State of the Market

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

Metro Sydney

H2 2022

February 2023

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RESEARCH & STRATEGY

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BTS and BTR Residential Apartments
Metropolitan Sydney – H2 2022

RESEARCH & STRATEGY

The housing sub-markets across Sydney have been extremely distorted due to the pandemic.

Over 2020-2022, prices of detached houses in many sub-markets increased by a considerable +30% (albeit Sydney dwellings overall remain 12.3% above the April 2020 market peak) whilst at the same time weekly rents of units and apartments in many sub-markets decreased by up to -30%. This should not occur in a balanced housing market.

As expected, both the "For Sale" and "For Rent" markets are continuing to recalibrate. The residential market is anticipated to continue to be volatile and remain distorted over 2023 until a new equilibrium is found.

It is important to appreciate that Australia is still dealing with the after effects of the pandemic. Whilst we may be through the lockdowns and have a vaccine, we are still dealing with the impact of fiscal and monetary decisions made during the height of the pandemic in 2020 – 2021 and, now more importantly, the largely lagged effect of nine interest rate rises to curb inflation.

Two of the key metrics to closely monitor, as they both affect demand in the housing and apartment markets, are interest rates and construction costs.

Once there is greater market certainty that we've reached the top of the rate tightening cycle (anticipated to be by mid-2023), overall market sentiment is expected to start improving. Once interest rates enter a cutting phase (which could be in early 2024), improved sentiment and ongoing supply issues are anticipated to trigger increasing house prices, signalling the commencement of the next cycle.

The current level of uncertainty is making investment and development decisions extremely difficult. Readers are once again 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.

Key themes from this analysis are summarised below:

Structural change in living preferences

Sydney is the most expensive housing market in Australia and also has the most mature apartment market (by quantum of apartments) in Australia. Sydney continues to experience a structural change in living preferences. This is primarily in the form of apartment living with residents not only more accepting of renting, but renting for longer.

The figures from the ABS 2021 Census show that 27% of Millennials (30-39 years old) are living in high-rise apartments (up from 12% in 2006) and additionally, 53% are renting (up from 44% in 2006) and are unable to enter the For Sale market. This segment of the population will drive significant demand for BTS and BTR apartments over the next decade.

The ABS 2021 figures also show that rightsizers / downsizers (65-year-old+) are also starting to embrace high-rise apartment living (10% up from 6% in 2006). Given many of these buyers have benefited from significant house price growth, are less impacted by interest rates, and are looking to downsize and age in place in more appropriate dwelling typologies, this trend will create substantial opportunities for owner-occupier BTS apartments (both low and high-rise) over the next decade.

Population Growth

Population growth drives the demand for additional and diverse dwelling types.

Sydney is very reliant on Net Overseas Migration (NOM) which offsets the loss of residents to other States (via Net Interstate Migration). Based on the most recent Government forecasts, Sydney will take the second largest share of NOM in Australia (32%) over the next decade. Much of this NOM includes international students and many will occupy apartments, which offer the most affordable entry price / rental points in the housing market.

It is important for the industry to be aware that NOM is forecast by the Government to return to close to pre-pandemic levels this financial year (FY23). In fact, based on several leading indicators, it is highly likely that NOM will be even higher than anticipated by the Government. This will create significant demand for new dwellings at a time when supply is struggling to be mobilised.

Headwinds

At present there are substantial headwinds facing the apartment industry. These headwinds are leading to projects being deferred to later into the cycle (and now also being abandoned). This is ultimately stifling supply.

These headwinds include:

Interest rates. Rising rates are increasing project costs and also diminishing purchaser capacity and buyer demand. This is leading to slow presales in many projects. Charter Keck Cramer observes that apartment product relative to houses stands to benefit from rate rises because buyers 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. Furthermore, given the shortage of rental accommodation at present, there is considered potential to pass on rate rises to renters in the form of rental increases.

This is likely to be attractive to investors as BTS and BTR apartments are able to act as a hedge against rising rates (and also inflation).

Construction costs. Alarmingly, but not surprisingly, these continue to increase and the impact of demand from Major infrastructure projects and the residual supply constraints have resulted in many projects not being financially feasible. This will lead to certain projects being deferred or even abandoned and Charter Keck Cramer anticipates may also lead to development site divestment. In a limited sector of the apartment market, there is considered potential at present to increase sale prices to offset additional costs (or part of them). We see this however being primarily limited to rightsizer/downsizer prestige projects in the current market.

