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Addressing the Institutional Investor Conundrum for Build-to-Rent in Australia

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The Programme is funded by a cross-section of businesses, representing key market participants. The IPF makes a contribution to the Programme and gratefully acknowledges the support of these sponsoring organisations:

INTRODUCTION

In 2023, the IPF Research Programme launched its second grants scheme to provide financial assistance to promote real estate investment research. No specific themes were suggested and prospective applicants were encouraged to examine issues that would advance the real estate investment industry's understanding of and implications for asset pricing, risk-adjusted performance and investment strategy. The scheme was also open to individuals, working within institutional organisations, where the grant may be used to fund data acquisition.

The Grant scheme was first run in 2021 when three applicants were awarded grants. This time, an appraisal of proposals received by the deadline of 31 August 2023 resulted in the provision of grants to six submissions, with limited supervision afforded by a sub-committee of the IPF Research Steering Group during the research period.

Each paper is available to download from the IPF website. We hope you find them a diverse and interesting read.

The following paper has been written by Piyush Tiwari, Raghu Dharmapuri Tirumala, Godwin Kavaarpuo, Samuel Swanzy-Impraim and Jyoti Shukla.

Richard Gwilliam
Chair IPF Research Steering Group
January 2025

The IPF Grant Awards Programme encourages the production of research that is of interest to the real estate investment community. This research is not overseen by the Research Steering Group and finished reports may contain opinions that are not necessarily in line with the opinions of the IPF.

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We also are grateful to twenty interviewees across three countries who generously shared their time and knowledge despite time-zone differences to help us unpack the institutional investor conundrum in the build-to-rent market in Australia. Due to confidentiality, we are unable to reveal their identities. Finally, we would also like to thank Faculty of Architecture, Building and Planning of the University of Melbourne where the research team is based for provided the conducive environment to complete the project.

Executive Summary

This report provides insights into the institutional investor behaviour towards build-to-rent (BTR) investment in Australia. Despite the appeal and the limited progress in policy environment for these assets, the capital flows from domestic institutional investors remains below expectations. The key objective of this study is to examine the enabling framework and the drivers of the investment decision-making of institutional investors towards this evolving asset class from investors' perspective to identify areas of future policy focus and market development. Data were sourced from semi-structured interviews with institutional investors in Australia, the UK and the US.

Key Findings

A priori beliefs held by institutional investors play a crucial role in shaping investment decisions and perceptions of BTR's potential. While the BTR market share in the US is around 13% of the total rental sector, Australia's BTR share in rental sector remains less than 1% due to several factors identified by our study.

The study finds that the market condition and market efficiency are conducive for robust growth of BTR sector in Australia. Against the backdrop of addressing an impending housing crisis, the demand preference for BTR housing is evident in the demographics, the shifting lifestyle preferences for rental over homeownership, and rapid urbanisation in Australia. Institutional investor confidence in the asset class, which is underpinned by returns and capital growth, is bedevilled by construction cost challenges, the interest rate environment and the market's immaturity. Furthermore, we expound that though Australia's BTR model at its infancy is premium, investors are also considering socioeconomic impact and sustainability to reflect their Environmental, Social and Governance (ESG) considerations.

There are three key regulatory barriers to BTR growth in Australia. Firstly, institutional investors are pushed back by the Goods and Services Tax (GST) and foreign investor restrictions through the Managed Investment Trust (MIT) tax rates. Current GST settings effectively mean that BTR is more expensive to build than traditional build to sell stock or even purpose-built student accommodation (PBSA), which attracts Commercial Residential status. Additionally, our analysis shows that the 30% MIT tax rate for BTR, which is double the MIT rate of the other property assets (i.e. 15%), significantly impacts the return on investment of foreign investors and constitutes a major setback for attracting more foreign institutional capital. Secondly, the absence of homogenous planning processes at both the local council and state level delay BTR development by up to two years. The challenges begin with the land acquisition phase, which feeds into the high land values and construction costs. The planning risk contributes to the overall development risks for BTR. To avoid these risks, many investors prefer lands with planning approvals, which comes at a higher cost to the development of BTR assets. Thirdly, our findings show that existing incentives to support affordable BTR have largely been inconsequential. Investors expect higher levels of government incentives to operationalise a sizable portfolio of affordable BTR.

Delving into the institutional investor behaviour towards BTR, we examined firm characteristics and investor experience. Firms that invest in BTR show uniqueness in size, capital base, organisational structure, international experience, and risk appetite, and these attributes tend to influence their investment strategies, risk management, and operational choices. Firms investing in BTR often possess significant operational capabilities, whether in-house or through partnerships. The ability to manage rental properties efficiently is critical to the success of BTR projects, particularly as operational costs and tenant satisfaction directly impact returns. The risk attitude also determines the willingness to take on development risks, market risks, and risk-adjusted return expectations. Australian super funds generally prefer investing in stabilised income-producing assets rather than engaging in new developments. This risk-averse stance is driven by the need to deliver consistent and predictable returns for members, particularly in uncertain economic conditions.

