Precisely Property Season 1 Episode 5

Inner Melbourne's Residential & Commercial Development Sites: Current Update & Outlook

Charter Keck Cramer and Precisely Property Podcast respectfully acknowledge the traditional custodians of country throughout Australia. We pay our respects to their elders past, present and emerging.

Richard: Hello, and welcome to another episode of Precisely Property. I'm your host, Richard Temlett, and I'm excited to have you with us today. If you're here for the first time, thank you for joining us.

I encourage you to listen to our previous episodes where we discuss all things property with a focus on dynamic discussions with industry leaders. In this episode, we're diving into what's happening in the development site sales space, as well as talking more generally about the housing crisis in Australia. So, sit back, relax and let's get started.

In this episode, I'll be speaking with Jesse Radisich of JLL. Jesse is the Director of the Victorian JLL Development Site Services team and has over 13 years of experience in the real estate industry.

Throughout his career, Jesse has developed a strong track record of success in managing complex development site project transactions and delivering creative solutions and exceptional results. In his current role, Jesse works with an outstanding team of JLL professionals across a range of specialised sectors who are committed to providing their clients with the highest level of service and support. And their development site services, Build to Rent team has a particular geographic focus on the inner suburbs of Melbourne with specific expertise in the residential, the Build to Rent, and the commercial development sectors. Over the years, Jesse has represented a range of clients, including local and offshore development and investment groups, high net with individuals, major corporations, government bodies, and not for profit groups. Finally, Jesse is very passionate about the development sector and is very active in advocacy for and support of the industry.

Welcome, Jesse.

Jesse: Thank you, Rich. Thank you very much for having me.

Richard: Jesse, before we jump into the podcast, I'm keen to just give everyone a bit of a background, in terms of our relationship. And, over the last 3 or 4 years now, as reflecting, on the way to work this morning, I've had the privilege of presenting with yourself and then also working with yourself and Josh (Rutman), on a number of bodies of work, and it's been an absolute privilege and pleasure to work with yourself.

And I won't embarrass you too much, but, when I speak with the industry, yourself and Josh (Rutman) have a fantastic brand, a fantastic reputation, as does JLL. And I'm really grateful that you've made the time to come on to this podcast because, one of the goals is really to get the leading experts in their various fields onto the show to talk about what's actually happening on the ground. And, as we were talking off record, I'm so excited to unpack your brain in terms of what you're seeing on the ground. I really feel a lot of our listeners are going to be very interested to hear what you have to say, how or the point we're at in the current market cycle compared to where we've been and where we're going. And, again, it's really just trying to have a forward-looking view of the market and gaining insights, to help everyone with their investment and their development decisions.

In terms of the agenda, what I thought I'd do today, and, again, just for our listeners, I'm keen to just learn a little bit more about yourself and your background. And as we're discussing off record why I'm keen to do this is because you are one of the leaders in your field. And no doubt there are people out there that might be 10-15 years younger than you starting out in their careers. I know when I was starting out in my career, I looked up to a lot of people and tried to understand what their qualifications and their experiences were or are. I'm keen to learn a little bit more about yourself, and I'm sure our listeners will enjoy that too.

The next thing I'm keen to discuss very briefly with yourself, but I think it's really important, is your team. You've made a comment, and I've seen it when I've presented with yourself and Josh (Rutman) a number of times about your high performing team. I'm a very big believer in actually building a high-performance team. I have a growth mindset, and I just commend you and Josh (Rutman) because when I've worked with you guys, I can see that you're very good leaders, you're very good managers, but you're building confidence across the team. You can feel free to give a shout out to some of the people in your team.

Finally, I'm keen to talk to you and get an update as well as an outlook on the sales activity across what you're seeing in the residential space, the Built to Rent space, and then the commercial office space. Particularly, I'm keen to understand things like where investor interest is coming from, what overseas locations or domestic locations, as well as where you feel we are in this cycle compared to where we've been in the good times and then also in the bad times, perhaps the height of the pandemic. And then finally, I know you are an advocate and support of the industry. I'm keen to talk with you and get your views on what needs to be done to resolve the housing crisis. It's not so much about talking about the issues or the problems. We know all that, and we will highlight that, but it's more talking about how we can resolve everything moving forward. We have a number of government listeners, and I speak with a bunch of them. I know you and Josh (Rutman) act for a few of them, and they also very much value your views and your advice. And I'm keen to talk with you about what we can do to solve the crisis.

So, with that in mind, the first topic of discussion, is could you please tell us a little bit more about yourself and your background?

Jesse: Absolutely, Rich. Thank you. And before we jump in, I'd just like to say how much I also value and appreciate our professional and personal relationship and the work you and the Charter team do. And your team specifically is really tremendous for our industry and our sector, and we really enjoyed working with you over the past few years as well. I think this podcast is the next step in that progression.