Purchaser Sentiment. Unfortunately, many purchasers read the negative media headlines and at present are delaying purchasing decisions. They are likely to return when rates stablise and there is more certainty about the economy.

Supply v Demand Imbalance

Sydney has for the second year in a row built fewer apartments than Melbourne. There continues to be a growing mismatch between several supply and demand-side metrics which is leading to a substantial shortage of supply of apartments in Sydney over the next few years.

The NSW Department of Planning & Environment significantly reduced population projections in 2022 anticipating average growth of 60,000 persons per annum, down from circa 92,500 persons per annum pre-COVID in 2019. Based on the reduced population projections, implied dwelling demand will average circa 28,500 dwellings per annum of which apartments will need to (and have historically) comprised the majority of new dwelling supply. With only 17,000 forecast apartment completions in 2023, 11,400 completions in 2024 and 2,800 completions in 2025, the imbalance between demand and supply continues to grow.

Leaving aside how difficult it is to obtain development approval for a project, it is currently taking a typical BTS apartment project of 75-100 apartments approximately 12 months from project launch to construction commencement, and a further 22 months from construction commencement to completion (conservatively 3 years). It is likely to take a BTR project of the same scale around 22 months to build out.

When this is considered in light of the already tight rental market, as well as substantial return in demand through population growth (which is anticipated to much higher than Government is forecasting), the market is anticipated to remain undersupplied in the short to medium term, and potentially exacerbated over the longer term.

Rents

There is a major rental crisis in Sydney. Vacancy rates in almost every sub-market are below the market equilibrium (3%) and this is anticipated to remain for the next few years.

Weekly rents are recovering very quickly from the pandemic and are close to pre-pandemic levels across many investor-dominated sub-markets. Whilst attractive to investors this does not bode well for affordability and overall liveability.

Foreign Buyers/ Foreign Institutional Capital

Charter Keck Cramer observes that foreign buyers are slowly starting to re-enter the Sydney BTS apartment market. In fact, many of our clients suggest that there is a significant amount of capital waiting to be deployed into Australia.

Government is reminded that foreign buyers are essential to support the recovery of the BTS apartment market in Sydney. Foreign buyers (investors) are more prepared to purchase OTP and still account for a large share of the presales in many apartment projects.

Government is strongly encouraged to reintroduce incentives such as OTP stamp duty concessions to foreign and local investors. This is one avenue to stimulate the BTS apartment market and mobilise the much-needed supply of rental stock.

Government is also strongly encouraged to embrace the large pool of foreign institutional capital waiting to be deployed into Australia. One avenue is to reconsider several tax settings as they apply to BTR. These include making changes to GST, changes to the Managed Investment Trust (MIT) rules and also further extending land tax discounts. The benefits could include a substantial amount of new rental stock being delivered to the market (and much faster than BTS rental stock which requires financial pre-commitment by way of OTP sales) which frees up existing rental accommodation for many households, provides greater choice and competition and reduces upwards pressure on rents.

Transfer Duty Changes

The NSW State Government recently brought into effect changes to transfer (Stamp) Duty. The changes now provide purchasers the choice of paying an upfront Stamp Duty amount, or an annual tax on residential properties with a price point up to $1,500,000.

Since commencement of the changes, many agents have reported an increase in market activity particularly from first home buyers within the established house and apartment markets, as the onus of making a considerable upfront payment has been removed. In light of considerable rental growth and additional upfront budget capacity, it is being reported that many buyers are making the decision to acquire a residential property even though interest rates continue to increase.

Although the change is recent, there is anticipated to be additional demand that flows through to both the apartment market and houses (priced below the $1,500,000 threshold) which is likely to translate into the OTP apartment market.

Prices

There is likely to be a natural price floor on price falls of established and contemporary BTS apartments in Sydney. This is due to the shortage of supply, return of demand, increasing rents, improving yields and desire of many buyers to enter the property market (trading off an unaffordable detached house for an apartment).

