

State of the Market

Residential Build to Sell (BTS)
and Build to Rent (BTR)
Apartments

Metro Sydney

H1 2022

August 2022

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State of the Market

BTS and BTR Residential Apartments

Metropolitan Sydney – H1 2022



There have been a lot of negative media headlines recently relating to the apartment markets across various Australian cities. **Whilst there are certainly headwinds to be aware of, it is Charter Keck Cramer's view that many of these negative headlines are not reflective of the entire market nor is it what we are seeing in the statistics or hearing on the ground from many of our clients.**

A lot has changed in the last 6 months since the release of Charter Keck Cramer's State of the Market Report H2-2021. The most significant of these changes has been the increase in interest rates by the Reserve Bank of Australia. Increasing construction costs also continue to pose a major headwind and risk for the industry. Whilst it is unpleasant to see builders entering liquidation or apartment projects being cancelled there are also several stories of builders being appointed to new BtS or BtR projects and developers successfully launching and selling out projects.

In this regard, readers are encouraged to look beyond some of these short-term issues and further into the market cycle as the key fundamentals for both BtS and BtR apartments remain. In fact, the statistics show that these have become even more prominent.

Important themes to be aware of at present include:

Net Overseas Migration (NOM)

NOM will return to NSW from FY 23 onwards with 58,000 people forecast for that year. Overseas migrants bring with them their living preferences which are often for higher density (apartment) living. Importantly, the Census statistics show that migrants typically rent for 4-7 years before purchasing a dwelling. This will continue to provide a strong and consistent level of renter demand for both BtS and also BtR apartment projects in well located areas supported by amenity, transport and retail. One of the most important risk factors as to how strongly and quickly the Sydney apartment market bounces back comes down to the number and ethnicity of migrants that make a decision to come to Sydney.

Structural change in living preferences & dwelling types

There are key structural changes that have become more pronounced in Sydney over the last decade. In 2011, around 31.6% of Sydneysiders rented and by 2021 this figure had increased to 35.9%. Furthermore, in 2011, around 10.2% of Sydney's total dwelling stock comprised higher density apartments (flats or apartments in 4+ storey block) and this increased to 16.7% by 2021. Charter Keck Cramer observes that the proportion of renters in Sydney are at similar levels to many cities in the USA and UK which have more mature BtS and BtR apartment markets.

Construction Costs

Increasing construction costs remain a major issue for the BtS and BtR apartment markets and have resulted in many projects becoming financially unfeasible. Charter Keck Cramer has advised several developers, and spoken with many more, about their options.

Many developers have decided to delay (but not abandon) launching their project until further into the current market cycle. Other developers have made the courageous decision to renegotiate contract prices with purchasers (and many have been successful). Finally, and as a last resort, various developers have made the commercial decision to cancel the project and return deposits.

Charter Keck Cramer observes that the relevant decision that has been made is developer and project specific and comes down to the stage of the project in the development pipeline, the brand of the developer, the location, and the target markets for the project.

As several projects will no longer proceed in the short term, it is anticipated that the current supply shortage will become even more acute over the next two years. This has the potential to cause rents to increase further given the existing shortage of supply of rental dwellings and ultimately translate into increased prices of new apartments across Sydney.

Rising Interest Rates

Rising interest rates are a headwind for the property market and often place downward pressure on prices. There are however several reasons why the apartment market stands to benefit from an increase in interest rates.

Firstly, purchasers have had their purchasing capacity diminished, and should they wish to enter the housing market they will need to trade-off dwelling type for location to enter the housing market of their choice. Well-built owner-occupier quality apartments are the most affordable option to meet their needs.

Secondly, given the shortage of rental accommodation at present, rate rises are likely to be able to be passed onto renters in the form of rental increases. This is likely to be attractive to investors as BtS (and potentially BtR) apartments are able to act as a hedge against rising rates (and also inflation).

Finally, local "mum and dad" investors will once again be able to rely on negative gearing in their property investment strategy and will likely view interest rate rises through this lens whilst they chase increasing rents and falling vacancies.

Outlook for BtS apartment market

It is Charter Keck Cramer's view that the next cycle of the apartment market in Sydney has already commenced (albeit somewhat impeded by recent headwinds). Demand is forecast to return from FY 23 whilst supply will have continued to diminish by this time, leading to a mismatch between supply and demand.

In fact, of all the cities in Australia, Sydney faces the largest supply crunch given its large reliance on the BtS apartment market as a form of accommodation. The rental markets are already quickly recovering from their COVID-19 induced troughs and this is being observed through falling vacancy rates, rising rents and reduced availability of rental stock.