In conclusion, for BTR to play crucial role in supplying rental housing in Australia, as in the US and the UK, a supportive regulatory and policy environment is essential. From an operational perspective, the BTR sector requires intensive property management, ongoing tenant engagement, and regular upkeep of amenities. Institutional investors are actively seeking ways to balance the trade-off between the lower yields that are currently typical for BTR projects and the longer-term security these investments offer. A deep financial market that offers long-term debt, such as the US-style government-backed long-term debt, and equity through the development of BTR-specific REITs, could help in reducing financing costs for BTR assets. Sustainability and ESG considerations have become significant themes within the BTR sector, reflecting the growing awareness among institutional investors of the importance of environmental and social governance.

1. Introduction

Build-to-Rent (BTR) is an emerging residential asset class in Australia, responding to lack of quality rental housing options and demand for long-term rental properties. According to the Planning Department, New South Wales, 'Build-to-rent housing is large-scale, purpose-built rental housing that is held in single ownership and professionally managed. Build-to-rent housing can provide more rental housing choice in areas where people want to live.' BTR ownership provides long-term revenue-generating assets for its investors, who typically are long-term institutional investors. This model of long-term rental housing, well-established in countries like the United States of America (US) , is gaining traction in Australia as a potential solution to the country's housing shortage and affordability crisis.

The BTR sector has attracted significant levels of both foreign investment (especially from established UK BTR and US 'multi-family' operators) and domestic capital. Major players investing in the Australian market include Mirvac, Greystar, Sentinel, and Investa. Investment sentiment towards BTR is generally positive, with investors recognising the benefits of stable income, high occupancy rates, minimal downtime, and diversified tenancy risk. The institutional investors' capital has been a major source of investment in BTR in the US. Features that Midgley & Burns (1977) associate with institutional investors are: availability of large investible capital, role as intermediaries who invest on others' behalf, potential to influence market due to their large capital base and limited competition at that scale, ready availability of investible capital. However, despite the potential and capital base, in Australia, domestic institutional investors have not allocated any significant capital to BTR assets. The PERE sentiment survey[1] of institutional investors has shown immense interest in the living sector, however, this has not translated into investment flows in the Australian BTR sector.

Proponents of BTR have attributed lack of domestic institutional investor interest in BTR to low returns on investment relative to other property asset classes and unfavourable taxation regime. Rapid increases in construction costs and rising development finance costs have made it challenging for large-scale high-density BTR apartment projects to proceed to construction. Inconsistent application of policy, planning, and taxation frameworks across states introduces substantial risk and uncertainty for developers and investors (Urbis 2024).

Recent policy changes have aimed to stimulate the BTR sector. The federal government has tabled a bill in the Parliament to reduce the withholding tax for BTR developments undertaken through eligible managed investment trust (MIT) and an increase in the depreciation rate for BTR properties, subject to certain conditions (GT Law 2023). The government has committed $10 billion to establish the Housing Australia Future Fund (HAFF), available to community housing providers, aimed at supporting the development of public and social housing. Several states, including New South Wales, Victoria, and Queensland, have introduced land tax discounts and other incentives for BTR developments (BuildingLink, 2024).

While previous research has examined the impact of planning, regulatory, and fiscal levers on the financial feasibility of BTR projects in Australia (Tiwari and Shukla, 2024), there remains a gap in the literature regarding institutional investors' perspectives and their response to this asset class. This study aims to fill this gap by investigating the investment objectives, risk perceptions, and decision-making processes of institutional investors specifically regarding BTR investments. By doing so, this

[1] D.Souza, C. (2024). Perspectives 2024: what investors think about private real estate, 7 February 2024, PERE, https://www.perenews.com/perspectives-2024-what-investors-think-about-private-real-estate/ (Accessed 18 December 2024).

research seeks to provide insights into the factors influencing institutional investment in BTR and potential strategies to increase capital allocation to this emerging sector.

The report is structured as follows: section 2 provides a brief overview of the scale and growth of BTR in Australia. Section 3 proposes a conceptual framework and section 4 presents the methodology. Findings are discussed in section 5. Section 6 highlights key policy implications emerging from the research. Section 7 concludes the discussion.

2. The scale and growth of BTR in Australia

Australia's BTR market is valued at $22.25 billion (about 0.2% of the total value of the residential market) (EY, 2024). The common type of projects in the BTR market are premium developments although it is increasingly seen as part of the solutions to Australia's housing crisis. While most developers are currently focused on multifamily projects located in prime locations, other types of BTR, such as single-family rentals, are expected to emerge as the market matures. As of October 2024, there were 23 operating BTR projects (8,708 units) – more than 80% of which are funded by foreign capital (EY, 2024). Another 20,261 were either under construction or planned (EY, 2024). Melbourne's market is the most active in terms of completed stock and pipeline projects. In Sydney, land is less available in prime locations and extremely expensive. Some of the major developers/investors in the space are Mirvac, Gurner Group, Investa, Novus, Hesta, Aware Super and Frasers.