My personal background, it's fair to say I have a property background. Both of my parents are town planners and have, at various stages in their lives and careers, also been builders and smaller time developers, small town house projects and whatnot. I've always grown up with property and development around the home. And I remember as a young boy being dragged to VCAT hearings with my dad, which was probably not enjoyable at the time, but a funny memory to look back on now.

Property was always going to be my direction. I wasn't exactly sure what I wanted to do, but I completed my degree at Deakin University, Bachelor of Property in Real Estate. And I remember in my second or third year of university, people started getting jobs. And I thought, “oh no, I better start thinking about what to do.”

And I started applying for some grad roles and grad programs, and I was fortunate enough to secure a grad program at Savills and from there, fell into the agency role. I seemed to take to it quite well and someone obviously thought that I was doing a half decent job and kept going with that. I ended up spending 10 years at Savills and had a wonderful time there. It's a really great business. And about three years ago now, I made the move to JLL.

So, I'm about 13 years into my career. I've only worked at two firms which I'm told is quite rare for agency or any business for that matter. And now in my role at JLL, heading up the development site services team and have a wonderful team of people that we work with. You've mentioned Josh Rutman who heads up our capital markets team and also works quite closely with me on the development site space. And then, Maddy Pizzey (Madeleine Pizzey) is an agent in our development site services team as well and an absolute up and coming superstar and doing some great things.

Not only in the property space specifically, but also advocating for women in property doing some great initiatives on that front and really building the profile of our team and JLL more broadly.

Richard: Fantastic, Jesse. Thank you very much for that. And, yes, I do feel it is very rare to have the tenure that you've had, but I think it's also probably a reflection of your character and your loyalty. I suppose as an aside, if there's any listeners that are keen to actually get in touch with, the JLL team and potentially talk about opportunities, please follow the notes or the links to Jesse below. I'm sure he'd be happy to have a chat with you and just talk a little bit more about what the opportunities are in the industry.

Alright. With that in mind, let's get into the meat and bones of some of the discussion for today. And when I was coming to work this morning, I basically thought, I'd like to give the audience points of reference because people right now keep saying things like, “the market's at the start of a cycle” or “it's turning” and so forth, and that's all well and good, but the best traction I've had is when I can give people points of references by looking at longer term averages or peaks or troughs. And I think probably the easiest thing, and you can correct me if I'm not on the right track here, but I'd like to believe that this could be a good point of reference, let's use a scale of 1 to 10, and one being the worst conditions you've seen.

So, for example, whether it's the GFC or let's use, the height of the pandemic when a number of commentators were thinking that the market was going to fall by 30%, perhaps that we were, going to all die of COVID and things like that. That can be the absolute worst sentiments, and worst conditions that people can keep as a point of reference, and then a 10 being the absolute booming periods that we've seen, perhaps, over 2013-2016 when there was a significant amount of overseas interest, a number of incentives that were allowing both foreign buyers and foreign developers into the market. So those are the two points of reference, one being absolutely terrible, ten being the best conditions. As we talk through now, and I know that you're doing a lot of sales and I appreciate it's just in Melbourne, but, and we can focus there certainly. If you've got any insights for more broadly, please also tie that in. I'm really keen to understand across residential, Built to Rent, and commercial, what you're seeing on the ground right now, where you think we are on that scale, and because I do have very real concerns that often what is reported in the media is not reflective of the entire market and is often very submarket specific. So, let's kick off there. What are you seeing or what have you seen over the last 12 months in this space?

Jesse: I think it's fair to say, Rich, that we are in an extremely challenging market, and anyone who tells you otherwise is probably being a little bit disingenuous at the moment. It is challenging on many fronts, but I'm also very positive and optimistic as I think you are about what is ahead of us.

But right now, where we sit here today, there are challenges, obviously, with delivery and construction. There's challenges with funding and financing. There's challenges with planning. There's not a lot of easy wins at the moment in the development sector. And if you look at where we've come from over the past five years, 2019 wasn't a great market either. That was, APRA potential controls on lending straight into COVID in 2020.

Richard: So just with 2019, on that scale of 1 to 10, and I appreciate, residential might be a bit different to commercial, but for 2019, where do you think, and it's not that I'm going to necessarily hold you to it, but just for our audience, on a scale of 1 to 10 in 2019, where do you think we were?

Jesse: Probably around a four, I would say, in terms of sentiment. But if you look at some consumer sentiment data right now, it's the worst it's ever been. Or at least in recent memory. So that's that is quite telling. Then, of course, we had a bit of a sugar hit coming out of COVID, and 2021 was a very strong year. But it's been bubbling away and a little bit challenging since then, I think it's fair to say.

Richard: So, with 2021 then, on that scale of 1 to 10, where did it rank?

Jesse: It was probably a 6-7.

Richard: Then in terms of bubbling away now, where do you think we are right now?

Jesse: I feel like we're 4 or a 5 right now, to be honest.