Outlook for BtR apartment market

There are already several BtR projects leasing up and operating in Sydney. It will be important to observe how the market responds to, and takes up, this offering. It appears that the projects are obtaining a rental premium although it is still too early to tell whether this premium will be maintained.

With over 35% of the population renting in Sydney, there is a substantial opportunity for BtR to supply rental accommodation that will be unable to be supplied by the BtS market in the short to medium-term. In the longer-term, and as the value proposition of BtR becomes fully understood by the renter market, it is anticipated that the rental premium will become materially greater than standard BtS apartment rents.

To conclude, given the strong underlying fundamentals, the BtR market in Sydney has the potential to emerge and become entrenched over the next decade much like has occurred in Greater London in the decade between 2011 and 2021.



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State of the Market

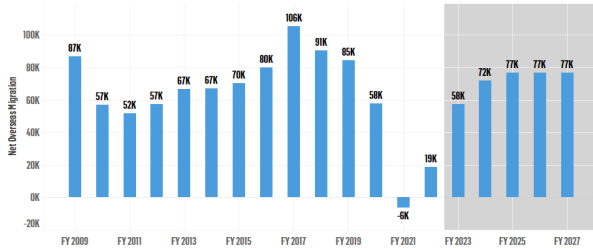
BTS and BTR Residential Apartments

Metropolitan Sydney – H1 2022

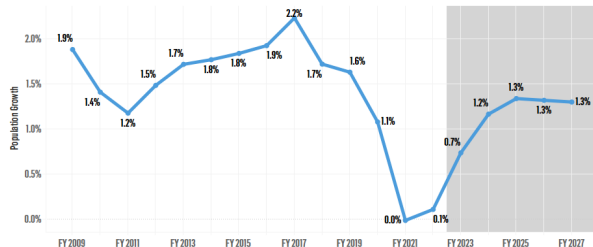


POPULATION INDICATORS

Net Overseas Migration*, NSW



Annual Population Growth*, Sydney



* FY 2023 - FY 2027 forecast by Centre for Population
Source: Australian Bureau of Statistics, Centre for Population, Charter Keck Cramer

DEMAND INDICATORS

Median Unit Price Q2 22

\$790,983

(down -0.6% on Q1 2022
up +0.4% on Q2 2021)
Source: Domain

Median Unit Rent (Jul 22)

\$532 p.w.

(up +1.7% on Jun 22
up +14.4% on Jul 21)

Vacancy Rate (Q2 22)

1.6%

(down from 2.9% in Q2 21)
Source: SQM Research

SUPPLY INDICATORS

Apartment Completions

199,700

Apartments have been completed in Metro Sydney since 2009.

	Project Sizes	
	Projects	Apts
1-50	2,401	63,877
51-100	750	53,446
101-150	221	27,004
151-200	105	18,049
201-250	68	15,304
251-300	25	6,988
300+	41	15,077
TOTAL	3,611	199,745

Source: Charter Keck Cramer

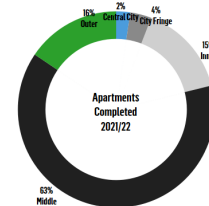
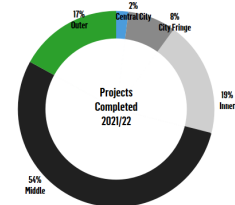
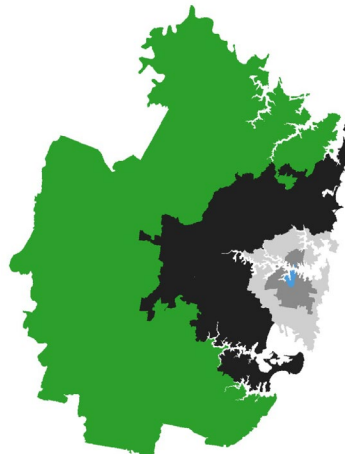
MARKET UPDATE

The most active region in metropolitan Sydney has historically been the *Middle Region*. This region has been attractive for apartment development because of supportive planning controls, land availability as well as house prices that allow feasible apartment development.

In FY 21/22 there were 7,100 apartments completed across 99 projects. The *Middle Region* was the most active in terms of projects completed (54%) as well as total apartments completed (63%).

The short-term future pipeline in metropolitan Sydney will continue to diminish. In FY 21/22, only 7,700 apartments commenced construction across 91 projects and a further 9,200 apartments were launched across 117 projects.