Several factors are contributing to the growth of the BTR sector in Australia:

a) Housing Affordability Crisis: Australia is grappling with an affordability crisis. Property prices have soared, and the demand for rental housing has outstripped supply, pushing rents higher and making it increasingly difficult for many people to find affordable housing. CoreLogic data shows that housing values increased by an average of 22.9% across Australia's capital cities in 2021, highlighting the severity of the affordability challenge.
b) Changing Demographics: More Australians are resorting to renting homes, with the share of private renting increasing to 26.2% in 2019-2020 from 19.9% in 1999-2000.[4]
c) Rental Market Tightness: The rental market in Australia is extremely tight across metropolitan areas, with vacancy rates below 1% in capital cities. This has led to strong rental growth, with two-bedroom apartment asking rents growing by 7-17% across major Australian capitals in 2022.[2]
d) Lack of New Supply: Despite the growth in rental market demand, the supply pipeline of new residential dwellings has not increased at the same rate. Based on current project timelines, the rental market is expected to remain under-supplied until at least 2025.[2]

Despite the positive market outlook, foreign capital still plays the dominant role in funding BTR projects, highlighting the need to attract more domestic institutional investment. To make investment attractive, states have introduced land tax concessions (50% concession on the taxable land value), though with different conditions (PricewaterhouseCoopers, 2024). In Queensland, 10% of dwellings in the BTR project must be affordable to benefit from the concession. New South Wales and Victoria have no equivalent requirements. In South Australia, there is an additional land tax relief for affordable BTR projects (PricewaterhouseCoopers, 2024). These varying requirements across states can create complexity for developers and investors, potentially hindering the sector's growth.

3. Theory and a conceptual framework

In the study of institutional investments in BTR housing, a comprehensive conceptual framework is necessary to understand of factors influencing investment decisions and outcomes. Providing an explanation of investor behaviour towards BTR investments would represent a useful contribution to the field. Such insights would help policy makers design effective policies to facilitate more investment in BTR and more generally the rental housing market.

The efficient market theory in finance assumes that investors are fully rational, and they always seek to maximise profits. In reality, and due to their cognitive or knowledge limitations, investors tend to deviate from pure rationality when they face uncertainty and risk (Simon, 1957). Since the seminal work of Simon (1957), which introduced the concept of bounded rationality, the role of agent's irrationality and behavioural factors in decision making have been examined in disciplines such as economics and operations management (Masini & Menichetti, 2012). The basis for the framework that is used in this study is the literature on behavioural finance.

Kahneman (2003) conceptualized that human thinking involves both intuition and logic. Intuition is characterised as quick, associative and emotional, while logic involves effort, rules, and is slower. Tversky & Kahneman (1974) argued that people rely on several heuristics when making judgements under uncertainty, which sometimes leads to severe and systematic errors in assessing the probability of events. The theory proposed by Tversky & Kahneman (1974) provides explanation for heterogeneity of behaviour among investors. This alternative explanation of observed behaviour in financial market contravenes efficient market theory and as Akerlof & Yellen (1987) argue individuals are not fully rational. The deviation from rationality is not random, rather agents often behave in a similar way (Akerlof & Yellen, 1987). Stulz & Williamson (2003) argue that culture of a country can affect financial market through three channels, by influencing the values, its institutional practices and resource allocation. However, financial markets, instruments and investors are interacting and dynamically evolving (Farmer & Low, 1999).

Application of behavioural finance approaches can be seen in examining questions that relate to market anomalies (Rosenthal & Young, 1990), price volatility (Shiller, 1981), overreaction and underreaction phenomena (Barberis, Shieifer, & Vishny, 1998), equity premium puzzle (Jagadeesh & Titman, 1993), underperformance of mutual fund and pension fund managers relative to passive investment strategies (Malkeil, 1995), market reaction to non-information (Cutler, Poterba, & Summers, 1991) etc. (Ahmad, Ibrahim, & Tuyon, 2017) highlight the presence of behavioural biases among individual fund managers, influence of fund governance and organizational structure. Shleifer (2000) argues that a framework that captures the way investors assess risk, their rules of thumb and how they forecast expected scenarios, would help understanding mechanisms underlying market behaviour.

A conceptual framework grounded in literature discussed above that facilitates examination of behavioural biases of institutional investors in their decisions towards investment allocations is proposed. The framework is applied to the context of BTR asset investment in Australia and is presented in Figure 1.