Richard: Please be honest in the sense that you're on the ground. You're dealing with buyers and sellers, and you can quite simply see whether transactions are occurring or not. So alright, for ranking pretty weakly right now, let's start with residential. So, I'm assuming you do both, Build to Sell, and Build to Rent, obviously. I don't know if you do any townhouse sales, but what are you seeing with Build to Sell? What are you seeing in that space and what's the interest or lack thereof?

Jesse: So, the Build to Sell space, the vast majority of interest we've been fielding and working with over the past 12-24 months is really only in that higher end residential space, boutique, owner occupier, apartment product where there is flexibility or elasticity in the revenues. And you've obviously been at the forefront of talking about revenue profiles and where things are and where things are heading.

And on a positive front, we have seen quite a bit of movement in revenues in certain locations throughout Melbourne, that has kept things moving quite a bit.

Richard: Just so the audience understand, when you say movement in revenues, is that the sale of product rather than land value?

Jesse: Yes. That's the sale per square meter of completed apartment product. And, obviously, development is just an economic equation. You need to have a certain gross revenue from the project, then you'll have certain costs. And hopefully, at the end, there's a little bit left over which is your margin. And there's not many developers out there who are developing for fun or for practice. So there needs to be a margin there. The story in the residential space right now is a revenue story and where you think you can deliver product, where you can achieve revenues sufficient enough to cover costs, which of course, we know have been rising substantially over the past 2 years or so. And there was an article yesterday in The Australian that says there's further rises to come. And I'm sure we'll touch on that at some point. And the issues that are driving that or the forces that are driving that.

But it feels like every site we're selling at the moment, developers are underwriting or having to underwrite an elevated level of project revenues or setting a new benchmark in terms of sales rates.

Richard: Wow. Okay. So that's really Build to Sell. I want to isolate Built to Rent in a second.

In terms of the actual transactions that are occurring, what are you seeing with those prices? Are they staying the same? Are they going backwards? Are they increasing? Obviously, in the areas that you're focusing on, what are you seeing?

Jesse: So land values for those sites in the premium suburbs, the inner east, inner southeast, probably the inner north like Fitzroy as well, those suburbs' land prices are either maintaining or even increasing a little bit because there is intensified demand from developers in those areas and for those sorts of sites because they're seeing it as a lower risk proposition or at least a proposition or a project where they can actually get a project out of the ground. The sector we've seen really drop off in recent years is in that larger scale Build to Sell project. You mentioned the years of 2013 through to probably 2017 when some of the bigger towers in the city were being built and the city fringe, and those days are gone for now. There's no projects getting out of the ground or very, very few projects getting out of the ground where you've got, say 100-200 plus apartments. And we desperately need those to come back to address the housing crisis that we all that we're in.

And whilst the 10 or 20 apartment projects are great for the developer doing those projects and the fortunate people buying those apartments, it's not addressing the housing challenges that we're all facing.

Richard: Certainly, we're going to get to those housing challenges in a second, but I'm keen to just bottom out. So, for Build to Sell development sites, where is the interest coming from? Is it local? Is it overseas?

If it is local, is it in Melbourne or is it interstate? And then, obviously, if it's overseas, what are the nationalities where the majority of that interest is coming from?

Jesse: Yes. It's predominantly local developers at the moment, and I'm sure every market's the same, but Melbourne is such a nuanced market as you know. And if you're having to set a new benchmark for revenues or sales rates, you need to really understand the local market. So, there's not many groups that are coming in with the ability or the inclination to deliver such a project and set a new benchmark. But the local groups who understand the local markets, the drivers, the nuance between streets and orientation, and very, you know, seemingly minor things that can make a huge difference in terms of a project's viability.

We're still seeing a fair bit of appetite from groups from Sydney into Melbourne. And as far as the offshore groups go, there's still quite a few groups that are well established in Melbourne and Australia who are delivering projects, looking to deliver new projects. And we're seeing a resurgence or a fresh wave of offshore capital looking to invest mainly into projects as capital or equity partners from the likes of Singapore and Japan, and we're fielding quite a bit of interest from those sorts of groups.

Richard: Isn't it funny? I had a note here to just highlight. I've done a lot of work recently, both for money coming out of Singapore into both Build to Sell or Build to Rent, and then also Japan. And in terms of Singapore, I remember it was around 2008-2009, and a couple of years after, there was a lot of Singaporean, and also Malaysian money that came in, and I'll just make the comment that it's some of the most highly educated data driven money that I've seen, and it always picks up my attention when the Singaporean money starts to move. It's highly educated.

And I was chatting with a few friends that are Singaporean, they're more in the legal space. They were telling me that, yes, it is highly educated, but they also work on a bit of a matrix. I'm still trying to work on specifically what that matrix is, but they say if the returns forward in that matrix, they're keen to move forward. And we're starting to see some of the returns falling into that matrix because Singaporean money is certainly moving forward. What I've seen over the last 6 months, which has been extremely interesting, is Japanese money.