METROPOLITAN SYDNEY APARTMENT REGIONS



Source: Charter Keck Cramer

METROPOLITAN SYDNEY BTS APARTMENT SUPPLY SNAPSHOT –FY 2021/22

7,100

Apts. Completed
[99 Projects]
2021/22

7,700

Apts. Commenced Construction
[91 Projects]
2021/22

9,200

Apts. Launched
[117 Projects]
2021/22

Source: Charter Keck Cramer

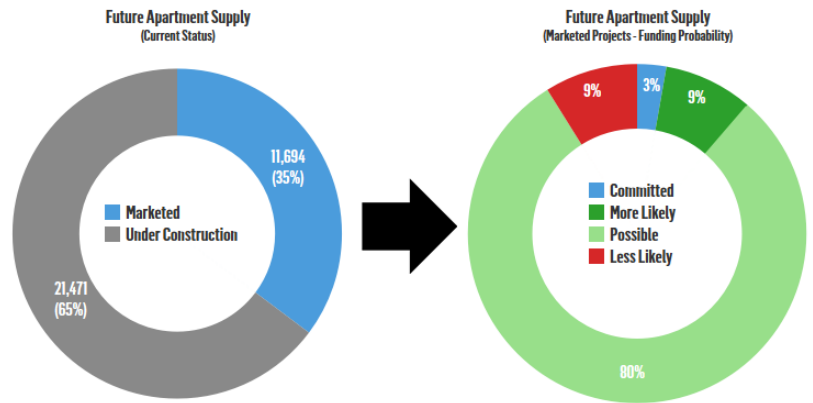
BTS FUTURE SUPPLY

There are currently 21,471 apartments under construction in metropolitan Sydney, with a further 11,694 apartments currently being marketed.

It should be noted that not all marketed projects will necessarily reach completion given the requirements to reach pre-sales targets before obtaining construction finance.

Charter Keck Cramer forecasts that 9% of those apartments currently marketed are less than likely to secure construction funding.

FUNDING PROBABILITY – ACTIVE PROJECTS



Source: Charter Keck Cramer

BTS APARTMENT LAUNCHES

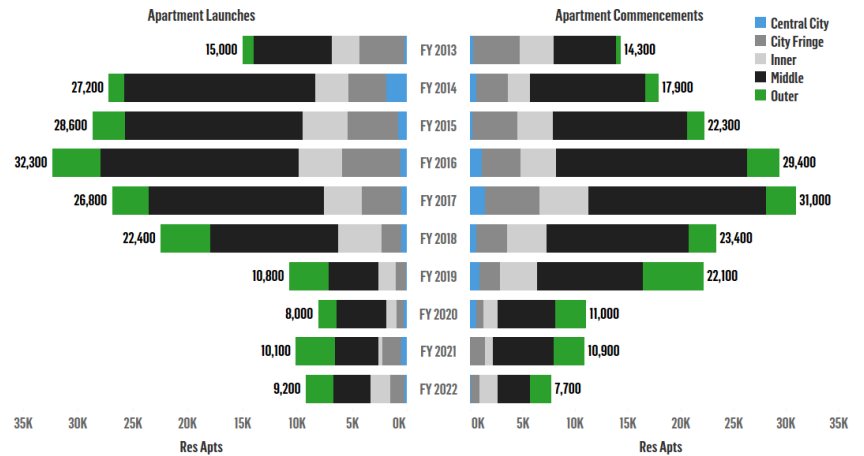
In FY 2022, there were a total of 9,200 apartments launched (for sale) to market.

This was the lowest number of launches recorded over the past decade and was -72% lower than the peak of 32,300 apartments in FY 2016. The most active region in FY 2022 was the *Middle Region*. The *Outer Region* over FY 2021 and FY 2022 has become more active and this is likely a reflection of first home buyer support schemes, increased house prices as well as supply side (planning) constraints and reduced investor activity in the *Middle Region*.

APARTMENT COMMENCEMENTS

In FY 2022, construction commenced on 7,700 apartments. This is the lowest number of apartment commencements recorded over the past decade and represents a decrease of -75% from the peak of 31,000 apartments in FY 2017.

