20] https://www.abs.gov.au/statistics/labour/earnings-and-work-hours/average-weekly-earnings-australia/may-2020#state-and-territory-earnings

[21] https://www.abs.gov.au/statistics/labour/earnings-and-work-hours/average-weekly-earnings-australia/may-2020#state-and-territory-earnings

[22] ABS 41300, Table 11.3, Housing Occupancy and Costs, Australia, 2017-18

Table 13 shows that Canberra has the lowest total percentage of gross household income spent on rent. This may be because Canberra has a higher proportion of public housing, as shown in Table 16, and also reflects the higher household income identified above.

### 4.4.7 Unemployment Rate

The table below shows the unemployment rate for October 2020[23].

Table 14: Unemployment Rate, October 2020

| Jurisdiction | % |
|---|---|
| **ACT** | 3.70 |
| **New South Wales** | 6.30 |
| **Victoria** | 6.90 |

The table shows that the unemployment rate for the ACT is markedly lower than that of NSW and Victoria. This is likely because employment in the ACT is dominated by sectors (such as Government), which were less affected by COVID-19 than others. Canberra has had low unemployment figures over a number of years, which supports the ability of the population to engage in long term rental tenure, and for an investor to see certainty in a BtR development over its life.

### 4.4.8 Proportion of Renters and Owners

The table below shows the percentages of households which were owners and renters in FY18.[24] Owners include those who own with and without a mortgage, and renters include private and public (housing authority) landlords. The percentages do not sum to 100% as other tenure types are excluded.

Table 15: Percentages of Renters and Owners, 2017-18

| Location | Owners % | Renters % |
|---|---|---|
| **Canberra** | 63.8 | 34.1 |
| **Sydney** | 62.1 | 36.2 |
| **Melbourne** | 66.7 | 31.3 |

The table shows that Canberra ranks second for proportions of both renters and owners.[25]

[23] ABS 62020.2 Labour Force, Australia

[24] 41300, Table 11.5, Housing Occupancy and Costs, Australia, 2017-18.

[25] 41300, Table 11.5, Housing Occupancy and Costs, Australia, 2017-18

The table below shows percentages of rental households by landlord.

Table 16: Rentals by Landlord Type, 2017-18

| Location | Private % | Housing Authority % | Total % |
|---|---|---|---|
| **Canberra** | 26.1 | 6.8 | **34.1** |
| **Sydney** | 31.2 | 3.6 | **36.2** |
| **Melbourne** | 28.9 | 1.2 | **31.3** |

The table shows that Canberra has a markedly higher percentage of housing supplied by a public housing authority than Sydney or Melbourne.

### 4.4.9 Capital Growth in Housing

The table below shows the annual growth in housing prices from FY19 to FY20,[26] and the average annual percentage change from 1993-2018.[27]

Table 17: Short and Long Term Capital Growth in Housing

| Location | Recent % | Long Term % |
|---|---|---|
| **Canberra** | 3.6 | 6.8 |
| **Sydney** | 8.1 | 7.6 |
| **Melbourne** | 8.8 | 8.1 |

The table shows that capital growth in Sydney and Melbourne is accelerating. However, growth in Canberra's property market appears to be slowing, albeit with a long term average which supports the ability of investors to make a long term return in BtR investments.

## 4.5 Analysis Summary

Analysis of the key metrics show that the ACT property market is largely favourable compared to Sydney and Melbourne to support the development of market BtR. Canberra has strong rental yields, low vacancy rates, higher incomes and a stable workforce. Furthermore, the ACT property market has shown to be fairly resilient with no indication that it has been materially adversely affected by COVID-19 pandemic (although it is noted that the ACT Government has introduced a number of measures to soften the impact of COVID-19 on the sector). Together, these metrics indicate a good platform to support the development of a BtR asset class in the ACT.

[26] Residential Property Market- June Quarter 2020, Chief Minister, Treasury and Economic Development, ACT Government

[27] https://www.aussie.com.au/content/dam/aussie/images/general/rebrand-2020/property-report-graphs/aussie_25_years_report.pdf

# 5 Lack of Uptake

Despite the favourable property market conditions in Canberra, the BtR product has failed to develop in the ACT. This section identifies those factors that are potentially limiting the uptake of market BtR product.

## 5.1 Summary of Constraints

The following table summarises the key factors limiting the uptake of a market BtR asst class in the ACT.

Table 18: Limiting Factors

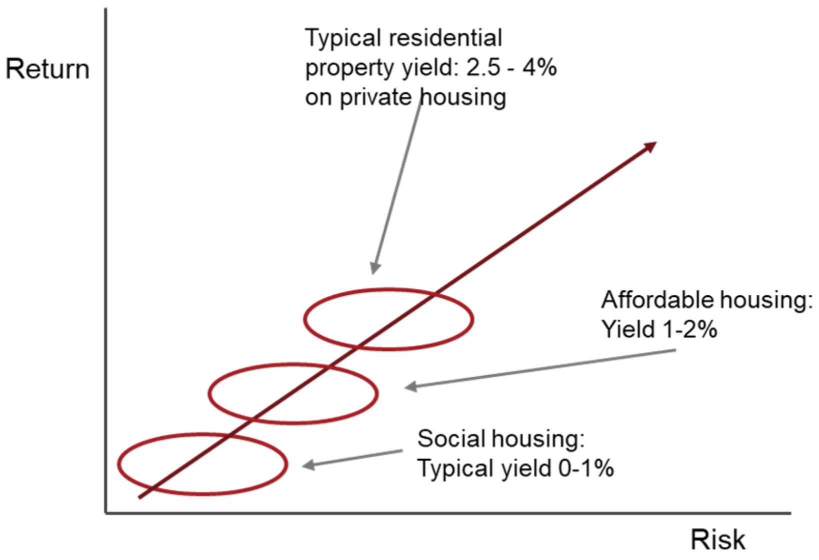
| Factor | Description |
| --- | --- |
| **Yield** | BtR as an asset class sits below the risk-return curve of other asset classes. |
| **Land Availability** | The availability of sites for purchase by BtR developers that are suitably sized and located. In addition, typically lower yields means that BtR developers are often at a disadvantage to Build to Sell (BtS) developers in bidding for sites. |
| **Absorption Rates** | The limited ability of the ACT market to absorb large scale residential rental developments given the relatively small size of the market. |
| **Size and Scale** | The size and scale of BtR developments required to encourage institutional investment and offset transaction costs. |
| **Tenant Appetite** | ACT has a significantly lower rate of net overseas migration; a key driver of tenant demand for BtR developments. |
| **Land Use Planning Constraints** | Planning policies that do not readily accommodate the unique features of BtR product. |
| **Less Favourable Planning and Taxation** | Taxation and planning treatment of BtR developments are often seen as less favourable than BtS. |
| **Amendments to Residential Tenancies Act (RTA)** | Recent changes to the RTA will impact the ability of BtR developers to increase rents by more than 10% above CPI. |
| **Cost of Debt** | Ability of projects to achieve satisfactory gearing and debt cost. |

Each of these constraints are discussed in more detail below.

## 5.2 BtR Yield

Yield refers to the measurement of a future income on an investment and is based on the rental income (does not include capital gain). Typically, as the level of risk increases, the expected level of return increases. The link between return and risk is shown in the figure below.