And I haven't seen that for a long period of time. And in fact, I saw it maybe in 2016 when there was a little bit of interest coming into the greenfield house and land market. That was at the time when a lot of Chinese money was coming in. More recently now, I've done a lot of work across Melbourne, Sydney and Brisbane, but particularly Melbourne and Sydney, Japanese interests looking to buy stakes or to buy sites. And I suppose when we were debating it internally, I think one of the reasons is interest rates are at very different points in Japan, and I think perhaps they are trying to diversify some of their portfolios.

When I've spoken with some of these Japanese clients, they have a mature BTR market. They certainly understand the fundamentals. They look at Melbourne and they go, "oh my goodness, why is there not more BTR in Melbourne?" And that, again, is highly educated, highly patient money that's coming in, and I think that's most likely opportunities that we need to keep an eye out for the future.

I suppose that's just comments from my end. I must admit, we probably actually work and advise some of the similar clients to some different sources.

Jesse: I'm sure we do.

Richard: Let's jump on to BTR then. You obviously are doing a lot in that space. What are you seeing interest wise, land values, for BTR?

Jesse: BTR is, as we know, one of the most widely discussed, sometimes misunderstood sectors that we that we operate in. There was a huge boom in terms of activity between, say 2021-2023 and that has certainly subsided somewhat and some of the heat has come out of that market, mainly given rising interest rates and the risk-free returns on offer elsewhere in the market. That has changed the dynamic and the capital flow into that sector quite significantly. And then you layer in rising construction costs and the numbers have become a lot more challenged.

That being said, the narrative around that sector is still extremely strong. And I don't think there's any doubting the product anymore or the sector or the nature of the offering. I think Build to Rent is most certainly here to stay. It's just now going through a period of consolidation. And we'll most likely see some of the smaller platforms that have been established merge or amalgamate with some of the larger platforms.

And that would just be the next step of maturity in the sector. And it still is a very young sector, I guess, here in Melbourne. It's still got a long way to go.

Richard: Two questions there that I'm dying to ask, and I know other people would be asking. The first one is with the Build to Sell versus the BTR sites, are BTR developers able to pay more for the sites? Are you seeing that? I'm interested to know. I know we discussed this about 12 or 18 months ago when you said there was a heck of a lot more activity here. Has that narrowed more in terms of sentiment improving for Build to Sell or, sentiment and returns increasing for BTR? What's actually happening? Are BTR operators or developers still coming and just being able to pay more for those sites? What are you seeing?

Jesse: It's a really interesting point, Rich. And we have noticed a clear inflection point in some of these deals we've been working on where, if it is in the right location, it does have the right characteristics, we can and have been seeing Build to Sell developers, out compete Build to Rent developers.

If the sales rates per square meter are sufficient or high enough for the Build to Sell developers, they can most certainly and have been outbidding Build to Rent developers. But if it's in an area where maybe the Build to Sell rates aren't as strong, but the rents would be quite strong, that's where Build to Rent developers are still very much coming to the fore and being quite competitive.

Richard: That's amazing to hear. Thank you for basically validating one of my hypothesis because I've had a number of BTR operators come to us and go, "look, we're struggling to raise capital. We can still raise debt, but it's on higher terms." Equity is extremely difficult to raise right now, and I've done some work with them to understand whether they can pivot the scheme to Build to Sell and get high revenues or pivot the scheme to, student accommodation. And I'm just wondering if you think that that's going to continue in the sense that some of these sites have been purchased two years ago with the finances' requirements for high weighted average cost of capital. They are very conservative right now, and I understand them because it's an emerging asset class. They don't want to take on the development risk, whether it's the planning or the construction.

Given that they're seeking higher returns now, do you think that either some of these BTR sites might come to market, or do you think that some of the schemes might pivot? What are your views on that?

Jesse: I think it's a moving phase, Rich, and it's something that's still playing out at the moment. Obviously, we're seeing quite a few of the sites we sold in recent years are now getting out of the ground, which is very exciting and pleasing to see. Some are still in planning phase. I'm sure there are some that are maybe held up because of capital challenges or because of return profiles that need to be addressed. And there is a consolidation happening and maybe some recapitalisation of some sites or some projects that are happening. But there seems to be no shortage of interested capital globally that's still very interested in the sector, particularly in Melbourne given the broader narrative. So that's still all playing out at the moment, but the tailwinds driving the sector and the housing sector, generally, I think, are giving everyone a pretty high level of confidence long term in the sector and in Melbourne.

Richard: Look. I agree with you. It's amazing. When I speak with a lot of these funds, and I basically break the presentation into two parts. I talk about the fundamentals, and then I talk about some of the returns. In the last couple of ones I've done, they've basically asked me to just skip the fundamentals because they understand it. They get it. And whether it's from Japan or overseas where there's mature markets, they get all that and they go, "yep, got no issues there." Let's talk about development risk and about the returns and land values and rents, and are rents going to continue to increase because that underpins our feasibility.