LAUNCHES AND COMMENCEMENTS OVER TIME



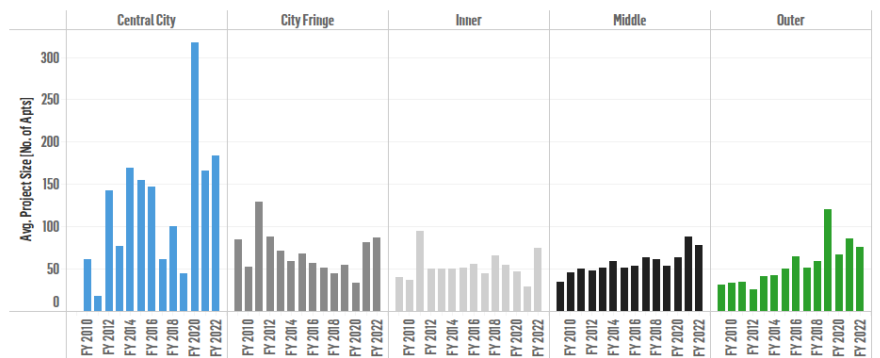
Source: Charter Keck Cramer

HISTORIC BTS APARTMENT LAUNCHES

Over recent years, the average size of new apartment projects within the *Middle Region* (the most active region) has trended upwards. The average size of apartments in projects in the *Outer Region* has also trended upwards.

A likely explanation for this is the delivery of large projects in urban renewal precincts around transport and infrastructure networks which have planning policy to support larger projects. In addition, larger apartments better enable working from home and highlight a potential shift to more family households residing in apartments.

APARTMENT LAUNCHES BY PROJECT SIZE



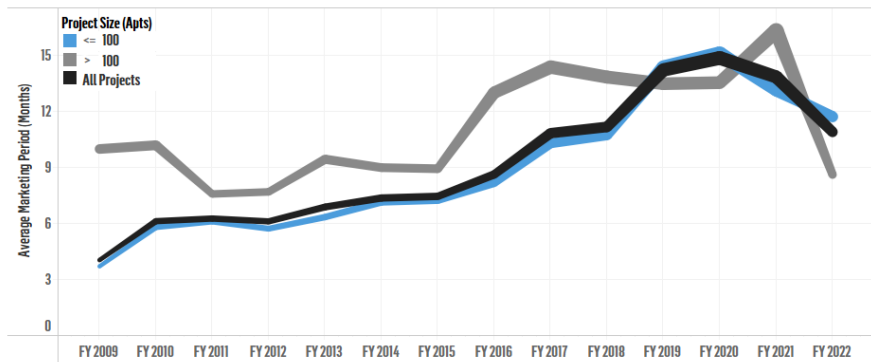
Source: Charter Keck Cramer

BTS APARTMENT PIPELINE

The average time taken to commence construction (from the date of launch) on new apartment projects in FY 2022 was 11 months. This decrease is likely a reflection of pent up demand and the shortage of apartment stock currently available to market.

Larger projects (100+ apartments) are taking an average of 9 months whereas smaller projects (less than 100 apartments) are taking an average of 12 months to proceed to construction.

AVERAGE PERIOD FROM LAUNCH TO CONSTRUCTION COMMENCEMENT



Source: Charter Keck Cramer

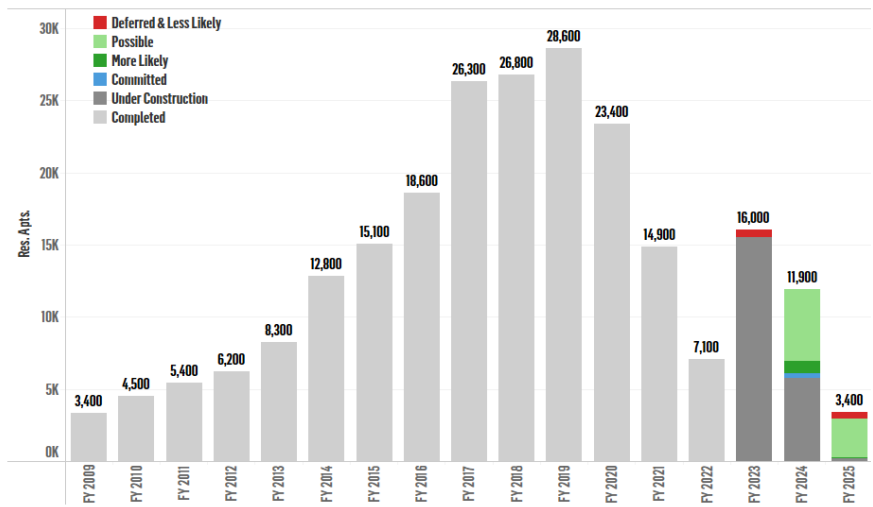
BTS APARTMENT COMPLETIONS

There were 7,100 apartments completed in metropolitan Sydney during FY 2022. This is a -75% decrease from the peak year of supply (28,600 apartments in FY 2019) and is the lowest level of annual supply since FY 2012 (6,200 apartments).