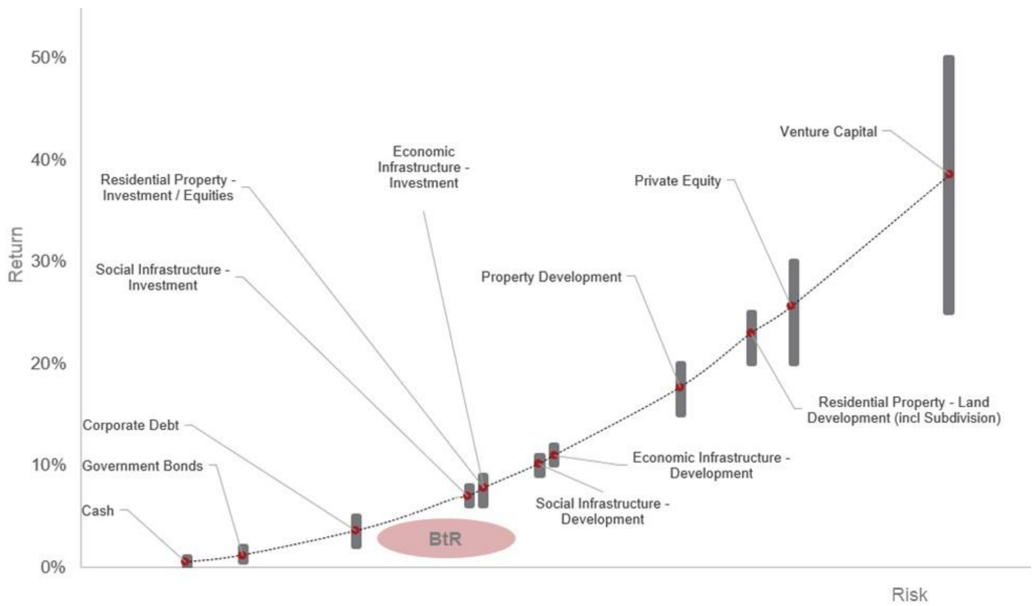
**Figure 2: Residential Property Yields**




As shown in the figure above, typically residential property yields range from 2.5-4%. This compares to affordable housing at 1-2% and social housing, typically around 0-1%, which have lower risk – return profile.

The following figure shows the risk-return curve expectation of various asset allocators, from low risk-low return expectations from cash through to high risk-high return expectations of venture capital.

**Figure 3: Risk-Return Curve Expectations of Asset Allocators**




As can been seen above, BtR developments typically sit below the risk-return curve expectations of other asset allocators in Australia. This has dampened institutional investment in BtR product, not just in Canberra but Australia-wide.

This situation has been somewhat influenced by Commonwealth taxation policies, including negative gearing and capital gains tax that results in 'mum and dad' type investors willingly accepting lower yields due to:

- Capital growth potential (and associated capital gain tax discount); and
- Negative gearing concession (as income return is topped up by negative gearing tax benefits).

This creates a bias towards owning property long term and accepting lower returns. In this environment, it is difficult for institutional investors to compete with 'mum and dad' investors. For this situation to change, the pink bubble needs to either more up or sideways (left) so that it hits the risk-return curve. Levers that government can use to assist this are discussed in subsequent sections of the report.

In addition, lower yields means that BtR developers tend to be at a disadvantage to BtS developers in terms of purchasing land. Given BtR developers tend to see lower immediate profits they can

## 5.3 Land Availability

BtR developments generally require large land holdings appropriately zoned for medium to high density residential developments, in locations that have strong appeal to renters with good access to transport and employment nodes.

The availability of sites for purchase by BtR developers that are suitably located and of sufficient scale may be a factor in attracting BtR investor interest in the ACT. In addition, typically lower yields means that BtR developers are often at a disadvantage to BtS developers in terms of purchasing land. All other factors being equal, BtR developers can generally afford to bid less than BtS developers for land given lower immediate profits (as dwellings will be retained rather than sold to the market).

## 5.4 Scale and Absorption Rates

BtR developments tend to be of significant size and scale (~100 to 300+ units). This level of scale is required to encourage institutional investment and offset significant transaction costs.

In providing the level of scale required, a key constraint is the capacity of the ACT market to absorb large scale residential rental developments. The table below compares the size of the market in ACT to NSW and Victoria.

Table 19: ACT Demographic and Property Metrics

| Metric | ACT | Sydney | Melbourne |
|---|---|---|---|
| **Population (millions)** | 0.30 | 5.00 | 4.70 |
| **Number of Dwellings (millions)** | 0.11 | 1.90 | 1.80 |
| **Properties Available to Rent** | 941 | 31,000 | 26,000 |

As can been seen in the table above, the ACT has a significantly smaller population and housing market compared to Sydney and Melbourne. This adversely impacts the market's potential capacity to absorb large scale developments. This is particularly evident when considering the number of properties for rent in Canberra at any point in time being around 900.

Delivering 200-300 plus units into the Canberra market will have a much greater impact than in Sydney, where there are over 30,000 properties for rent. This effect could include slow uptake of new rental stock, which impacts on the return from a BtR development, or a broader negative impact on sales and rental values in the surrounding area due to excess supply. This is turn affects the return from BtR, as the rental amounts charged will be benchmarked against market rents.

Nevertheless, Canberra's current low rental vacancy rate (0.9%) may act as a mitigant against the absorption risk. This was evident with the leasing of the 107 unit development in Amaroo, the Marquee, that was tenanted within 7 weeks, albeit with up to 8 weeks rent-free.

## 5.5 Tenant Appeal

BtR product appeals to those segments of the market that prefer a high-density urban lifestyle. As a result, tenant demand, as evident in BtR developments in Sydney, is often driven by overseas migration, particularly from those migrating from areas with a high proportion of households occupying apartment or other high density housing options. This is because this demographic of the market often dislikes long commutes, spread out services, high transport costs, car dependence, quietness, and social isolation associated with a low-density, suburban lifestyle, and seek out high-density urban forms that are similar to their previous environments. Furthermore, they tend to be willing to pay a premium for product that meets their living preferences, rather than seek out a more affordable suburban, car-oriented lifestyle.

Net overseas migration is the net gain or loss of population through immigration (overseas migrant arrivals) to Australia and emigration (overseas migrant departures) from Australia. The table below compares the net overseas migration of ACT to NSW and Victoria.

Table 20: Net Overseas Migration

| Metric | ACT | NSW | Victoria |
|---|---|---|---|
| **Net Overseas Migration** | 3,100 | 86,200 | 84,500 |

As expected, ACT has a significantly lower rate of net overseas migration compared to NSW and Victoria, a key driver of demand for market BtR product.

## 5.6 Inflexible Planning Policy

ACT's planning system and policies make provision for the zones in which residential development will be allowed, and the standards residential developments are required to meet. Generally speaking, this is done without distinction between properties that are intended for owner-occupier and properties that are intended for rental which means that BtR developments are subject to the same planning system and policies as BtS developments.

BtR developments, however, are unique, and as a long term rental business, they require a different built form to BtS developments to ensure their returns are competitive. In particular, BtR would require more space for:

- Additional services (for example, gyms, libraries, dog-walking areas, yoga classes);
- On-site management functions (for example, leasing suites, community managers' offices); and
- Traffic (for example, wider corridors, goods lifts, loading docks for deliveries and removalists).

To accommodate these features and others, BtR developments may benefit from more flexible planning policies, such as:

- Increased Plot Ratio;
- Reduced individual dwelling size (in return of shared amenities); and
- Reduced car parking requirements.