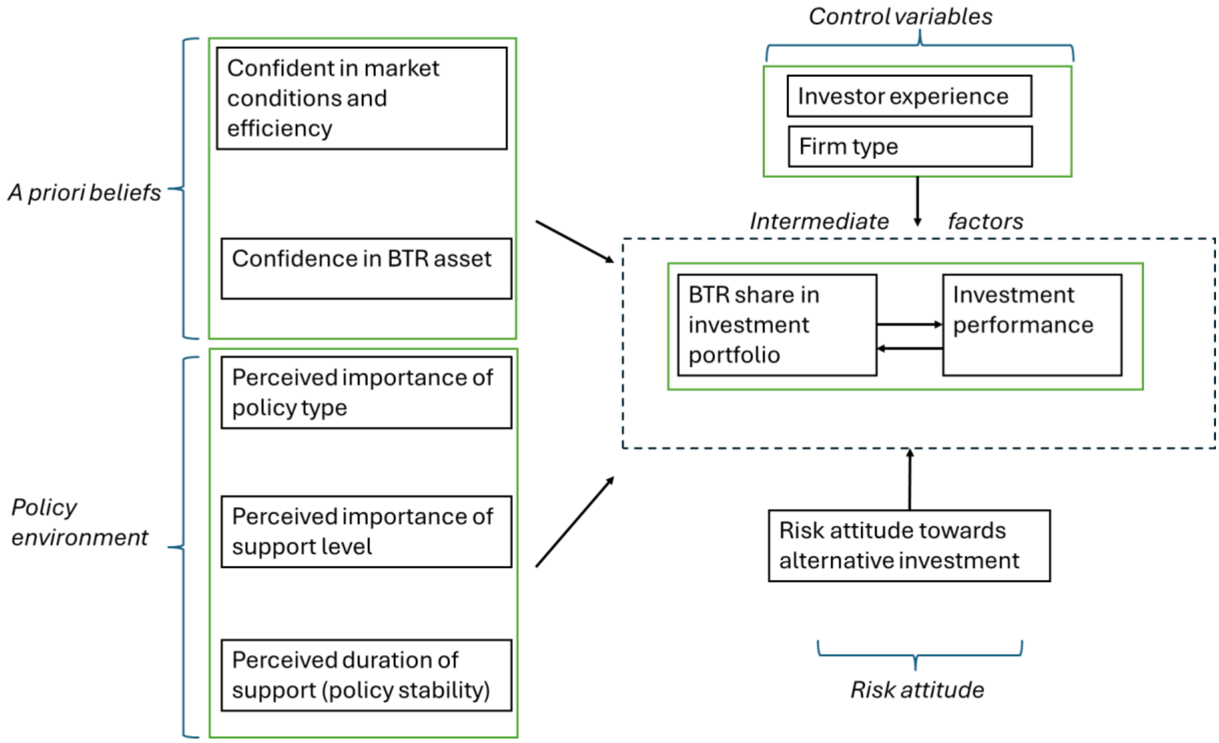


Figure 1: A conceptual framework
Source: Authors

The conceptual framework begins with four key enablers: *A Priori* Beliefs, Policy Environment, Firm Characteristics, and Risk Attitude. *A Priori* Beliefs encompass investors' initial perceptions about the market condition, market efficiency and confidence in BTR assets; performance, including their potential social and environmental impacts. Market conditions include stage in economic cycle, real estate market trend, and demographic shifts, which are critical in shaping investment opportunities and strategies. The Policy Environment broadens to include not only planning and tax policies but also zoning regulations, building codes, and incentives aimed at promoting sustainable development.

Firm Characteristics are control variables that include internal attributes such as the size, type, and investment strategy of the firm, which dictate its capability to engage in and support BTR projects. Investor experience in investing in an asset class domestically and/or internationally helps navigate their approach to investment and due diligence.

Risk Attitude reflects the investors' general tolerance for risk and their specific attitudes towards real estate investments, influenced by comparative assessments with other asset classes.

Intermediate factors such as Investment Strategy Formulation, Due Diligence Process, and Asset Allocation Decisions bridge the initial enablers and control variables with actual investment actions. These factors detail how investment strategies are developed based on the initial enablers and control variables, how potential BTR projects are rigorously evaluated for risks and compliance, and how decisions are made to include BTR in the investment portfolio.

Further, the characteristics of the investment itself are considered, including the scale of investment, geographic diversification, and the types of properties involved, such as multifamily or single-family rental housing. Performance Metrics such as rental yield, capital appreciation, total return, and risk-adjusted return are used to evaluate the success of the investments. A successful investment outcome either realised or observed would increase further allocations. Investment performance of BTR assets in portfolio provide feedback loop. The feedback loop in the framework is particularly vital, emphasizing the iterative nature of investment decisions. This loop illustrates how positive or negative portfolio returns influence future investment strategies, leading to continuous adaptation based on performance feedback.

External factors like macroeconomic conditions, technological advancements, and social trends are also integrated into the framework through *a priori* belief about the market to account for their impact on BTR investments. The availability and involvement of different stakeholders in BTR sector — investors, property managers, tenants, and regulators—contributes to the confidence in this asset class.