It's been very interesting to see that they don't need to be convinced. Perhaps a few years ago when I did some of those presentations, and we've done a bunch of them together where we talk about the structure changes in living preferences or, take up of apartment living, they see that they don't need to be convinced on that. But it is very much going, well, why would we put money into BTR when we could put it into, for example, a wind farm in India? We had a debate with one of the financiers about that. And it was interesting to just hear their views because they looked, basically, that money is very agnostic. It doesn't really matter where it's just chasing a return. It's chasing a return over a period of time. So whilst it sees the fundamentals, whilst it can see that it's actually a defensive or low risk asset class, it's still unsure with where the returns are going to lie. And so I suppose I'm interested to see how that plays out as the Build to Sell market continues to improve, and I genuinely believe that it is already improving. I do believe we're going to get continued increase in revenues and projects. There will come an inflection point. I'm not sure when it's going to come. Rents will continue to rise. Prices will continue to rise.

Finally, we were able to actually get a supply response. That could be expedited if the government started incentivising the market, and no doubt we'll get onto that in a few minutes' time as to what needs to occur. But I'm just interested to know. I suppose I went on a bit of a tangent there because I was just trying to work out where we're going to be in 6-12 months' time, especially with this BTR space. The fundamentals are definitely there. It's just convincing some more capital to actually take, I suppose, make the investment.

Jesse: I think it's all spot on, Rich, and these are the conversations we have over coffee quite regularly. The world has changed, and there's risk free returns that can be achieved in many places globally. So, the investment case needs to be made for why Residential, why BTR, why Melbourne. I think there's a pretty strong case to be made for all those points.

And there's plenty of large global real estate groups that still don't have anywhere near the exposure they would like to have in residential or in living sectors globally. But then they know, as you said, and probably thanks to much of your great work that Melbourne and the narrative around Melbourne is extremely strong.

There's no doubt about it. There's a lot of negative talk around Melbourne and Victoria and politics. I'm sure we'll get into a little bit of that at some stage.

But the pure fundamentals around Melbourne and the supply and demand dynamics at the moment, and just the fact that Melbourne is still one of the best cities in the world to live, there's still a lot going for it.

Richard: Well, before we get into all those politics and really the housing crisis, I'm keen to just close out what you're seeing in the commercial space. And I'll make an observation, and then I'll hand over to you. But I've studied the market for the last 10-15 years. And when I think of, for example, the CBD or the inner fringe areas, I know you're active in a lot of those areas, it points in the cycle where commercial office is much more attractive and, obviously, you probably get higher returns based on the risk you're taking. That flips around again at different points in either the property or the economic cycle, and then it goes to residential and it flips back to commercial office. And it's amazing. You can see a few sites across all the capital cities, but because we're talking about Melbourne today, that have actually flipped permit wise from residential to commercial, back to residential, leading into 2019, the commercial office market was, and it looks like on the stats, and I'm not as close to it as my colleagues in the commercial space, but, certainly, there's a huge amount of supply coming on board, particularly in Melbourne. There were very, very strong fundamentals, very strong white-collar growth.

Obviously, we went into the pandemic, and that supply effectively flooded the markets and vacancy rates increased, and we had a structural change in both living and then working preferences. We also, at the same time, though, had the emergence of the commercial office markets in the fringe, especially in Cremorne and Richmond. I'm interested to know what's happening now, because there was a point into COVID where a lot of the residential sites I remember working on, and they were flipped to commercial office, and they were speculatively built. They didn't even have anchor tenants. I'm wondering now what's happening with where the commercial market is at, office market is at, with where build costs are at, with the residential market now starting to turn.

What are you seeing in that space, on the ground, both from those sites and then also developer buyer interest?

Jesse: It's a really great summary, Rich. The office sector is clearly a very cyclical sector, probably more so than residential, which is much more stable. There's a lot of people who have done very well out of office in recent years and many who continue to do very well out of office. But we know that, particularly in the development of new office, it is quite challenging on a number of fronts.

There's obviously the tenant story and just the office story generally, which is being challenged by the work from home narrative coming out of COVID and whatnot. And then we have construction costs, which, of course, are affecting all sectors. And then I think the biggest challenge in new office development is just their view on where exit cap rates will sit. And when you combine those three, leasing uncertainty in certain areas, construction costs, and then what it's going to be worth at the end. And the variance can be huge if we're talking just for round numbers of 5% cap or a 5.25% cap. The difference is huge. And it doesn't seem like much when you say 5.25% or 5%, but it is significant. So there's a lot of uncertainty in the new build space. But I'm a big believer in the office story. I mean, we're sitting in a great office here today. We've just been fortunate enough to move into our new offices.

Richard: I saw that. Congratulations.

