Build-to-Rent Update

Australia – May 2023

The build-to-rent (BTR) model is gaining traction in Australia. With a particular focus on Western Australia (WA), the following is an insight into the sector and its potential benefits to the Australian housing market, as well as potential challenges faced by developers.

However, for those with an interest in developing a BTR project in WA, there is some good news in the state's 2022-23 budget.

Current State of Play

The BTR model has been successful in both the US and the UK. In Australia, the BTR trend has accelerated in recent years, such that more than 23,000 BTR dwellings across more than 70 properties exist in the current development pipeline across the nation.[1]

Research published by the Australian Institute of Health and Welfare showed that in April 2023, approximately 31% of Australian households are renters.[2] This represents approximately 2.9 million households that developers can serve through the BTR model.[3] Pair that with increasing house prices and rental yields for traditional housing stock, and developers are becoming more interested in implementing a BTR development model than ever.

The Business Model

BTR projects are usually large-scale residential developments where all properties within it are owned and managed by a single operator/manager. Each individual property within the development is then rented out to tenants for a medium to long term, rather than selling them to individual residents or investors.

For investors, BTR developments promise weekly and reliable long-term cash flows, rather than short-term sales revenue. For tenants, some of the benefits include flexible lease terms, high-quality residences and the security of an institutional landlord. Naturally, however, a BTR project requires unique considerations to attract tenants to lease a property, particularly when rental agreements for a BTR development can reach up to three years.[4]

One of the key drivers for attracting tenants is by having a high standard of amenities available to residents, making it feel as if they are part of a community, rather than just a block of flats. Some BTR developments have rooftop terraces, dog parks, co-working spaces, private dining rooms, cinemas, and active areas with swimming pools, gyms and saunas.[5]

On-site 24/7 property management is also a big drawcard for tenants, as a BTR development's amenities and common areas are professionally and uniformly maintained. In addition, tenants are usually allowed more freedom to customise the internals of their property than they would in traditional tenancies (i.e. hanging pictures, pets, etc.).[6]

Challenges for BTR Developers

Although the sector is growing, BTR is still in its infancy in Australia, particularly in WA, where there are only a few developments in the pipeline. Drawing on international and other domestic markets, there have been several main challenges facing BTR developers in WA.

BTR developers in Australia have recently struggled with obtaining adequate debt funding for new projects. The lower relative return compared to build-to-sell projects, the novel nature of the asset class and longer investment horizons have deterred funders from investing in BTR projects.[7] As such, more upfront equity is required to complete BTR developments than other types of real estate developments.

Another challenge is that state residential tenancy laws tend to be tenant-friendly. For example, residential tenancy laws in WA impose restrictions on terminating residential tenancy agreements, limit the frequency of rent raises, and limit a landlord's ability to recover land holding costs from tenants (i.e. land tax and local government rates).[8] Residential tenancy laws also differ from state to state, which may impose more challenges for developers looking at developing multiple BTR projects across Australian jurisdictions.

Finally, taxes have posed one of the biggest challenges to establishing BTR projects in Australia. The biggest culprit is yearly state land taxes, but the inability to claim goods and services tax (GST) credits for building operating and management expenses also poses problems.[9] Large international institutional investors are also impacted by high foreign investment taxes.[10] However, tax relief has been, and continues to be, implemented across Australia to encourage more BTR project investment from Australian and foreign investors.

1 Ernst & Young, 'A new form of housing supply for Australia: Build to Rent housing', page 18.

2 https://www.aihw.gov.au/reports/australias-welfare/home-ownership-and-housing-tenure.

3 Ibid.

4 Stephen Fitzsimon, Melbourne Real Estate (https://www.realestate.com.au/advice/build-to-rent/).

5 https://www.realestate.com.au/advice/build-to-rent/

6 Ibid.

7 n (1), page 13.

8 *Residential Tenancies Act 1987* (WA) ss 30, 48 & Part V.

9 Australian Housing and Urban Research Institute, '*Regulation of residential tenancies and impacts on investment*', AHURI Final Report No. 391, page 24.

10 Ibid.

BTR Tax Relief Initiatives

Since BTR projects are owned by an entity that holds the land not as its primary residence, that ownership entity is required to pay land tax in the state in which the BTR project is constructed. Unlike stamp duty, land tax is an annual charge that will eat into rental yields. As such, high land taxes have been a barrier to entry for BTR developers to construct large-scale projects in Australia.

As Australia battles with a housing shortage, particularly with rental properties, several states are taking action to encourage BTR investment. For example, New South Wales introduced a 50% land tax reduction for developers constructing BTR projects, as well as duty and land tax surcharge exemptions for foreign BTR investors. Victoria, Queensland and South Australia also have tax-based initiatives to encourage more BTR investment. WA has since followed suit by announcing, commencing 1 July 2023, a 50% land tax discount for eligible large-scale BTR projects (with further details yet to come).[11]

The prime minister also announced on 28 April 2023, after a meeting of National Cabinet, two initiatives to encourage foreign investment into BTR developments in Australia. For eligible BTR projects commencing after 9 May 2023, the federal government will:

- Reduce the Managed Investment Trust (MIT) payment to foreign residents' withholding tax rate from 30% to 15%
- Allow investors to utilise a higher depreciation rate, from 2.5% to 4% per year, for eligible BTR projects.[12]

As such, it is now becoming easier and more attractive for BTR developers to construct these kinds of projects in Australia, as well as attracting investors and tenants alike.

If you are interested in developing or investing in a BTR project in Australia, we are available to assist with a full range of services at all stages of the BTR development.

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11 For example: https://www.mediastatements.wa.gov.au/Pages/McGowan/2022/05/Tax-reform-and-incentives-to-deliver-a-housing-supply-boost.aspx; https://www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent#:~:text=The%20NSW%20Government%20introduced%20a,during%20the%20COVID%2D19%20recovery

12 https://www.pm.gov.au/media/meeting-national-cabinet-better-future-federation