Risk attitude and its management is an integral component, encompassing diversification techniques, hedging strategies, and other risk mitigation tools like insurance that safeguard the investment portfolio. Experience of investing in alternative assets provides confidence to investors extending their exposure to BTR assets. Sustainability factors are also crucial, incorporating ESG considerations such as energy efficiency, social impact, and governance practices to align with contemporary investment expectations of institutional investors.

4. Methodology

The research uses a qualitative research design in understanding the behaviour of investors in navigating the BTR landscape.

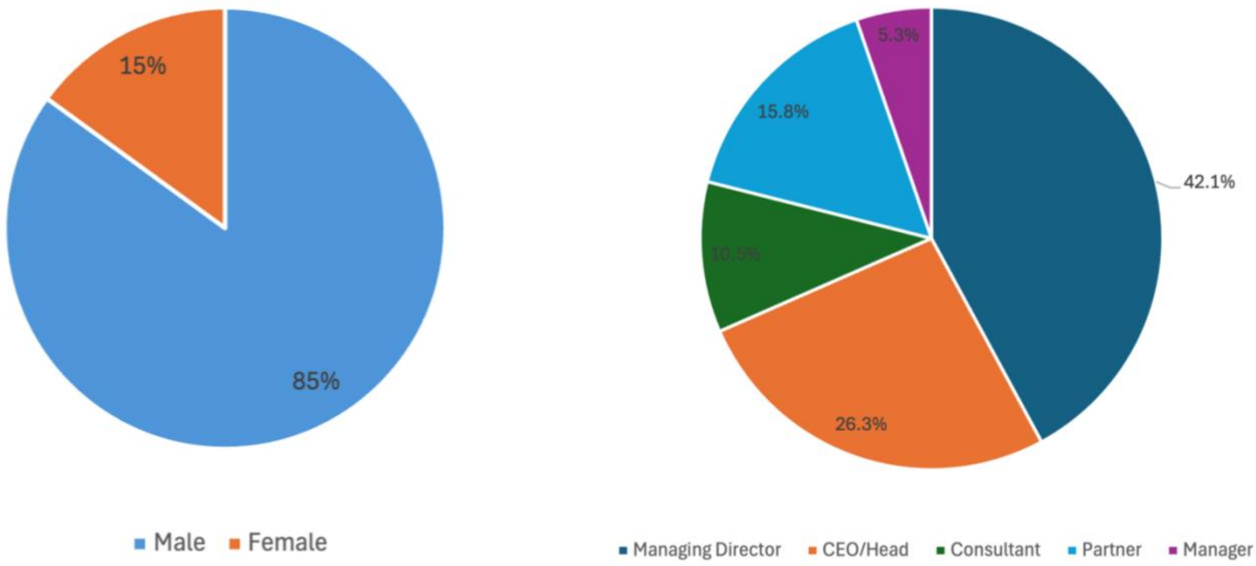
A desktop review of the factors contributing to investment into BTR assets, experiences and challenges of investors and developers into this asset class in Australia, and globally, was conducted. The findings informed the design of primary data collection instrument about the specific areas to cover and the relevant questions. Given the complexity of investment decisions in BTR, semi-structured interviews were deemed the most appropriate data collection tool to provide both consistency in questioning and the flexibility to explore nuanced insights.

The prepared semi-structured interview guide was reviewed by an industry expert with extensive experience in BTR investment advisory. Their comments were used to revise the guide which was used in collecting data from various stakeholders in the built to rent space, in Australia and overseas.

Given the special focus of the study, only senior-level professionals with experience in property investments (including BTR) and BTR development were recruited as interviewees. These were identified using a mix of internet searches and snowballing. Identified prospective respondents were invited via email. We continued recruiting and interviewing participants until no new information was observed in the interviews. This suggested that we had reached a saturation point. In total, 54 individuals were approached out of which 20 agreed to the participate and completed the interviews. Our sample size exceeds the recommended 12 interviewees needed in qualitative studies. Each interview lasted about 45-50 minutes. All research activities were conducted under strict ethical standards, with protocols and materials approved by the University of Melbourne's Ethics Committee. We ensured all participant information was confidential and handled in strict compliance with the university's data privacy guidelines.

A large proportion of the interviewees held senior positions, such as Managing Directors, Directors, and General Managers. About 20% directly managed funds or portfolios. Respondents included professionals from pension funds, global real estate service companies, investment consulting firms, and developers. Most respondents were male (85%), while the female interviewees predominantly held senior roles, either as Managing Directors or senior consultants. The range of professional experience spanned from 8 to 31 years, with an average of 19.6 years, ensuring a depth of knowledge in the BTR sector.

Figure 2: Gender distribution of respondents.