Jesse: Thank you. And we can't wait to get you up there.

It truly is a remarkable space. And anyone who says the office is dead should come up to JLL at 101 Collins Street because it is truly phenomenal. We're very lucky. So, I think that is the trend that we're seeing, which is businesses want to be in the best space and their employees want to be in the best space. A-grade and premium office is still holding up very, very well.

What we are seeing though in the development space is those B-grade and C-grade buildings, whether it's in the city or the city fringe, are being either repurposed but more prominently or more frequently redeveloped. So, they're now at a point in the circle where the asset value is either on par or very close to the land value, and that is unlocking more opportunities for supply in the residential sector.

Richard: Very interesting. Well my gut says, looking at some of the stats too, so it's not just my gut, I do feel that there are those opportunities in the residential space where just over the next couple of years, in particular, as the residential cycle starts to really kick into gear to pick up those sites and then do exactly what you've described, it'll obviously come back to the financial decision, but Build to Sell is very well understood.

I chatted with a number of financiers, and right now, they're basically going, "would we do Build to Sell or Build to Rent?" And a lot of them actually flipping back to Build to Sell.

Jesse: Yep.

Richard: So I feel that they just understand the financing of it.

Jesse: Yeah.

Richard: It doesn't mean that Build to Rent, it still has a very good role to play. And I had a financier, on the last episode, and he had some fantastic insights into the financing and the financials of Build to Rent. But it's just interesting. I feel, overall, there's opportunities for those commercial sites potentially to just be picked up by residential developers or certainly doing at a minimum mixed use.

Jesse: Yeah. And that's what we're seeing as well, Rich. We know there's quite a few developers now who are adjusting their mandates or lining themselves up or their businesses up to start delivering, quote on quote, larger scale residential projects again, whether that's 50, a 100, a 150 plus, which is really what we need. And just to quickly round out on the office sector, I think that if there's any listeners out there or anyone in the market who has the ability to deliver office in the right location, I think they'll be richly rewarded over the coming years. Because the more office that comes out of the market, the lower the vacancy rates are going to be in the right areas. And for the right product in the right location, the tenant demand is very strong.

If anyone can deliver a high-end office project in Armadale, Toorak, South Yarra, they're going to do pretty well.

Richard: Very interesting. We're actually doing a little bit of work and talking to various clients on that. So, again, you're probably speaking to the same ones, but all the listeners, please reach out to Jesse and the team. I'm sure they'll be able to help you out and point you in the right direction.

I know we're running short on time now, but I'm keen to talk a little bit about the housing crisis. I suppose the question I'm going to ask you, you and Josh (Rutman) are often overseas, often in Singapore. I love Josh's stories about how Singapore's run out of land and they're reclaiming land and building. That's not the question I want to ask. What I would like to ask, and let's start off, is with overseas capital, what's happening with the tax settings here? What are they seeing, and what do they need to actually make the investment decisions? Are they holding off? Are they proceeding? Let's start with that.

Jesse: The tax framework and the tax settings we have in Victoria, Rich, are a huge challenge for all of us, and I think I heard the other day or a few weeks ago that we have 27 property taxes in Victoria.

I need to confirm that. I don't know that categorically, but I did hear that from a pretty good source the other day, which just gives you a sense for what we're up against in our sector in Victoria. And some of the more recent taxes that have come in like the foreign investor surcharge and the vacant residential surcharge, I think it's called, and the absentee owner surcharge. They're all causing big issues, not just for offshore groups, but even interstate groups.

Richard: Yep.

Jesse: Focusing on housing supply. If you look around the city at all the big towers, not a single tower was built without foreign investment. And that's foreign investment from the developer and the actual project team, but also from buyers of the actual apartments. And that provides housing for locals as well. So, it's a huge part of our sector, and it's of critical importance.

And at the moment, we're almost turning away that investment that we so desperately need in Melbourne. And I know that the view for many is that it's making it easier or more affordable for us and for locals to buy real estate. But the simple fact is we need more supply, and we need it desperately. And we need a lot more. You know the numbers better than anyone.

Richard: I definitely do, and I suppose the reason why I asked you the foreign capital is when I have presented to them, they've gone, "Richard, we see the fundamentals. We don't need you to explain that to us. Let's talk about the finances, and let's talk about the taxes." 12 months ago, for example, in BTR, you updated us on what was happening with MIT. It's been 12 months later. We don't have certainty. We need certainty before we can make our investment in our development decisions. We don't have certainty. We are likely to actually place our capital elsewhere. We still really like Australia, but Victoria is just too uncertain.

And why I raised that is I was incredibly disappointed when I saw the federal government or the debate in Parliament with MIT where basically they turned around and they said the great Australian dream is for detached houses, not foreign capital building flats. Leaving aside the arguments or the debate that we'll have about the great Australian dream, which, by the way, for the listeners, I certainly do believe in, I believe that there's a role for house and land. There's a role for townhouses. There's a role for apartments, both Built to Sell, Built to Rent. What that statement shows, it's a fundamental lack of understanding of the housing market.