Assuming all marketed stock proceeds to construction, around 16,000 apartments are anticipated to be completed in FY 2023 (with a catch up from FY 2022 caused by COVID-related delays and lockdowns) and 11,900 apartments in FY 2024.

Given the increase in construction costs and slow pre-sales rates, it is anticipated that these numbers may decrease over the next 2-3 years leading to a more pronounced shortage of BtS apartments in Sydney.

COMPLETIONS OVER TIME



Source: Charter Keck Cramer

BTS FUTURE COMPLETIONS BY REGION

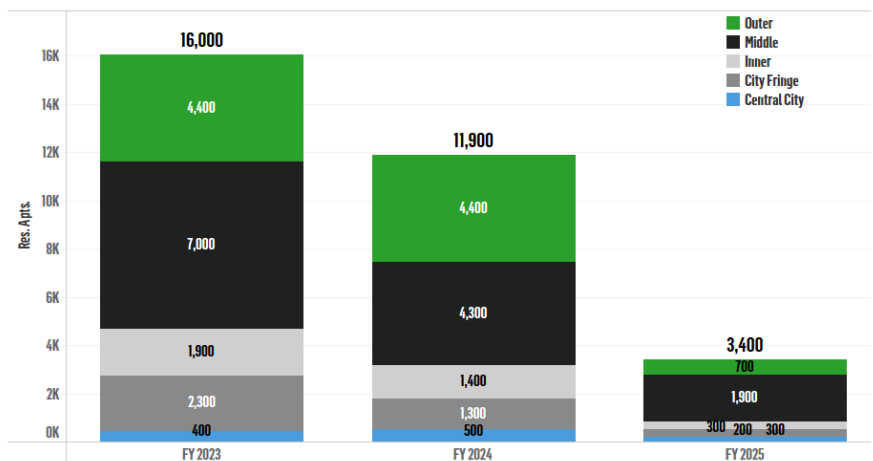
In FY 2023, there are projected to be 16,000 apartment completions in metropolitan Sydney.

The *Middle Region* will account for the greatest volume (7,000 apartments) followed by the *Outer Region* (4,400 apartments).

Over FY 2024 and FY 2025 the *Outer* and *Middle Regions* are forecast to be the most active.

The metropolitan Sydney apartment market is continuing to mature and spreading out from the *Middle Region* and into the *Outer Regions* as house prices increase and apartment delivery becomes feasible in many of these sub-markets.

FUTURE COMPLETIONS – REGIONS OF METROPOLITAN SYDNEY



Source: Charter Keck Cramer

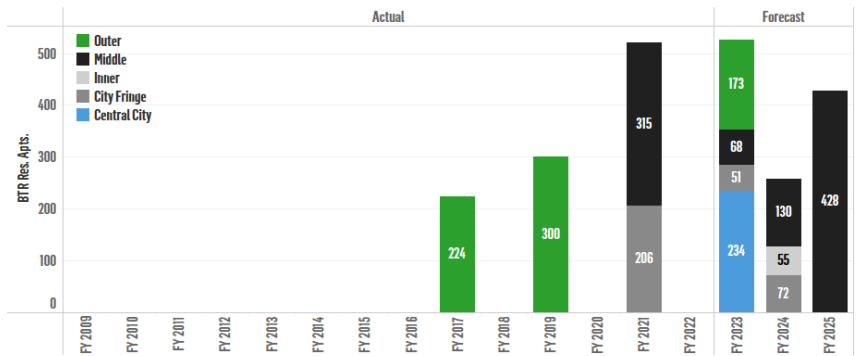
BTR COMPLETIONS

Build to Rent (BTR) is an emerging residential asset class in Australia. Whilst BTR has not yet been officially defined* in Australia, Charter Keck Cramer is tracking all projects that are held by developers for long term rental.

There were 224 apartments in one project completed in FY 2017 and 300 apartments in two projects completed in FY 2019 in the *Outer Region*. There were also 206 apartments in one project in completed in the *City Fringe* and another 315 apartments in the *Middle Region* completed in FY 2021.

Based on projects that are under construction, there are also 1,211 apartments in six projects forecast to be completed in FY 2023-2025.