Given the mix of interviewees, not all companies directly invested into BTR projects. Some provided advisory services. There was almost equal numbers of respondents across the groups of stakeholders covered by the study. Thirty-five percent of the respondents worked in global real estate professional service firms, advisory, or consulting firms, providing valuable insights at the market level for BTR in the UK and Australian markets. These were renowned experts who provided market-level insights about BTR across the UK and Australia markets. All consultants also had previously managed BTR projects in their respected jurisdictions (UK and Australia). Thirty percent were developers who owned and managed property assets and had exposure to BTR. Indeed, a distinct feature of these developers was that they also co-invested into the physical assets. Except for one, that was involved in different property assets (office, industrial, retail), all the others operate within the living sector. The final group (35%) of respondents were in super funds/ pension funds, trust, investing, and asset management space. Almost half (43%) were based in the US.

The interviews were anonymised, transcribed, cleaned, and analysed in NVivo. We used thematic analytical techniques, which are most suitable for understanding the experiences and behaviours of actors (Braun & Clarke, 2006), following the six-step steps outlined by Kiger and Varpio (2020). In brief, it involved familiarisation with the data, generating and refining codes, searching for themes, reviewing the themes, defining and naming the themes and writing the report. In generating these themes, we were guided by the conceptual framework discussed in section 3 as a guiding structure. Finally, we triangulated the Australian findings with experiences from the US and UK. The purpose is to understand the levels and market conditions that enabled the multifamily asset class to develop in those markets, generating lessons for Australia.

5. Discussion

The BTR sector in Australia is still in the early stages of maturity, with institutional investors beginning to make sizable commitments. For instance, **R1** reports that their firm has allocated significant capital across projects either completed, under construction, or in planning, with Sydney and Melbourne being the primary focus. This regional concentration reflects the strong rental demand in major metropolitan areas, where housing shortages are prominent.

Similarly, **R5** shares that their company has three ongoing BTR projects in key areas in Sydney, and Melbourne, aiming for 3,000 units across the portfolio. Similarly, **R6** is managing 2,200 apartments spread across five BTR assets in Sydney, Melbourne, and Brisbane. These investments by major players further support the notion that the sector is gaining traction and is attracting significant capital.

R17 brings a wealth of experience from the US BTR market. They are now participating in Australia's HALF Funding program with a focus on affordable housing, following a similar strategy in the Australian market as in the US. Other institutional investors, super funds in particular (though limited in number), are collaborating with developers and community housing providers to create mixed-income BTR projects, highlighting a growing trend toward incorporating affordability into BTR developments.

These investments illustrate that while most projects are centred in established urban centres like Sydney and Melbourne, investors are starting to explore opportunities in Brisbane and Perth, anticipating future demand in those markets. **R1** anticipates that as BTR asset portfolio grows, the scope will expand to include cities such as Canberra, Perth, and Adelaide, where rental markets are also becoming increasingly constrained. This gradual expansion to other cities reflects the sector's growth trajectory and the increasing recognition of BTR's potential in different markets.

5.1 Enablers of BTR Investment

5.1.1 *A Priori* Beliefs about BTR in Australia

Institutional investors' initial beliefs about the BTR sector espoused through their belief in market conditions, confidence in the performance of BTR assets, and their socio-economic and environmental impacts, are shaping their investment strategies and views on the sector's future potential. These beliefs, gleaned from in-depth industry interviews and triangulated by current market analysis, offer insights into the factors influencing institutional investment in Australian BTR landscape.

Market conditions and efficiency

Existing Customer Demand and Sector Growth Prospects: A belief among all interviewees is the existence of a robust and unmet demand for BTR in Australia, echoing trends observed in mature markets like the US. This demand stems from a confluence of factors, including evolving demographics, shifting lifestyle preferences favouring renting over homeownership (a view articulated by **R19**), and rapid urbanisation. The chronic undersupply of housing, coupled with escalating property prices, further amplifies the appeal of BTR as a viable housing solution for a growing segment of the population.

The ongoing undersupply of rental housing, coupled with high rental prices, positions BTR as an appealing solution for the rental market. **R1** draws a parallel between the US and Australian markets, highlighting the potential for the Australian BTR sector to emulate the growth trajectory witnessed in the US.

A comparative analysis reveals that the BTR market in Australia, which currently accounts for 0.2% of the total rental housing market (as stated by **R19**), is significantly underdeveloped. By contrast, in the

US, BTR represents 13% of the residential market, while in the UK, it comprises about 5% of the total rental sector.[2]

R19 suggests that, with the right regulatory and economic conditions, the Australian BTR market could grow to represent at least 5% of the rental sector over the next few decades, potentially reaching a market size of $500 billion.

As rental demand continues to rise, especially in cities like Sydney and Melbourne, institutional investors are increasingly viewing BTR as a strategic asset class capable of providing both income stability and portfolio diversification.