Given current market conditions, and in the absence of a decline in construction costs or underlying land values, the price of new apartments across many sub-markets are simply going to have to increase so that they can be feasibly delivered. Charter Keck Cramer observes that although this is already starting to occur in several sub-markets, particularly in projects aimed at rightsizers / downsizers, a number of key market fundamentals will need to shift before these opportunities are available throughout the broader market. As the supply crunch continues, prices across many other sub-markets and prices will follow suit over time.

Land Values

With construction costs continuing to rise and pricing of new apartments not yet able to be increased, Charter Keck Cramer anticipates a potential rationalisation of development site pricing, which may alleviate pressures on the financial feasibility of new apartment projects. Until such time as the market realigns and apartment prices are able to be raised, this could be an important factor to assist in the delivery of more apartment product.

Highly leveraged developers not in a position to landbank are likely to divest sites over the short term. This may present an opportunity for well-capitalised developers who may be able to pick up development sites at a reduced premium. From a BTR perspective, growing rents, increasing yields and opportunities for a rationalised site acquisition cost may assist developers to stack up projects financially in Sydney which has been a major issue in comparison to other States.

Outlook for Build to Sell

The BTS apartment market is anticipated to continue to remain slow for the first half of 2023 and until there is more certainty with interest rates (as well as the outcome of the NSW State election which is to be held in March 2023).

Presales are anticipated to begin to pick up from the point at which interest rates stablise (assumed mid to late-2023) and will start to accelerate when the interest rate cycle moves into a cutting phase. Pre-sale performance may improve sooner should the Government take action and incentivize the investor market.

Outlook for Build to Rent

The BTR apartment market is quickly emerging in Sydney with four projects (1,200 BTR apartments) Completed and a further five projects (1,000 BTR apartments) currently Under Construction and due for completion over 2023-2024.

There are also over 4,900 BTR apartments across fifteen projects at the early stages of the development process, however it continues to be very challenging to get projects to stack up as well as to secure funding for construction.

Given the strong rental growth in Sydney, it is anticipated that those developers that are able to proceed with construction will benefit from little direct competition in the marketplace and achieve strong rental returns and premiums.

The fundamentals to support BTR in Sydney exist, and with over 35% of the population renting, 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.

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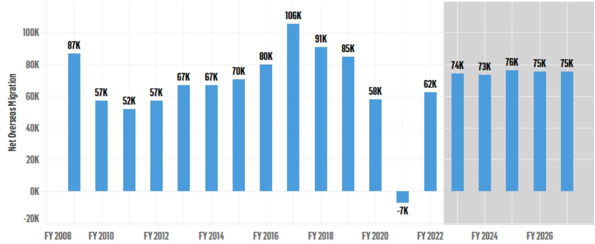
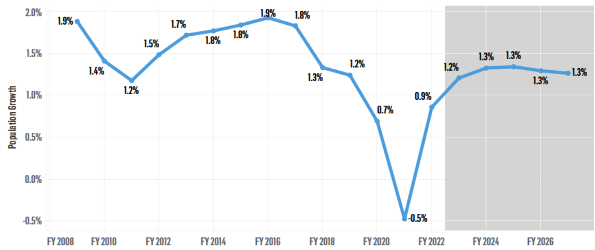
RESEARCH & STRATEGY

POPULATION INDICATORS

Net Overseas Migration*, NSW



Annual Population Growth*, Sydney



* Forecasts provided by Centre for Population

Source: Australian Bureau of Statistics, Centre for Population, Charter Keck Cramer

DEMAND INDICATORS

Median Unit Price Q4 22

$748,422

(down -1.2% on Q3 22
down -6.5% on Q4 21)

Source: Domain

Median Unit Rent [Dec 22]

$585 p.w.

(up +0.9% on Nov 22
up +22.9% on Dec 21)

Vacancy Rate [Q4 22]

1.5%

(down from 2.8% in Q4 21)

Source: SQM Research

SUPPLY INDICATORS

Apartment Completions

203,200

Apartments have been completed in Metro Sydney since 2009.