COMPLETIONS OVER TIME - METROPOLITAN SYDNEY



Source: Charter Keck Cramer

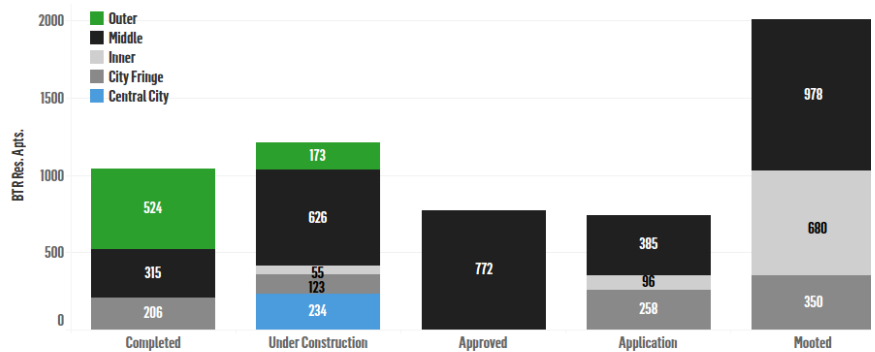
* For the purposes of the charts in this section, Charter Keck Cramer has defined BTR apartment projects that are (1) purpose built for rental with single ownership and management, (2) larger than 50 apartments. Charter Keck Cramer has also included projects that are classified as Built to Rent to Own as well as Co-Living but has excluded projects with apartments retained for long term rental (and then later sell down).

BTR SUPPLY BY REGION

There are approximately 772 apartments in two projects at the Approved stage in metropolitan Sydney with both located in the Middle Region. There are over 2,750 apartments in nine projects at the Application or Mooted stages across metropolitan Sydney. They are all located in the *Middle, City Fringe and Inner Regions* of metropolitan Sydney.

Charter Keck Cramer observes that finance for the construction of many of these projects is currently very difficult to obtain which is likely to lead to many of these projects not being built in the short-term.

CURRENT AND FUTURE COMPLETIONS – REGIONS OF METROPOLITAN SYDNEY



Source: Charter Keck Cramer

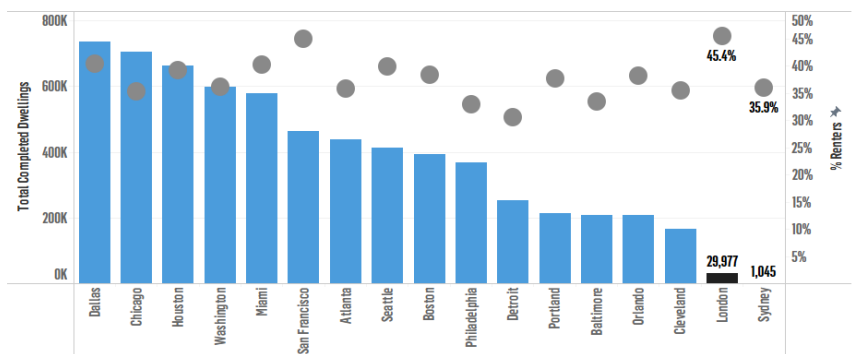
MATURITY OF BTR MARKETS

The quantum of supply of multi-family (or BtR)* dwellings can be used as a proxy for the relative maturity of the BtR market in a particular city. Charter Keck Cramer has compared the total completed BtR dwelling stock in cities in the USA, UK and Australia with the proportion of residents in each city that are renting.*

There are several cities in the USA that have mature BtR markets, and which also have similar proportions of renters to Sydney.

Charter Keck Cramer also observes that in the decade to 2021 there were 30,000 units completed in Greater London with a further 16,000 under construction. Whilst Greater London does have a higher proportion of residents that rent, these figures do provide insight into the opportunity to deliver BtR dwellings in Sydney over the next decade to meet the underlying demand for rental accommodation.

TOTAL COMPLETED MULTI-FAMILY (OR BTR) DWELLINGS VS % RENTERS IN VARIOUS US, UK AND AUSTRALIAN CITIES



Source: ABS 2021, Office of National Statistics 2020 (estimates), British Property Federation 2021, US Census Bureau 2020, NMHC 2020, Charter Keck Cramer

*These figures are based on the respective Censuses taken in either 2020 or 2021 as well as from figures produced by the National Multi-Family Housing Council (USA) and the British Property Federation (UK).

*Renters include both public and private renters (so that an apple with apples comparison is able to be made).

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Sources: Charter Keck Cramer, Australian Bureau of Statistics, SQM Research, Domain.com.au, New South Wales Planning Department

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