And your point is incredibly well made that in especially the medium but the high-density space, there's a lot of foreign buyers who are prepared to purchase off the plan. They will then allow presales hurdles to be achieved, construction to be provided, buildings to get built out. What that then means is that additional dwellings are built. So that ultimately puts downward pressure on prices and rents. And for anyone listening, please jump into our state of the market reports.

You can see in Sydney over 2018, I believe there are around 30,000 apartments delivered. That's the first time I did a body of work for a developer, and we're analysing both prices and rents. It's the first time, again, leaving aside what happened in COVID, that rents and prices actually remained flat. And when we looked at it, we basically said, "well, look at that quantum of supply that's actually coming to the market." Now it didn't oversupply the market, but it gave people choice, and just added to the supply.

So, the government has a target of 1,200,000 dwellings. That's 75,000 in New South Wales, 80,000 in Melbourne. We're not going to get anywhere near those figures without foreign capital. So that's why foreign capital is important. Those are the taxes that I want to just start addressing in terms of giving the investor market certainty.

Talk to me more about what other issues you're hearing on the ground that are causing you concern that I suppose you'd like the government and decision or policy makers to actually hear your views on and make decisions on.

Jesse: Planning is obviously a big challenge, but I don't think it's the solution for all of our problems. When you look at the housing market and the key drivers for affordability, I see them as being the economic factors, whether a project is financially viable. If there's affordability in place.

So, can people borrow to buy a product or buy a residential apartment or a home? And is there sufficient serviceability? I think a big challenge at the moment is obviously the serviceability constraints which is APRA. And that is obviously putting a lot of strain on how much people can borrow and therefore, adding to the affordability constraints that everyone is experiencing from higher borrowing rates.

And as you know, that is pushing buyers down the spectrum from, say, a $1,000,000 home to a $700,000 home, and you and your team have done some fantastic work on how that looks and what the impact that is having.

Richard: Yep. Look, for a while, I've been saying, and I can say on the podcast, I don't believe that the APRA serviceability buffers right now reflect where the market is at, and I do think that they need to have a and I know that their office has been outspoken with trying to be responsible with capital requirements. But unfortunately, I think that's another metric or buffer that is not responding to the current market settings, there's no silver bullet to resolve the housing crisis, whether it's change in interest rates or incentives or APRA changes. But it's an incredibly complicated market, and there's a number of levers that actually do need to be pulled, and it always astounds me that you've got these buffers that seem to just miss where the market is actually at. And, I suppose what I'm really saying today is I do think we should have a debate about, a long hard think about, whether those requirements are the same as when they were put in either during the pandemic or even before that in 2017 when there was a concern, and it was an unjustified concern about investors inflating the market. That certainly one thing I'm keen for the industry to really look into and actually consider, and I do feel that will then translate into greater buying and purchasing capacity.

And you're right then. As we've described, it is the cascade effect where buyers need to decide whether they're going to trade off the dwelling, or the location in which they want to live. And I'm very much about actually giving everyone a choice. And right now, they don't have the choice. The reality is they need a place to live.

The reality is with where the interest rates are at and where the serviceability buffers are and a lack of supply, they're being forced to make very difficult decisions. And I just remind the government that this is not going to change until policy settings are changed. And even when those policy settings come in, it's still going to take a number of years for new whether it's planning or financing to actually flow through and stock be delivered. So, decisions made today impact from a year or 18 months' time, and they really need to be made now.

Jesse: And you mentioned incentives, Rich. That is a huge factor. Obviously, a big, big part of the apartment boom in the in the mid-teens to the late teens was off the plan stamp duty concessions. And that is, obviously, only one lever that can be pulled, but it is something. And I'm sure there's plenty of other avenues that could be explored to stimulate that market. But at the moment, there's really no incentive at all for developers to be delivering larger scale projects or for investors primarily to be buying investment apartments, which is a big driver of any large-scale project.

You're not going to sell 200, 400, 500 apartments to owner occupiers in one building. It's just not how it works. You need that investor element to actually get these projects out of the ground and therefore, provide that housing to the owner occupiers. And the rental yields are obviously now more compelling than they have been. So, there is tailwinds for investors or incentives for investors from a financial perspective to look at that sort of product. But then you look at the change to the land tax thresholds, and that's been another hit to that part of the market because that's now those investors and owners are getting hit with land tax when they previously weren't only a few months ago.

Richard: Well, Jesse, thank you for that. I know we're running short of time. Is there anything or any further comments you want to make before I close out our session for today?