Whilst there is some flexibility under the Territory Plan to accommodate these requirements, there may be benefit in having specific planning policies for BtR developments as recently introduced in NSW. This includes greater flexibility in some planning rules to ensure the special design and amenity features of BtR developments can be delivered (refer to section 3.3.1). It is noted, however, that further work would be required to determine the suitability or level of community support for such planning policy changes in the ACT.

## 5.7 Non-Favourable Tax Treatment

BtR developments, when compared to BtS, are often seen to be unfavourably taxed. Taxation treatment of BtR developments is not necessarily a uniform impediment but may apply to individual developments making individual projects more challenging. In the ACT context this includes:

- Mixed use developments – Currently mixed-use development in the ACT that are not unit-titled are charged commercial rates (which are significantly higher than residential). Whilst mixed use developments can be unit titled, where rates are apportioned between commercial and residential uses (i.e. the commercial units pay commercial rates, the residential units pay residential rates), this adds a layer of legal and planning complexity that anecdotally is seen to be a limiting factor with BtR developments, given they commonly include a commercial component.
- Lease Variation Charges (LVC) - A LVC is applied when a lease holder receives permission from the ACT Government to vary their lease to enable new or additional development. LVC is currently calculated as 75 per cent of the uplift in value of the lease from the new or additional development. At this rate, it can be costly for developers to redevelop old commercial stock into new residential BtR developments. Furthermore, LVC is a tax unique to the ACT and when applied, increases the cost of development (although it is noted that other jurisdictions have different development levies which also add cost).

- Stamp Duty, Land Tax and Rates - In 2012, the ACT Government began phasing out stamp duty. To compensate for the loss of revenue, the Territory Government introduced higher rates. This negatively impacts BtR developments compared to BtS developers, who as long term property holders are subject to higher recurrent costs, rather than an initial once off payment. It is noted, however, that the upfront saving may assist with project feasibility in the early stages of the development project lifecycle.
- Federal Taxes - At a Commonwealth level, the treatment of GST, MIT Withholding and Income Tax also has an impact on BtR viability.
  - Currently local investors are unable to claim GST credits on the land and construction costs incurred to develop a BtR project (which is available for BtS developments). Residential rents are not liable to GST, so therefore BtR developers incur the full 10 per cent GST costs on any BtR development.
  - Foreign investors can invest in residential real estate in Australia through an MIT, however, will be subject to a 30 per cent MIT rate. This compares to other real estate asset classes (commercial, retail, industrial, leisure etc.) that are eligible for the 15 per cent MIT concessional tax rate. Affordable housing, a subset of the residential asset class, is now also eligible for the concessional 15 per cent MIT rate due to recent reforms. Based on this, BtR developments may attract a significantly higher income tax impost for foreign investors when compared to other real estate asset classes if they are not eligible for the 15 per cent MIT concessional tax rate.

## 5.8 Amendments to Residential Tenancies Act

Recent changes to the *Residential Tenancies Act 1997* (the RTA) include the provision that property rent increases must not be 'excessive'. Generally, a rental rate increase is presumed to be excessive if it is more than the amount set under the legislation: the 'prescribed amount.' There is a formula for calculating the prescribed amount, but in simple terms, this is ten percent more than the increase in the rents component of the housing group of the Consumer Price Index (CPI).[28]

This will impact the ability of BtR developers to increase rents by more than 10% above CPI, and therefore may act as a potential deterrent to BtR developers.

## 5.9 Cost of Debt

In order to be successful, BtR projects rely heavily on low cost capital, primarily from institutional investors, however the property development and financial landscape in Australia currently makes this difficult.

Australian BtS development is predominantly debt-financed through project finance provided by banks, while some larger BtS developers also borrow at a corporate level in money markets. BtR development requires a different level of finance, involving a mix of debt and equity finance, which will require funding from a wider range of financial institutions, including superannuation funds, foreign pension funds and sovereign wealth funds.

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[28] Fact Sheet: Residential Tenancies Amendment Act 2019: Excessive Rent Increases: https://www.justice.act.gov.au/sites/default/files/2019-10/Fact%20Sheet%20-%20Residential%20Tenancies%20Amendment%20Act%202019%20-%20Excessive%20Rent%20Increases.pdf

The current financial landscape in Australia may prohibit BtR developers from achieving the required level of gearing and financing terms to undertake projects in the ACT. For example, Sentinel Property Group's BtR development in Perth was 100% equity financed as they were unable to secure third party finance due to the banking sectors' limited understanding of the asset class and risk adverse stance.

# 6 Solutions to Constraints

As listed above, there are several factors that are limiting the uptake of market BtR developments in the ACT. However, there are potential solutions that governments can use to overcome these barriers. These are detailed below and will be further explored and tested in subsequent stages of the BtR Feasibility Analysis.

## 6.1 Land Availability

Land supply and availability is a significant impediment to BtR developments. Governments can seek to address the land supply issues through:

- Releasing land with a lease restriction for the specified purpose of BtR developments;
- Provision of Government owned land for BtR developments;
- Provision of Government land with a Crown lease purpose clause of BtR with potential for covenants preventing unit-titling
- Providing Government land under a long term leasehold, with commitments for inclusion of BtR housing. Other jurisdictions have provided leasehold terms of up to 49 year, but it may be as long as 20 years depending on project economics;
- Zoning overlays that restrict use of land for purposes other than BtR, so that BtR becomes the highest and best use of land; and
- Variant of the Land Rent Scheme.

## 6.2 Size and Scale

To overcome the need for significant scale without impacting the market's capacity to absorb the development, there may be opportunity to:

- Aggregate sites, where the required scale is achieved through a combination of smaller sites; or
- 'Salt and pepper' developments, whereby sites are spread throughout a local area.

By diluting the concentration of the BtR development, it will be easier for the market to absorb the new product without impacting rental values in surrounding areas. This may involve government releasing a number of smaller sites that can be developed as a single BtR project.

BtR investors' appetite for bundling of sites will be tested as part of the market sounding process to be undertaken as part of Stage 2.

## 6.3 Absorption

Another solution to address absorption issues is to drip feed product to the market, rather than flooding the market by releasing all new product at once. The issue with drip feeding product, however, is that developers receive reduced rental revenue until all the product is released and tenanted.

To assist developers with cash flow during this time, Government could delay:

- Land purchase payment; or
- Payment of taxes and/or duties.

## 6.4 Taxation Treatment

Government may consider changes to the tax treatment of BtR developments to assist with BtR project viability and uptake.

A reduction in land tax is the most common lever being applied across other jurisdictions. The general argument put forward as to reducing land tax on BtR developments is based on the premise that if the land is used as a BtS rather than BtR, the Government would be likely to receive less revenue from land tax. This is due to some purchasers being owner occupiers who do not pay land tax. Therefore, reduced land tax does not necessarily constitute revenue foregone by Government in this instance.

Other taxation levers include stamp duty exemptions or concession on rates. There is an argument that the phasing out of stamp duty and the associated increase in rates to offset the lost revenue has placed BtR developments at a disadvantage to BtS developments given they hold onto assets long term and that Government should seek to rectify the imbalance.

Amendments to lease variation charges (LVC) may also be an option. LVC is a tax unique to the ACT and when applied, increases the cost of development compared with a similar development in other jurisdictions (although it is noted that other jurisdictions have other types of development levies that add cost).

Consideration could also be given to introducing an apportionment mechanism for mixed use developments that are not unit titled to address equity issues. The possibility of introducing a new method of apportionment that does not require unit titling (as in other states), which was a recommendation in the *2018 Public Accounts Committee (PAC) Inquiry into the Methodology for Determining Rates and Land Tax for Strata Residences*. The Government noted the recommendation, but there has to date been no appetite to progress this further.