Furthermore, the anticipated growth of the BTR sector is intrinsically linked to the expectation of product diversification. While the current BTR projects in Australia is dominated by premium rental unit offerings, there is a growing recognition of the need to cater to a wider spectrum of renters. **R1** envisions BTR evolving to encompass diverse housing solutions, including co-living spaces, single-family rental housing, and later-living rental communities, thereby addressing the multifaceted housing needs of the Australian population.

Robust Rental Market: Australia's rental market is currently experiencing robust demand, characterised by historically low vacancy rates and increasing rental prices. This strong rental market, fuelled by factors such as population growth, limited housing supply, and changing demographics, creates a favourable environment for BTR investments. **R3** highlights that the national rental housing vacancy rate is significantly lower than historical averages, indicating a high demand for rental accommodation. This observation is further supported by data from the Australian Bureau of Statistics, which reported a national rental vacancy rate of 1.2% in June 2023, the lowest level since 2006 (Domain Research, 2024).

Construction Cost Challenges: The construction industry in Australia is grappling with escalating costs, driven by supply chain disruptions, labour shortages, and inflationary pressures. Rising construction costs pose a significant challenge for BTR developers, impacting project feasibility and potentially squeezing profit margins. **R2**, **R3**, and **R5** acknowledge the impact of construction cost inflation on BTR project viability, highlighting the need for prudent cost management and innovative construction methods to mitigate challenges that this pose. Between 2020 and 2024, house construction prices have increased by 40.8%, further emphasizing the severity of this issue (Australian Bureau of Statistics, 2024).

Interest Rate Environment: The current high-interest rate environment in Australia presents both challenges and opportunities for BTR investors. High interest rates relative to the rates that prevailed during the decade preceding 2020 have increased the cost of debt financing, impacting project feasibility and potentially dampening investor appetite. **R2** notes that the cost of debt has risen to 'mid to high sixes,' (mid to high range of 6%) making it challenging to achieve the desired yields on BTR projects. However, this environment also creates opportunities for investors with access to cheaper capital or those seeking to acquire existing assets at potentially discounted valuations. **R4** points out that rising interest rates have led to a reassessment of investment strategies and return expectations, prompting a more cautious approach from some investors.

Evolving Investor Preferences: Investor preferences are evolving, with a growing emphasis on ESG considerations and a shift towards alternative asset classes like BTR. This shift is driven by a desire for

[2] See for example Board, C. (2023). The state of BTR market in the UK, REDirect, https://www.redirectconsulting.com/blog/the-state-of-the-btr-market-in-the-uk (accessed 18 December 2024).

diversification, stable returns, and alignment with sustainability goals. **R2** and **R5** note the increasing importance of ESG credentials in attracting institutional capital, while **R8** highlights the potential for BTR to offer attractive returns compared to traditional asset classes like office and retail, which are facing structural challenges. The 2023 PwC Emerging Trends in Real Estate Asia Pacific report identifies a growing appetite for alternative sectors like BTR, driven by their perceived resilience and potential for long-term growth (PWC, 2023).

Regulatory and Policy Environment: The regulatory and policy environment surrounding BTR in Australia is complex and in flux. According to **R19**, 'The investment climate is affected by regulatory challenges and a decrease in housing production, making investors cautious.'

While some states have introduced incentives like land tax concessions to promote BTR development, the lack of a consistent national framework and ongoing debates around issues like the GST and MIT tax rate create uncertainty for investors. **R2**, **R5**, and **R10** emphasise the need for regulatory clarity and a supportive policy environment to unlock the full potential of the BTR sector and attract greater investment. The Property Council of Australia has been advocating for policy reforms to address these challenges and create a level playing field for BTR consistent with other property asset classes (Property Council of Australia, 2024).

Focus on Major Metropolitan Areas: The focus of BTR developments has primarily been on major metropolitan areas, such as Sydney and Melbourne, with expansion plans to include cities like Brisbane, Perth, Canberra, and Adelaide as the market matures and demand in these areas grows. **R1** notes that these areas are strategic choices due to their strong rental demand, which support the feasibility of BTR projects. The concentration in major cities is also attributed to the availability of suitable development sites, access to infrastructure and amenities, and the presence of a large renter demographic.

Urban Dynamics and Geographic Considerations: Differences in urban dynamics across cities also affect BTR market conditions, as noted by **R2**. For instance, Brisbane has seen minimal impact from work-from-home trends on the demand for inner-city residences, whereas Melbourne continues to grapple with these shifts. Such nuances underscore the importance of localised market understanding for strategic BTR investment and development. Careful consideration of factors such as employment opportunities, infrastructure development, and demographic trends is essential for identifying suitable locations and tailoring BTR offerings to specific market needs.