Project Sizes		
	Projects	Apts
10-50	2,441	64,900
51-100	761	54,200
101-150	226	27,600
151-200	106	18,200
201- 250	69	15,500
251-300	25	7,000
300+	43	15,700
TOTAL	3,671	203,200

Source: Charter Keck Cramer

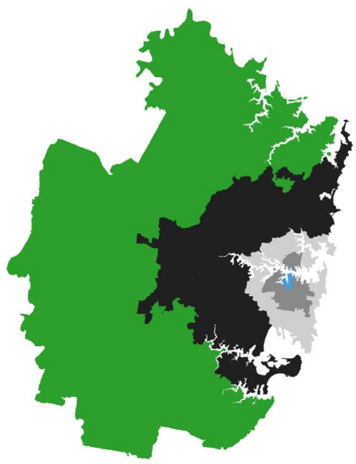
MARKET UPDATE

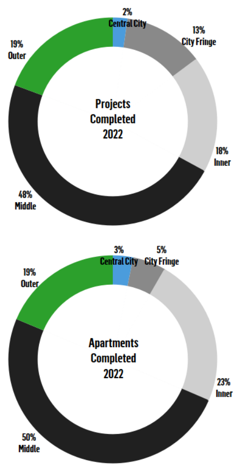
Sydney's *Middle Region* has historically delivered the greatest number of new apartments. Sydney's *Outer Region*, however, demonstrates its growing importance to metropolitan Sydney's apartment supply in an evolving market.

In 2022, there were 6,000 apartments completed across 88 projects. The *Middle Region* remains the most active in terms of projects completed (48%) as well as total apartments completed (50%).

Completions will increase over 2023 compared to the level observed in 2022. Notwithstanding this, low apartment launches and commencements in 2022 mean Sydney's short- to medium-term pipeline of apartments will be limited.

METROPOLITAN SYDNEY APARTMENT REGIONS





Source: Charter Keck Cramer

METROPOLITAN SYDNEY BTS APARTMENT SUPPLY SNAPSHOT – 2022

6,000
Apts. Completed
[88 Projects]
2022

8,600
Apts. Commenced Construction
[90 Projects]
2022

9,200
Apts. Launched
[108 Projects]
2022

Source: Charter Keck Cramer

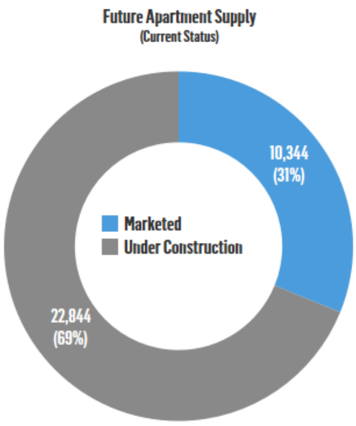
BTS FUTURE SUPPLY

There are currently 22,844 apartments Under Construction in metropolitan Sydney, with a further 10,344 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.

On this basis these figures are likely to be revised downwards as various projects proceed through the development cycle.

FUTURE SUPPLY – ACTIVE PROJECTS



Source: Charter Keck Cramer

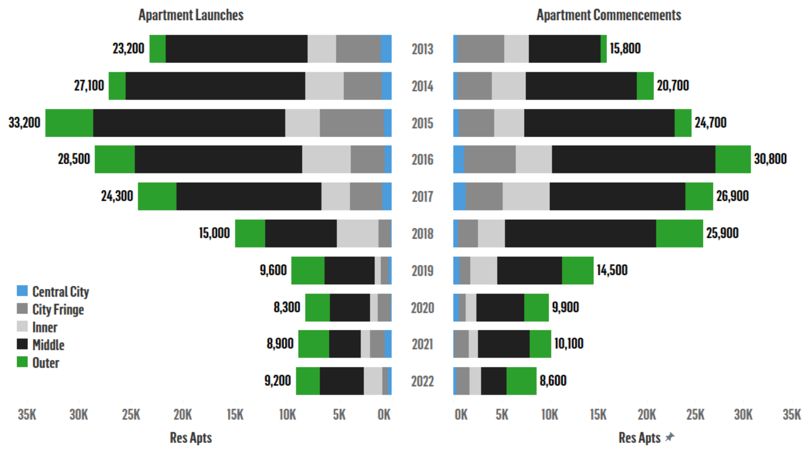
BTS APARTMENT LAUNCHES

In 2022, there were a total of 9,200 apartments launched (for sale) to market. This was the fourth consecutive year of sub-10,000 launches and represents a considerable decrease on the 27,300 averaged through 2013-2017. Over the past decade, the *Outer Region* has become increasingly important as a source of new apartment supply – likely a reflection of increased house prices as well as supply side (planning) constraints in more central locations.