## 6.5 Planning Policy Reform

Greater planning certainty could be provided for BtR developments which meet defined local planning rules with sector-specific building/design codes. This is because the required minimum apartment sizes and mix do not contemplate the proportionally greater amount of shared space.

Benefit of a design guide specific for BtR product may include:

- Greater flexibility to reduce unit sizes;
- Greater flexibility to reduce car parking requirements.
- Greater building bulk and scale; and
- Planning bonuses and enhanced Plot Ratios.

It is noted that suggested planning policy changes may be inconsistent with the development outcome intent, whereby planning guidelines are considered at a precinct level rather than by development type. As such, further work would be required to determine the suitability or level of community support for such changes.

## 6.6 Cash Grants

Government can provide cash grants or rental subsidy guarantees to support the development of BtR product. However, it is noted that there is generally little support for cash grants, like the Queensland Government's approach, as this approach is unlikely to create a sustainable BtR sector. This is because there is a need to match project timing and risk, and thus it is generally a more efficient outcome for government to assist projects through delaying payment of taxes and/or land payment until letting risk is satisfactory or take some stock as affordable or social housing.

## 6.7 Summary

These solutions are summarised in the table below, noting that these approaches may not be applicable or currently allowable in the ACT under current planning guidelines and as such would require further work to determine suitability and support for such changes.

**Table 21: Solutions to Constraint Factors**

| Constraints | Solutions |
| --- | --- |
| **Land Availability** | • Releasing land with a lease restriction for the specified purpose of BtR developments;<br>• Provision of Government owned land for BtR developments;<br>• Provision of Government land with a Crown lease purpose clause of BtR with potential for covenants preventing unit-titling<br>• Providing Government land under a long term leasehold, with commitments for inclusion of BtR housing. Other jurisdictions have provided leasehold terms of up to 49 year, but it may be as long as 20 years depending on project economics;<br>• Zoning overlays that restrict use of land for purposes other than BtR, so that BtR becomes the highest and best use of land; and<br>• Variant of the Land Rent Scheme. |
| **Size and Scale** | • Aggregate sites – providing scale through a combination of smaller sites<br>• 'Salt and pepper' developments, whereby sites are spread throughout a local area |
| **Absorption** | • Drip feed development into the market, or provide a mitigant for lower revenues due to delayed take-up of rental stock, by:<br>o Delaying land purchase payment; or<br>o Delaying taxes / duties |
| **Taxation Treatment** | • Exemptions or concession on land tax, rates, stamp duty or lease variation charges<br>• Introduce an apportionment mechanism for mixed use developments that are not unit titled to address equity issues |

| Constraints | Solutions |
| --- | --- |
| **Planning Policy** | • Introduce more flexible planning policies specific to BtR developments, such as:<br>o Greater flexibility to increase plot ratio requirements to account for greater prevalence of shared facilities in BtR developments<br>o Greater flexibility to reduce minimum car parking requirements<br>o Concessional planning allowances, such as greater density or height, for BtR development |
| **Grants** | • Provide one-off cash grants through upfront capital contribution or rental subsidy / guarantee. |

There are diverse views as to the role of government in developing a sustainable BtR asset class. There is no agreed or evolved platform, with stimulants recently announced by other jurisdictions new and largely untested in the Australian market (refer to section 3.3).

## 6.8 Benefits and Risks of Market Intervention

There are a number of benefits and risks in governments intervening in the housing market to support the development of a BtR asset class.

### 6.8.1 Benefits of Market Intervention

The key benefits of intervening in the market to support the development of an BtR asset class include:

#### Increased Rental Supply

A key consequence of government intervening in the market to support development of a BtR asset class is the associated increase in rental supply. This is seen as a benefit due to Canberra's tight rental market, with a vacancy rate of only 0.9% for October 2020[29].

#### Diversification of Housing Typology

A BtR asset class provides the opportunity to diversify housing typology and expand the spectrum of rental housing options.

The challenge of increasing the supply of residential rental housing is not simply a matter of releasing more land and building more houses. Crucially, housing stock must also be suited to the needs and the means of renters. This means providing different housing options, which offer a choice of dwelling size, tenure type and price.

#### Improved Security of Rental Tenure

A key characteristic of BtR product is that it is held long term and traded as an operating asset. As a result, BtR housing provides longer term leases and reduced turnover of stock providing greater security of tenure for tenants.

[29] https://sqmresearch.com.au/graph_vacancy.php?region=act%3A%3ACanberra&type=c&t=1

### Accelerate Delivery of Housing Supply

By partnering with the private sector, government is able to leverage private sector capability and finance to accelerate the delivery of rental properties to the market. It therefore provides government the opportunity to reallocate scarce resources that would otherwise be devoted to construction of dwellings.

### Monetise Government Owned Lands

By releasing land for BtR developments, government can 'unlock value' from a zero-revenue generating asset to increase the supply of rental housing and meet government housing targets.

### Potential inclusion of Affordable Housing

There are examples in Australia of governments supporting BtR developments that provide an affordable housing component. Under this model, the private sector operates and maintains the affordable housing, representing a low level of retained risk by government. However, this requires additional government incentive or investment given that BtR developments with an affordable housing component are unlikely to be viable.

### Economic Stimulus

By intervening in the market, Government will support BtR developments that would otherwise be unfeasible. In the short term, this will increase housing construction and support jobs and investment as the economy recovers from the impact of COVID-19.

## 6.8.2 Key Risks of Market Intervention

The key risks of government intervening in the market to support the development of an BtR asst class include:

### Downward Pressure on Rents

By intervening in the market, this will result in increased rental supply and as a result of the new supply, there may be downward pressure on rents. This may have a twofold consequence of:

- Artificially deflating private property investment; and
- Placing downward pressure on rental yields and reducing existing investor's returns.

Any downward pressure on rents would upset existing property investors and may not be seen as politically favourable. More detailed analysis would be required to determine the materiality of this risk.

### Home Ownership Affordability

Bringing a new source of capital into the market may adversely impact home ownership affordability. This is because it will create greater competition for land which will push up land prices in general and in turn impact housing ownership affordability.

### Rental Demand for Older Properties

By bringing newly built rental product into the market, this may impact demand for older styled rental properties as renters seek newer and more modern layouts and designs. The potential financial impact on existing investors may prove politically unfavourable.

### Government Investment

Historically, BtR developments typically yield lower returns than BtS developments. As a result of the lower yields, BtR developments often require some form of investment by taxpayers via government concessions and/or incentives to offset the financial impact of lower returns.

### Public Perception

There is a risk that the government will be criticised as to the public purpose served by government investment in profit making entities.

## 6.9 Assessment of Levers

Should the Territory wish to support the development of BtR product, there are a number of levers at its disposal to overcome the key factors limiting greater uptake.

A key consideration for Government in determining the most appropriate lever will be consideration of its strategic objective as being:

1. To develop a sustainable BtR asset class, or
2. To provide a one-off government supported BtR development as an economic stimulus response as the economy recovers from the impact of COVID-19.

The second objective can be quickly achieved by offering land to the private sector through a competitive tender process with bids nominating the required capital contribution from Government. However, this approach will not build a sustainable BtR asset class.

The application of changes to policy levers will be further explored and tested as part of the Financial Feasibility Analysis (Stage 2).