Jesse: I think I'm optimistic about the future as you are, Rich. I think, despite the challenges that we're talking about at the moment, and you're doing such a great job in articulating to the market and the advocacy you and your team do for the sector is critical. And particularly, the government work because, hopefully, they're listening to you because I think everything that you're telling them is spot on. But there's definitely brighter times ahead for the sector. I think we are at the low point now. And for all the developers out there who are taking positions now, which there are plenty doing so, and buying sites with slightly longer dated settlements or plans for the future, I think they'll be well rewarded.

And, I'm very excited about what's to come.

Richard: Jesse, thank you very much for that, I share your sentiment there, and I would just remind our listeners that property development and investment is, and I'm stating the obvious, it is cyclical. Typically, the cycles go 7-10 years. The last show when I spoke with one of the private financiers, we basically landed on, and I certainly reiterate that I feel we're at the start of a very strong boom, especially in residential across all capital cities, but in the East Coast cities. And I'm looking forward to seeing that really starts to emerge. Government has a critical role in terms of incentivising the market. I know we've got a federal election that may well be even later this year or early next year.

I'm interested in watching very carefully to see what policies come out there. Again, I remind our listeners that that will create a little bit of uncertainty until there's the outcome of the election because no doubt there'll be debates about negative gearing, rent freezes, population growth. We just have to manage that in the work that we're doing and then look forward and further into the cycle.

In terms of closing out today, there were a couple of learnings that I certainly have taken out and just for the listeners to take away. The first one is I thought it was very interesting to get Jesse's view on where he feels we are in terms of on the ground, ranking development site sales from a ranking of 1 being terrible to 10. And, just to recap, in 2019, he felt it was about a 4, if I'm correct. In the middle of COVID and there were low interest rates and a number of incentives and a lot more positivity, we got up to about a 6. Unfortunately, now we're down at a 4. And I think that's everyone to keep in mind because there's two ways to look at it you can say, and you can continue to be very negative. Or you could potentially say that there's opportunities, countercyclical opportunities that you could pick up now. And, certainly, that's the theory or not even the theory, the investment logic that I subscribe to because I can see the fundamental imbalance between supply and demand and a number of projects not being able to be activated. And the ones that back themselves, I genuinely do feel will be rewarded.

I also thought it was very interesting that you basically said that sites are being purchased, but developers are really making and there are assumptions that revenues are going to increase. And I've said for a while now, I genuinely feel that there's a different financing model that needs to be introduced right now to basically understand and reflect or respond to where we are, not just in the market cycle, but also the impact of the pandemic. I have spoken with a few financiers about that, and I'm convinced that there's people out there in finance that are much smarter than me that can actually start setting up structures to actually fund land purchases based on what Jesse was describing in terms of revenue increases.

The second last point that I thought was interesting is the return of Build to Sell versus Build to Rent. Because I do remember two years ago, Build to Bent was definitely the darling, of that asset class. And, it was a countercyclical play. It wasn't relying on presales, and supply could, at that time, get mobilised quicker because interest rates are much lower. It's interesting now with the increase in interest rates and building costs that the weighted average cost of capital means that perhaps it has reached an inflection point where Build to Sell now is going to start to become more financially viable.

We'll have to just watch and see how that plays out. But for any developers out there looking to pick up sites, first of all, obviously, go and speak with Jesse and Josh and get their views on the market. But consider doing Build to Sell as well as Build to Rent and potentially even commercial office based on Jesse's views, which certainly I agree when I speak with the teams or the values and I look at the stats.

And then finally, just to close out, our government clients, I've said this a number of times, but I'll continue to say it. Taxes now, first of all, need certainty. Investment and development decisions cannot be made in an uncertain environment. We need certainty with MIT, with a whole bunch of taxes and charges. In addition to that, I appreciate that we're in a substantial budget deficit, but taxing an industry and taxing it again and taxing it to death is not the way to resolve a housing crisis. Ultimately, a lot of those costs, if projects are even financially viable, will get passed to the consumer, and that does the opposite to what everyone is trying to achieve with housing affordability. I'm convinced that a debate needs to be had on changing whether it's stamp duty or land tax or capital gains tax or negative gearing.

I've got someone on the show in a few shows' time to actually start debating how that could potentially occur because I speak with a lot of people internally, particularly our CEO, Peter Hutchins, and we're both not really convinced that the tax setting and tax structure in Australia is actually fit for purpose. Now, do we have all the answers? No. But I want to have a debate to try and get to all the answers because the decisions we make today will impact both our kids and our grandkids into the future, particularly with how long supply takes to get mobilised.

So that's what I wanted to say for today. I hope everyone really enjoyed listening. Jesse had some fantastic slides that I'll post in the show notes. Please, reach out to him or Josh (Rutman) or the JLL team. They are fantastic to chat with and excellent at what they do. And please keep listening in.

We've got a couple of really exciting speakers coming on in the next few shows. Thank you very much.

Richard: Thank you very much for listening to this podcast. If you enjoyed the episode, please make sure to subscribe to our podcast so you never miss an episode as we've got more exciting content coming. We'd love to hear your thoughts.

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