APARTMENT COMMENCEMENTS

In 2022, construction commenced on 8,600 apartments. This is the lowest number of apartment commencements recorded over the past decade and represents a decrease of -72% from the peak of 30,800 apartments in 2016.

LAUNCHES AND COMMENCEMENTS OVER TIME



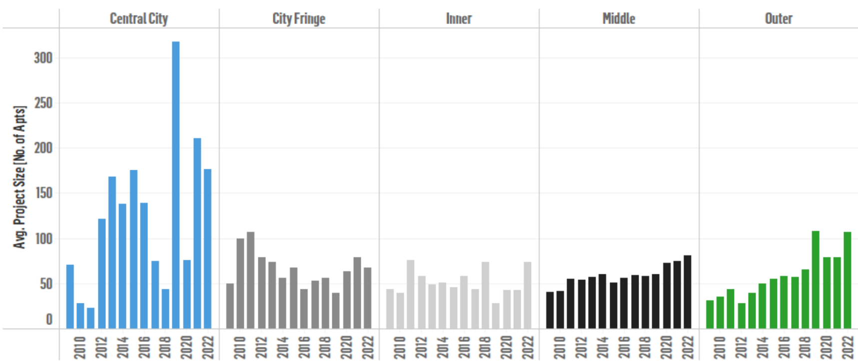
Source: Charter Keck Cramer *Apartments are defined in this report as contemporary own your own (OYO) apartments that are delivered in projects that have 10+ apartments. Student accommodation and serviced apartments are excluded from this analysis.

HISTORIC BTS APARTMENT LAUNCHES

The average size of new apartment projects within the *Middle Region* (the most active region) continued to trend upwards during 2022, now measuring above 80 apartments per project. The average size of apartment projects in the *Outer Region* has also trended upwards over recent years.

This is fuelled by the delivery of large projects in urban renewal precincts around transport and infrastructure networks which have planning policy to support higher densities.

APARTMENT LAUNCHES BY PROJECT SIZE



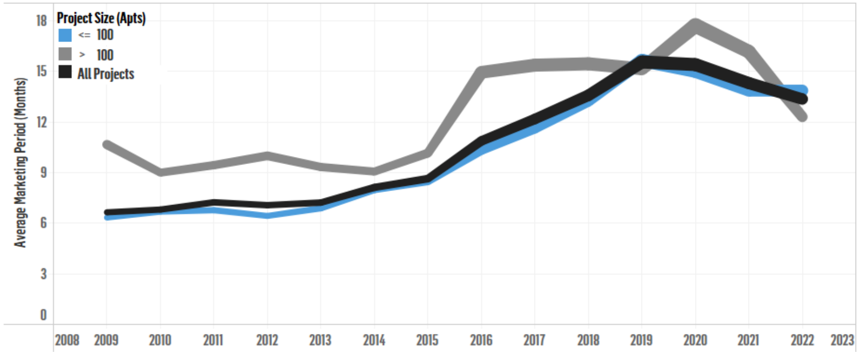
Source: Charter Keck Cramer

BTS APARTMENT PIPELINE

For projects of all sizes, the average period between marketing launch and construction commencement remains elevated compared to the long-term average. Larger projects (100+ apartments) have a marketing period of 12 months (down from 16 months) whilst smaller projects have a marketing period of 14 months.

The current time taken to pre-sell projects is a reflection of the very challenging economic environment and headwinds in the apartment industry over 2022.