# 7 Affordable Rental Housing

This section provides an overview of affordable rental housing and demonstrates the increasing need for this type of housing in the ACT. It also identifies the barriers to supply and presents potential solutions for the ACT Government's consideration, including the BtR model.

## 7.1 Definition

The term 'affordable housing' in its broadest sense is used to refer to housing for rent or purchase that is affordable to households whose financial capacity to obtain private housing is constrained. It relates to housing that is appropriate for the needs of a range of very low to moderate income households, and priced (whether mortgage repayments or rent) so these households are able to meet their other essential basic living costs.

Rental affordability was a prevalent theme and priority area of ACT Housing Strategy (2018). This strategy document defines affordable housing as "*when a household spends less than 30% of their income on housing costs, and that household falls within the lowest 40% of household income*"[30].

## 7.2 Income Quintile 2

ACT has approximately 150,000 households which the ACT Housing Strategy divides into five income quintiles, as shown below[31].

**Figure 4: Income Quintiles**

| INCOME QUINTILE 1 | INCOME QUINTILE 2 | INCOME QUINTILE 3 | INCOME QUINTILE 4 | INCOME QUINTILE 5 |
|---|---|---|---|---|
| ANNUAL INCOME<br>$0 – $55,000 | ANNUAL INCOME<br>$55,000 – $100,000 | ANNUAL INCOME<br>$100,000 – $144,000 | ANNUAL INCOME<br>$144,000 – $208,000 | ANNUAL INCOME<br>$208,000 + |
| AFFORDABLE RENTAL PAYMENTS<br>$0 – $321 PW | AFFORDABLE RENTAL PAYMENTS<br>$321 – $579 PW | AFFORDABLE RENTAL PAYMENTS<br>$579 – $836 PW | AFFORDABLE RENTAL PAYMENTS<br>$836 – $1,198 PW | AFFORDABLE RENTAL PAYMENTS<br>$1,198 + PW |
| HOME PURCHASED WITH AN AFFORDABLE MORTGAGE<br>$0 – $260,000 | HOME PURCHASED WITH AN AFFORDABLE MORTGAGE<br>$260,000 – $483,000 | HOME PURCHASED WITH AN AFFORDABLE MORTGAGE<br>$483,000 – $691,000 | HOME PURCHASED WITH AN AFFORDABLE MORTGAGE<br>$691,000 – $990,000 | HOME PURCHASED WITH AN AFFORDABLE MORTGAGE<br>$990,000 + |

The ACT Government has identified those in Income Quintile 2 as a demographic in increasing need of affordable rental housing in the ACT. As shown in the table above, based on the annual income of Income Quintile 2, affordable rental payments range between $321-$579 per week.

[30] ACT Housing Strategy, October 2018, Glossary of Terms

[31] ACT Housing Strategy, October 2018

## 7.3 Housing Stress

Low income earners are particularly susceptible to housing instability as market factors lead to higher private housing prices. A household is defined as being in housing stress *"when it pays more than 30% of its gross income in housing costs and its income is amongst the lowest 40% of all households."*[32]

Although Canberra is Australia's second most affordable city for renting[33], this is skewed by higher than average wages that push prices up so that the bottom end of the market is struggling to afford to pay rent. This is also exacerbated by the typically tight rental market with rental vacancy rates remaining below or at 1% for the past six years. With a total pool of around 73,000 private rental properties, finding an affordable rental property among the 900 or so that are typically available at any point in time is very difficult. Moreover, properties within reach of low income families who do not qualify for public housing are typically smaller, older, less energy efficient and not well located for employment and services.

The most recent 2020 Report on Government Services identified that in 2017-18, approximately 8,038 (almost 73%) of low income private rental households in the ACT were in rental stress; that is, paying more than 30% of their income on rent. This is up 16.4% from 2015-16.[34]

## 7.4 Rental Subsidy

The subsidy amount is the gap between the median market rent and the affordable rental payment. This subsidy may manifest as provision of housing for rent at a level below the median amount.

The table below shows that those households in Income Quintile 2 paying the median weekly unit rent of $495 require a subsidy of up to $174 per week to avoid housing stress.

Table 22: Income Quintile 2

| Income Quintile 2 | |
|---|---|
| **Annual Income** | $55,000 - $100,000 |
| **Weekly Income** | $1,057 - $1,923 |
| **Affordable Rental Payment** | $321 - $579 |
| **Median Weekly Unit Rent**[35] | $495 pw |
| **Subsidy Required (Excess)** | $174 - ($84) |

The level of rental subsidy is based on the median weekly unit rent. In Canberra's inner city suburbs, particularly suburbs like Civic and Acton, where rents are higher than the median, the required subsidy level would be higher.

[32] ACT Housing Strategy, October 2018, Glossary of Terms

[33] ACT Housing Strategy (2018)

[34] Productivity Commission (2020) Report on Government Services 2020, Part G, Table GA.4: Proportion of low income private rental households in rental stress, by State and Territory, 2017-18

[35] Domain Rent Report, December quarter 2020: https://www.domain.com.au/research/rental-report/december-2020

## 7.5 Barriers to Delivery of Affordable Rental Product

Provision of affordable rental housing, being rental housing offered at a discount to market rent, is highly unlikely to be provided by the market, as this is a constraint on the income that can be earned from land and development.

Given project economics, there is generally a need for government investment to offset the financial impact of reduced rental payments. This means that affordable housing in Australia is typically provided through:

- Community Housing Providers (CHPs) or organisations with a defined purpose of housing provision;
- Sites which are zoned for affordable housing (noting this is currently not possible in the Territory Plan);
- Planning or development restriction requirements which mandate a portion of affordable housing in a development; or
- Land sale contract documents requiring delivery of affordable dwellings.

## 7.6 Potential Solutions

This section explores the potential solutions available to the Territory to overcome the barriers to the provision of affordable rental housing. This includes:

- Option 1: ACT Government deliver on its own;
- Option 2: ACT Government incentivise the private sector to deliver a mixed tenure development that comprises an affordable housing component; and
- Option 3: ACT Government partners with CHPs.

Each of these options are discussed in more detail below.

### 7.6.1 Option 1: Territory Deliver

Under Option 1, the ACT Government solely delivers, funds, maintains and operates the provision of affordable rental housing to Income Quintile 2.

As the Territory directly funds and delivers the affordable housing, it means that ultimately all risk resides with the ACT Government. However, this option does provide the Government with the greatest control over delivery and operation and the ability to retain ownership of the land as well as flexibility in relation to its use.

While it may be possible under this option to utilise innovative means of raising finance (such as Territory-led issue of a housing bond), in the current low interest rate environment the Territory is likely to be able to borrow funds at a comparable rate to such offerings, with a lower level of complexity in arranging financing.

### 7.6.2 Option 2: Partnership with the Private Sector

Under Option 2, the ACT Government partners with the Private Sector to deliver affordable housing.

The benefit of this partnership with the Private Sector is that:

- It enables Government to accelerate delivery of housing rental supply;
- Government benefits from the capabilities and expertise of the private sector;
- Provides a flexible structure where commercial terms are driven by the responsibilities and relationship between the parties;
- Potential access to Commonwealth Rental Assistance (CRA) by tenants[36]; and
- Access to concessional MIT rate if a foreign investor.

This option will require tax payer investment to incentivise the private sector to deliver a mixed tenure residential development that includes a component of affordable housing through one or more of the mechanisms below:

- Provision of Government land, potentially under a Ground Lease arrangement[37] utilising the BtR model, or amended form of the Land Rent model currently in use;
- Cash or capital grant;
- Taxation relief, such as land tax exemptions, specific to sites or developments incorporating affordable housing;
- Affordable housing inclusion on Crown leases when land is rezoned for residential development;
- Planning concessions, such as bonus density or increased Plot Ratio where affordable housing comprises a required percentage of a development; and/or
- Rental guarantee or rental top up to close the gap between affordable and market housing.

### 7.6.3 Option 3: Partnership with CHPs

Under Option 3, ACT Government partners with CHPs to deliver, maintain and operate affordable rental housing. A number of Australian CHPs, such as St George Community Housing, Compass Housing and Mission Australia Housing, have a proven record of partnering with government, institutions and large-scale developers to successfully bring new affordable rental housing supply to market. This includes projects in new geographic areas, so it is likely they would have interest in a project in Canberra if the scale and term were of sufficient size.

A high level overview of the capacity of the CHP sector is provided in Appendix A.

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[36] CRA is the main form of housing assistance in Australia, with over 40 per cent of households in the private rental market receiving these payments

[37] A Ground Lease is a long term lease agreement usually between 25 and 40 years.

The advantage of this partnership is that CHPs benefit from a number of structural or regulatory circumstances which make them suited to partnership, including:

- Concessional rates of investment return required, as internal mandates are generally driven by social outcomes as opposed to financial or economic returns;
- GST exemptions through charitable status;
- Lower cost of equity as CHPs, or non-profits, tend to require a lower rate of return than the private sector;
- Access to National Housing Finance & Investment Corporation (NHFIC) long term funding, which is restricted to CHPs and provides long tenor finance at rates below commercial banks;
- Eligibility to access National Housing Infrastructure Facility (NHIF) grants which can contribute to a lower total cost of development for eligible projects (of which affordable housing projects would meet criteria and requirements);
- Potential access to Commonwealth Rental Assistance (CRA) by tenants; and
- Access to concessional affordable housing MITs.

Despite these benefits, this option will still require government investment due to the lower rental returns through one or more of the following mechanisms:

- Provision of cash or capital grant;
- Provision of Government owned land or discounted land;
- Offering Government land through long term leasehold for affordable housing provision; or
- Restrictive covenants on land.

Although this option requires government investment, the unique structural and regulatory framework of the CHP sector means that it often produces a more efficient use of capital with significant risk transfer. This has driven other jurisdictions to increasingly consider use of the CHP sector to deliver affordable housing.

Whilst CHPs in the ACT have experience in the management of tenants and property, the sectors' financial capacity and capability to deliver large scale affordable housing developments is yet to be tested. There is, however, precedent for CHPs successfully moving across jurisdictions if projects are of sufficient scale. For instance, Mission Australia Housing has a focus on NSW and Victoria, however. They have established operations in Tasmania and are partnering with the Tasmanian Government to deliver housing.

Consideration could also be given as to whether the ACT Government wishes to target specific disadvantaged cohorts amongst Quintile 2, such as women or Indigenous, as this may lead to more targeting of CHPs.

In conclusion, due to project economics there is a need for government investment to deliver affordable housing. From a government perspective, it is important to find the most efficient solution that delivers the highest number of housing stock per dollar invested, alongside appropriate qualitative outcomes. This will be tested as part of the financial feasibility modelling component of Stage 2.

# 8 Summary of Findings

The following section provides a summary of the key findings.

## 8.1 Location Parameters

It is possible to define parameters which define locations more suited to adoption of the BtR model. Key location parameter considerations include:

- Access to transport and employment nodes;
- Located near anchor institutions, such as universities and hospitals;
- Larger land holdings appropriately zoned for medium to high density to allow land costs to be amortised across a larger number of units (to allow scale);
- High rental demand;
- Consumer sentiment for higher density living;
- High rental yield to ensure the income return is sufficient to accommodate debt;
- Good underlying economics, including stable employment and population with low market volatility; and
- Smaller household compositions conducive to living in smaller sized apartments, often with increased plot ratio.

## 8.2 Territory's Suitability for BtR

Analysis of key housing market metrics shows that the ACT has more favourable metrics than Sydney and Melbourne, indicating it could be suited to the adoption of the BtR model. These metrics include:

- High rental yield;
- Low rental vacancy rates;
- High personal and household incomes;
- Low unemployment; and
- Consistent population and housing market growth.

## 8.3 Factors Limiting Uptake of Market BtR

Despite the strong market characteristics identified, the BtR market is yet to develop in the ACT. This is caused by a number of factors, including those shown below.

Table 23: Factors Limiting BtR Market in ACT

| Factor | Description |
|---|---|
| **Yield** | BtR as an asset class sits below the risk-return curve of other asset classes. |
| **Land Availability** | The availability of sites for purchase by BtR developers that are suitably sized and located. In addition, typically lower yields means that BtR developers are often at a disadvantage to Build to Sell (BtS) developers in bidding for sites. |
| **Absorption Rates** | The limited ability of the ACT market to absorb large scale residential rental developments given the relatively small size of the market. |
| **Size and Scale** | The size and scale of BtR developments required to encourage institutional investment and offset transaction costs. |
| **Tenant Appetite** | ACT has a significantly lower rate of net overseas migration; a key driver of tenant demand for BtR developments. |

| Factor | Description |
|---|---|
| **Land Use Planning Constraints** | The need for more flexible planning policies to accommodate sector-specific building/design code features of BtR product. |
| **Less Favourable Planning and Taxation** | Taxation and planning treatment of BtR developments are often seen as less favourable than BtS. |
| **Amendments to RTA** | Recent changes to the RTA will impact the ability of BtR developers to increase rents by more than 10% above CPI. |
| **Cost of Debt** | Ability of projects to achieve satisfactory gearing and debt cost. |

## 8.4 Potential Solutions for Market BtR

The potential approaches which Government may utilise in addressing the constraints identified above are identified in the following table. It is noted that these approaches may not be applicable or currently allowable in the ACT under current planning guidelines and as such would require further work to determine suitability and support for such changes.

**Table 24: Solutions to Constraint Factors**

| Constraints | Solutions |
|---|---|
| **Land Availability** | • Releasing land with a lease restriction for the specified purpose of BtR developments;<br>• Provision of Government owned land for BtR developments;<br>• Provision of Government land with a Crown lease purpose clause of BtR with potential for covenants preventing unit-titling<br>• Providing Government land under a long term leasehold, with commitments for inclusion of BtR housing. Other jurisdictions have provided leasehold terms of up to 49 year, but it may be as long as 20 years depending on project economics;<br>• Zoning overlays that restrict use of land for purposes other than BtR, so that BtR becomes the highest and best use of land; and<br>• Variant of the Land Rent Scheme. |
| **Size and Scale** | • Aggregate sites – providing scale through a combination of smaller sites<br>• 'Salt and pepper' developments, whereby sites are spread throughout a local area |
| **Absorption** | • Drip feed development into the market, or provide a mitigant for lower revenues due to delayed take-up of rental stock, by:<br>  o Delaying land purchase payment; or<br>  o Delaying taxes / duties. |
| **Taxation Treatment** | • Exemptions or concession on land tax, rates or lease variation charges<br>• Introduce an apportionment mechanism for mixed use developments that are not unit titled to address equity issues |

| Constraints | Solutions |
|---|---|
| **Planning Policy** | • Introduce more flexible planning policies specific to BtR developments, such as:<br>o Greater flexibility to increase plot ratio requirements to account for greater prevalence of shared facilities in BtR developments<br>o Reduced minimum car parking requirements for residential developments including BtR<br>o Concessional planning allowances, such as greater density or height, for BtR development |
| **Grants** | • Provide one-off cash grants through upfront capital contribution or rental subsidy / guarantee. |

## 8.5 BtR to Deliver Affordable Housing

Project economics mean market delivery of affordable housing projects is unlikely without Government intervention or support, as a superior return can be achieved through delivery of housing at full market rent.