AVERAGE PERIOD FROM LAUNCH TO CONSTRUCTION COMMENCEMENT



Source: Charter Keck Cramer

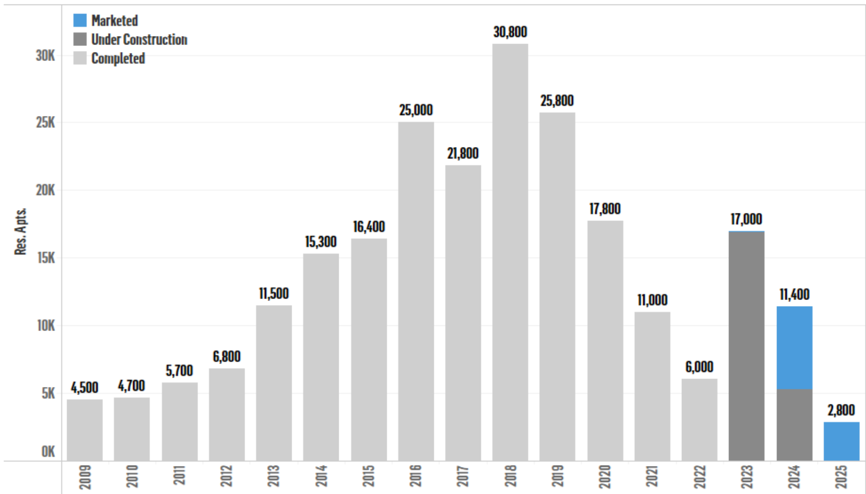
BTS APARTMENT COMPLETIONS

Apartment completions in Metropolitan Sydney fell to 6,000 during 2022. This is the lowest level of completions achieved in over a decade and reflects a -45% decline on the previous year. It is also lower than total completions for Melbourne in 2022.

There are approximately 17,000 apartments currently Under Construction and due to complete this year, with a further 5,300 forecast for Completion in 2024. There are also 6,100 apartments Marketed and that may be delivered in 2024 and a further 2,800 apartments Marketed, and which may be delivered in 2025.

Given the low supply of apartments over 2022 combined with the strong population growth forecast for Sydney over the next few years, the BTS market is expected to remain in short supply relative to demand. This imbalance may be exacerbated further if projects are delayed due to the economic environment, higher interest rates and the rise in construction costs.

COMPLETIONS OVER TIME - METROPOLITAN SYDNEY



Source: Charter Keck Cramer *Apartments are defined in this report as contemporary own your own (OYO) apartments that are delivered in projects that have 10+ apartments. Student accommodation and serviced apartments are excluded from this analysis.

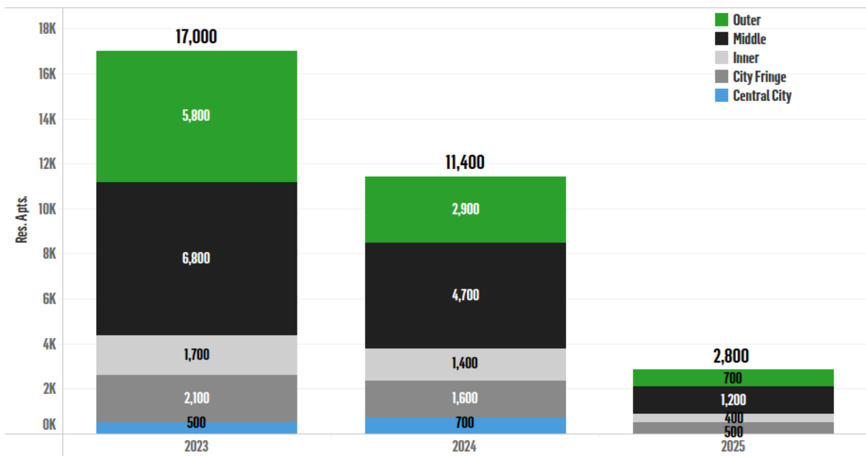
BTS FUTURE COMPLETIONS BY REGION

In 2023, a total of 17,000 apartments are projected to be delivered in metropolitan Sydney.

The *Middle Region* will be the most active this year, with 6,800 apartments expected to complete, closely followed by the *Outer Region* (5,800 apartments). These two regions remain the most active in 2024, delivering a total of 7,600 apartments.

The *Middle* and *Outer* Regions of Sydney are playing a key role in housing Sydneysiders and this trend is forecast to continue over the next few years.

FUTURE COMPLETIONS – REGIONS OF METROPOLITAN SYDNEY



Source: Charter Keck Cramer

BTR COMPLETIONS

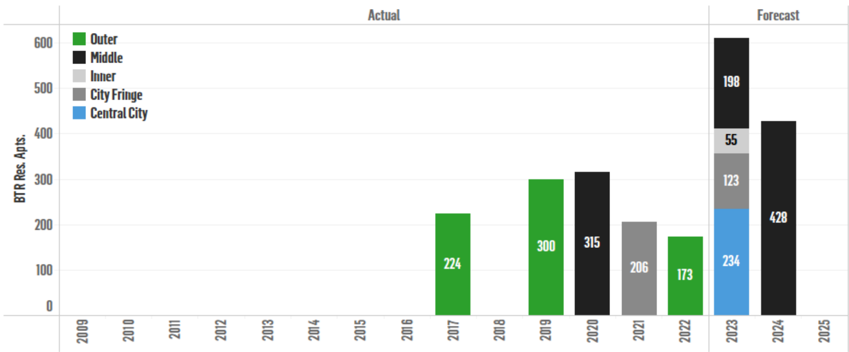
Build to Rent (BTR) is an emerging residential asset class in Australia. Whilst BTR has not yet been officially defined* in Australia, Charter Keck Cramer is tracking all projects that are held by developers for long term rental.