Government may address this shortfall through involvement under the following options:

- Option 1: ACT Government deliver on its own;
- Option 2: ACT Government incentivise the private sector to deliver a mixed tenure development that comprises an affordable housing component; and
- Option 3: ACT Government partners with CHPs for delivery of affordable housing.

These options will be further explored as part of Stage 2.

# Appendix A: CHP Sector

The CHP sector has grown in sophistication and complexity over the past 15 years and is increasingly partnering with government to finance and develop social and affordable housing. These projects are often facilitated by government through land for redevelopment or subsidies to ensure viability and title transfer that improve leverage capacity.

CHPs have demonstrated they have the capacity and sophistication to help drive developments and manage projects at scale, to provide affordable housing solutions.

Some examples of more recent projects and general capability within the CHP sector include:

### Mission Australia

Mission Housing Australia has partnered with Frasers Property Australia and Citta Property Group to redevelop the 8.2 hectare Ivanhoe public housing estate in Macquarie Park. The project and associated developments have been funded by the NSW Government and the private sector as part of the Communities Plus program. Valued at around $2.2 billion, the redevelopment will incorporate over 3,000 new dwellings with approximately one third of those being either new social housing or affordable homes.

### Compass Housing Services Co Limited

Compass manages over 6,500 properties in New South Wales, Queensland and New Zealand. Through SAHF, it is delivering an additional 600 new dwellings across NSW, in the cities of Newcastle, Wyong, Lake Macquarie, Gosford, Maitland, Port Stephens and Singleton. A fifth of those dwellings will be allocated in a model where tenants pay 25 per cent less than market rate. The remaining 80 per cent of Compass' new SAHF dwellings are being built for people who are currently on the state's social housing wait list.

### St George Community Housing

St George Community Housing (SGCH), the largest community housing provider in NSW, provides housing to more than 11,000 people in 6,500 properties. It is currently delivering on a development pipeline of 317 affordable housing dwellings.

### Brisbane Housing Company Limited

Brisbane Housing Company Limited (BHCL) is Australia's first CHP to receive a global AA-credit rating. It has created over $400 million in residential dwellings and have sold in excess of $100 million to investors and owner occupiers.

### Hume Community Housing

Hume Community Housing provides homes and services to more than 9,000 customers across New South Wales. It builds new properties, manage tenancies for owners, and provide services and support to its customers through a range of partnerships.

### Unity Housing Company

Unity Housing Company manages more than 3,000 community housing properties in South Australia. In recent years, Unity has delivered more than 350 new dwellings at a total cost of more than $108 million.

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Environment, Planning and Sustainable Development Directorate (EPSDD)

# Built to Rent Feasibility Analysis

## Stage 4: Summary of Findings

PAXON GROUP

Corporate Finance
Management Consulting
Project Finance and Infrastructure

Perth • Sydney • Melbourne • Brisbane • Adelaide • Darwin | July 2021 – Final Report

# Table of Contents

# 1 Introduction

## 1.1 Scope of Works

Paxon Group (Paxon) has been engaged by the Environment, Planning and Sustainable Development Directorate (EPSDD) to prepare a Build to Rent (BTR) Feasibility Report and associated financial model. The BtR Feasibility Report has been commissioned to aid future decision making and to progress further consideration of the BtR model in Canberra.

The report is being delivered over three stages as follows:

- Stage 1: Research & Benchmarking
- Stage 2: Feasibility Analysis, including financial model and market sounding
- Stage 3: Expression of Interest (EOI) Considerations.

Having completed the above stages, this report seeks to summarise the key findings and recommendations of interest of the first three stages. For more detailed analysis, refer to the individual reports issued at each of the stages of the BtR Feasibility Report.

## 1.2 Context and Background

The ACT Government is looking to the growing BtR sector to support its policy objectives of increasing the amount of affordable and secure rental housing in the ACT, which has one of the most expensive rental markets in the country. Concurrently, the ACT Government is seeking to implement a range of initiatives to fast track infrastructure investment that improves access to the housing continuum as part of its response to the COVID-19 pandemic and its economic impacts.

The ACT Government has a long-held commitment to intervene where the housing market fails to provide for people in its community, with key objectives of the ACT Housing Strategy (2018) to grow the supply of affordable private rental properties, as well as provide better protections and security of tenure for low-income households. Its strong desire to find lasting solutions to the problem of affordable housing, as well as deliver on the Parliamentary Agreement commitment to the development of affordable rental housing, are key drivers of the Government's commissioning of this project.

## 1.3 Benchmarking

The market BtR model, which focuses on increasing the supply of long term rental housing, is an established practice in both the UK and USA. However, it is very much in its infancy in Australia, mainly due to current property market conditions and the taxation landscape.

Governments in other jurisdictions in Australia are currently introducing a number of new stimulants to encourage greater expansion of the BtR model to increase the supply of rental housing, including land tax concessions and planning policy reforms. These measures, however, are somewhat untested and it is not yet known whether they will have any significant impact on the development of a sustainable market BtR asset class in Australia.

Governments have also been exploring the BtR model as a means to deliver affordable housing, being rental housing offered at a discount to market rent. Mechanisms being utilised include the provision of a direct subsidy, provision of land or discounted land and/or facilitated through Community Housing Providers (CHPs). The CHP sector's unique structural and regulatory framework means that this approach generally produces a more efficient use of capital.

# 2 BtR Model in the ACT

## 2.1 Market BtR Characteristics

BtR can be defined as a type of residential development that comprises purpose-built rental accommodation, which is held in single ownership and held as a long-term revenue-generating asset.[1] The asset characteristics make the product attractive to the renter, as well as being matched to the investor type, as detailed below.

To appeal to tenants, BtR developments tend to have:

- Higher levels of amenity and inclusion of premium onsite services;
- Situated in long term desired locations – inner city, close to facilities, transport and employment nodes; and
- Include a commercial and/or retail component.

Characteristics matched to the investor type, include:

- Single ownership, held long term;
- Traded as an operating asset with rents generally charged above market rent;
- Large scale ~ 100-300+ units;
- Unique design features, such as smaller apartment sizes, higher density; and
- Tailored towards delivering long term sustainable yield, lower than that required by typical property developers (due to longer term nature of BtR project).

## 2.2 Presence of Key Market Fundamentals

For BtR as an asset class to be successful in a market, there needs to be supportive market fundamentals to create a sustainable BtR market. Comparison of ACT market fundamentals against Sydney and Melbourne can be found in the table below.