There are over 1,200 BTR apartments across four projects that have been Completed in Sydney.

There are five projects containing over 1,000 BTR apartments that are currently Under Construction, and which are forecast to be completed over 2023-2024.

Given the structural changes in living preferences highlighted in the final section of this report, it is anticipated that BTR will emerge at scale in Sydney over the next decade.

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).

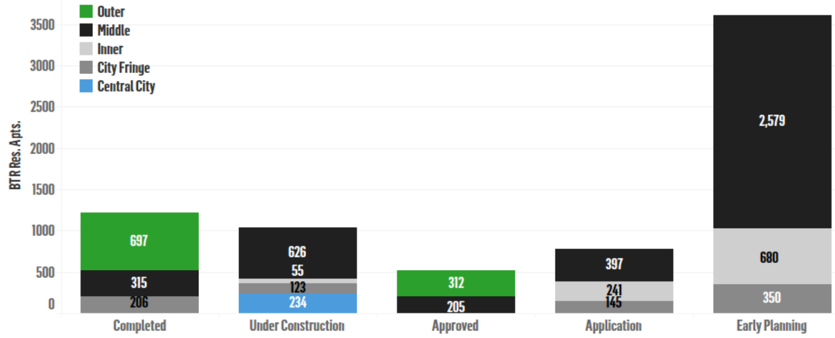
BTR SUPPLY BY REGION

There are more than 500 apartments in two projects at the Approved stage in metropolitan Sydney. These are located in the *Middle* and *Outer Regions*.

There are almost 4,400 apartments in thirteen projects at the Application or Early Planning stages across metropolitan Sydney. These are predominantly located in Sydney's *Middle Region.*

Charter Keck Cramer observes that finance for the construction of BTR projects remains difficult to secure and may lead to a proportion of these projects not proceeding in the short-term.

CURRENT AND FUTURE COMPLETIONS – REGIONS OF METROPOLITAN SYDNEY



Source: Charter Keck Cramer

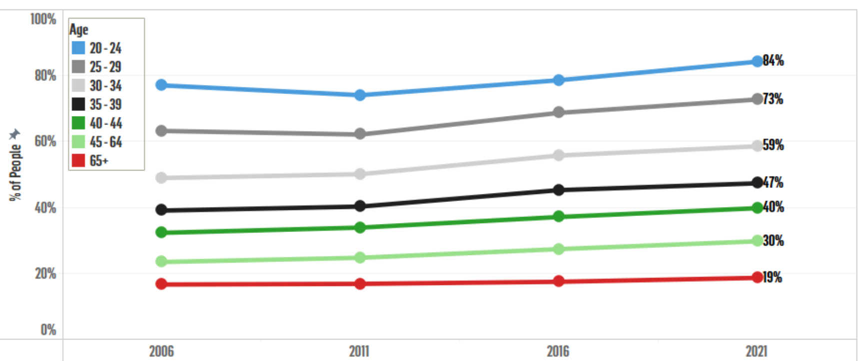
TENURE CHANGE

There is a structural change in living preferences occurring in Sydney where greater proportions of residents are renting and also renting for longer before they transition into home ownership.

Sydney is the most expensive housing market in Australia and suffers from substantial housing affordability issues. As a result, there are high proportions of younger residents currently in the rental market and this trend is anticipated to continue over the next decade.

The two key target markets for BTR over the next decade are likely to be the Millennials and the Generation Z who, given they are already in the rental market, are anticipated to be the early adopters of the BTR product offering.

RENTERS BY AGE GROUP - SYDNEY



Source: ABS 2021, Charter Keck Cramer.

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Sources: Charter Keck Cramer, Australian Bureau of Statistics, SQM Research, Domain, Centre for Population.


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