Table 1: ACT Property Market Fundamentals

| Market Characteristics | Canberra | Sydney | Melbourne |
|---|---|---|---|
| **Rental Yield[2]** | 5.3% | 3.5% | 3.5% |
| **Rental Vacancy[3]** | 0.9% | 3.6% | 4.4% |
| **Median Weekly Unit Rent[4]** | $495 | $470 | $388 |
| **Weekly Household Income[5]** | $2,087 | $1,750 | $1,542 |
| **Unemployment Rate[6]** | 3.7% | 6.3% | 6.9% |

[1] BtR in Australia: Product Feasibility and potential affordable housing contribution, July 2019

[2] https://sqmresearch.com.au/property-rental-yield.php?region=vic%3A%3AMelbourne&type=c&t=1

[3] https://sqmresearch.com.au/graph_vacancy.php?region=vic%3A%3AMelbourne&type=c&t=1

[4] Domain Rent Report, December quarter 2020: https://www.domain.com au/research/rental-report/december-2020

[5] https://www.abs.gov.au/statistics/labour/earnings-and-work-hours/average-weekly-earnings-australia/may-2020#state-and-territory-earnings

[6] ABS 62020.2 Labour Force, Australia

As shown above the market fundamentals for the Canberra rental market are favourable when compared to Sydney and Melbourne, which supports the development of a BtR asset class. Canberra has high rental yields, low vacancy rates, high median rents, high weekly household incomes, and a stable workforce which all compliment the implementation of BtR.

## 2.3 Constraints on BtR Uptake

Despite the favourable property market conditions in Canberra, the BtR product has failed to develop in the ACT. The factors that may be limiting investor interest in BtR product in the ACT are detailed below. These incorporate factors specific to the Territory, as well as general constraints which have resulted in the slow uptake of market BtR model across Australia compared to many overseas locations.

**Table 2: Stage 1 BtR Constraints**

| Factor | Description |
|---|---|
| **Comparable Yield** | The BtR asset class assumes a greater risk than what the return profile compensates for. A BtR developer assumes a development risk, which would normally require a 10-15% return on investment, however, BtR assets typically only return 6-8% over their asset life. This risk-return mismatch is a result of a number of influencing factors; however, taxation policies, at a state and federal level, are key drivers of the BtR yield challenge. |
| **Land Availability** | The availability of sites for purchase by BtR developers that are suitably sized and located are limited. Typically, lower yields mean that BtR developers are often unable to compete with Build to Sell (BtS) developers in bidding for sites. |
| **Absorption Rates** | The ACT market has a limited ability to absorb large scale residential developments, offering the kind of rental product that BtR offers (noting there are only around 900 dwellings available for rent at any given time). Furthermore, whilst the ACT market may be able to absorb a one off BtR development given the tight rental market, BtR developers look to establish a pipeline of projects that have sufficient size to justify entering a new market. |
| **Size and Scale** | The size and scale of BtR developments required to attract institutional investment given the need to offset transactional costs and ability to achieve cost efficiencies relative to the overall size of the Canberra market. |
| **Tenant Appetite** | ACT has a significantly lower rate of net overseas migration; a key driver of tenant demand for BtR developments as evidenced in BtR developments in Sydney. |
| **Land Use Planning Constraints** | Planning policies that do not readily accommodate the unique features of BtR product. |
| **Less Favourable Planning and Taxation** | Taxation and planning treatment of BtR developments are often seen as less favourable than BtS, including:<br>• Land Tax and General Rates (given dwellings are retained rather than sold to the market); and<br>• Lease Variation Charges when recycling stock. |
| **Rent Revision Limitations** | Recent changes to the *Residential Tenancies Act 1997* that impact the ability of BtR developers to increase rents by more than 10% above CPI. |

| Factor | Description |
|---|---|
| **Cost of Debt** | Ability of BtR projects to achieve satisfactory gearing and debt cost. |

## 2.4 Addressing Market BtR Uptake

Given the constraints listed above, the following table details potential solutions to the barriers. These solutions involve Government intervention in the implementation of BtR developments to increase the commercial viability of BtR developments.

**Table 3: Market Uptake Solutions**

| Constraints | Solutions |
|---|---|
| **Land Availability** | • Provision of Government owned land for BtR developments;<br>• Provision of Government land with a Crown lease purpose clause of BtR with potential for covenants preventing unit-titling;<br>• Providing Government land under a long term leasehold, with commitments for inclusion of BtR housing. Other jurisdictions have provided leasehold terms of up to 49 year, but it may be as long as 20 years depending on project economics;<br>• Provision of a Concessional Crown lease to BtR developers. |
| **Size and Scale** | • Aggregate sites – providing scale through a combination of smaller sites;<br>• 'Salt and pepper' developments, whereby sites are spread throughout a local area; or<br>• Provide sites that can accommodate developments of 200+ dwellings. |
| **Absorption** | • Drip feed development into the market, or provide a mitigant for lower revenues due to delayed take-up of rental stock, by:<br>o Delaying land purchase payment; and<br>o Delaying taxes / duties. |
| **Taxation Treatment** | • Exemptions or concession on land tax, general rates, stamp duties or lease variation charges; and<br>• Removal of the land tax foreign investor surcharge. |
| **Planning Policy** | • Introduction of more flexible planning policies specific to BtR developments, such as:<br>o Greater flexibility to increase plot ratio requirements to account for greater prevalence of shared facilities;<br>o Greater flexibility to reduce minimum car parking requirements; and<br>o Concessional planning allowances, such as greater density or height. |
| **Grants / Subsidies** | • Provide a one-off cash grant through upfront capital contribution; or<br>• Provide an ongoing periodic subsidy to compensate for discounted affordable rents. |

## 2.5 Addressing Delivery of Affordable Housing Rental Product

Provision of affordable rental housing, being rental housing offered at a discount to market rent, is highly unlikely to be provided by the market, as this is a constraint on the income that can be earned from land and the development. Given the project economics, there is generally a need for government investment to offset the financial impact of reduced rental payments. Throughout Australia, this support is typically provided through:

- CHPs or organisations with a defined purpose of housing provision;
- Sites which are zoned for affordable housing (noting this is currently not possible in the Territory Plan);
- Planning or development restriction requirements which mandate a portion of affordable housing in a development; or
- Land sale contract documents requiring delivery of affordable dwellings.

Governments are also looking to utilise the BtR model to facilitate the delivery of affordable rental housing. For example, the Queensland Government has launched a number of pilot BtR projects, in which the private sector delivers affordable rental product on privately owned land in return for rental subsidy payments, and more recently, expanded the pilot to State owned sites.

The Community Housing Renewal Program (CHRP) in New South Wales and the Public Housing Renewal Program (PHRP) in Victoria are examples of projects delivering social and/or affordable rental housing using a BtR model. Both CHRP and PHRP are being delivered on Government land, with the PHRP in Victoria adopting an approach whereby market BtR developments are collocated with social housing on public land.

# 6 Progressing BtR on Government Sites

To progress the implementation of BtR on Government sites, the pathway depends on whether government is seeking to increase the supply of private market rental housing or affordable rental housing.

If Government's objective is to increase the supply of private market housing through the BtR model, Government could look to select and enact appropriate policy changes. The proposed changes to taxation, planning and general rates policies are an example of policy changes that can be made by Government to make BtR developments more feasible.

Alternatively, if Government is looking to provide one-off government support to BtR developments as an economic stimulus response, the optimal approach would be to offer sites with mandated BtR conditions on the Crown lease provided to the acquirer. This could be achieved through a competitive EOI process with bids nominating the required capital contribution (if required) from Government.

Where Government decides to prioritise the provision of affordable housing, the following approach is suggested:

1. Decide the mix of market and affordable housing required in the development;
2. Choose whether Government will provide any concessions for BtR developments;
3. Model the likely subsidy and confirm Government's appetite to provide a subsidy of this type; and
4. Launch EOI process in line with Stage 3 report considerations.

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