Market benchmark: The relative immaturity of the market presents challenges. The lack of established benchmarks and transactional data can create uncertainty for investors, hindering accurate valuations and risk assessments. **R2** observes that the predominance of development projects over stabilised assets in Australia poses additional challenges for investors seeking immediate income-generating opportunities. **R14, R15, R17** emphasised that the lack of a benchmark index is constraining domestic institutional investment in BTR assets. They mentioned that the current index used for benchmarking does not include residential assets. The Australian Prudential Regulation Authority (APRA)'s prudential norms on investment by superannuation fund requiring benchmarking to indices such as S&P/ASX 300 A-REIT Index for listed property, and MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index – NAV-Weighted Post-Fee Total Return index for unlisted property (which do not include residential) has constrained allocation of capital to BTRs. **R13**, however, opined that concerns about residential not being part of index are overrated. In their opinion, 'While this is legitimate concern, a few super funds have already made allocations to the (BTR) asset locally suggesting a more intricate unparking on the issue. Compared to matured assets such as industrial, BTR requires extra work in the form of forward funding or forward committing to a project long before any rents can be generated. BTR is more complicated than other assets.' The complexity could be the reason for shying away from BTR investment rather than the benchmarks. **R19** reinforces the view further, 'Foreign equity, which constitutes 80% of the BTR sector, is attracted to the Australian market due to rent growth driven by housing shortages, despite the absence of a benchmarking MSCI index.’

Confidence in BTR assets

Comparative Market Maturity Stage: Australian BTR sector is still in its nascent stage compared to more mature markets like the US. **R19** emphasised that as the sector matures, it is expected to draw upon lessons learned from international markets, refining its offerings, and establishing best practices.

Stability and Returns: BTR is widely perceived as a stable and resilient investment, particularly appealing in an environment characterised by economic uncertainty and market volatility. Industry professionals, including **R2** and **R3**, emphasize the stability of BTR cash flows, especially when compared to more cyclical asset classes like office and retail. This inherent stability, coupled with inflation-linked rental income, positions BTR as a defensive asset class capable of delivering consistent returns over extended periods.

The long-term nature of BTR investments aligns with the investment horizons of institutional investors such as superannuation funds, further solidifying its attractiveness. **R6** underscores this advantage, noting that BTR offers more resilient cash flows compared to other asset classes, with reduced capital expenditure requirements, minimal downtime, and fewer incentives. These characteristics contribute to a more predictable and sustainable income stream, enhancing BTR's appeal as a core holding within a diversified portfolio.

Diversification Benefits: BTR assets offer diversification benefits for institutional investors. By incorporating BTR assets into their investment mix, investors can effectively reduce overall portfolio risk and volatility. **R2** highlights the critical importance of geographic and sector diversification, and BTR's distinct characteristics make it a valuable addition to a well-balanced portfolio.

The sector's resilience during economic downturns, as evidenced by stable occupancy rates during the COVID-19 pandemic, further reinforces its role in portfolio diversification. **R7** echoes this sentiment, emphasising that BTR's steady cash flows make it an attractive option for diversification, particularly when compared to sectors like office and industrial that are currently experiencing heightened volatility.

Enhanced Tenant Experiences: Living in BTR units is marketed as delivering exceptional tenant experiences. This commitment to tenant satisfaction manifests through the provision of superior amenities, professional management services, and a strong emphasis on community building. **R1** and **R4** underscore the importance of high-quality amenities and services in attracting and retaining tenants, fostering a sense of belonging and loyalty.

This tenant-centric approach distinguishes BTR from traditional rental options, enabling operators to charge higher rents, achieve higher occupancy rates, and enjoy longer tenancy durations, ultimately contributing to superior investment returns. The emphasis on community building and resident satisfaction further distinguishes BTR, appealing to a discerning renter demographic seeking a more holistic and fulfilling living experience. **R12** also notes the growing importance of ESG considerations in attracting tenants who are increasingly conscious of sustainability and social responsibility.

Rental and Capital Growth: Investors anticipate rental growth and capital appreciation in the BTR sector, driven by robust demand and constrained supply dynamics. **R1** and **R2** emphasize the potential for attractive returns, particularly over the long term. These financial prospects are paramount in attracting institutional capital, as investors seek to achieve their target returns and outperform benchmark indices. The ability to adjust rents periodically in response to market conditions further enhances the potential for income growth and capital appreciation. **R6** highlights the expectation of rental growth in BTR, fuelled by the persistent mismatch between supply and demand in the Australian housing market.

Navigating Challenges and Building Confidence: While the *a priori* beliefs surrounding BTR are largely positive, several challenges and uncertainties persist. Concerns regarding foreign investment dominance and potential capital flight have been raised, prompting discussions about ensuring domestic ownership and control. **R10**, however, argues that these concerns are unwarranted, as BTR investments typically involve local management and a commitment to long-term asset ownership and operation.

The successful operation of BTR assets necessitates specialised expertise and efficient management practices. **R2** emphasises the importance of having the right people and systems in place to deliver high-quality tenant experiences and optimise operational costs. The use of technology is seen as a key enabler for achieving operational efficiencies and enhancing the overall investment proposition.

Furthermore, the lack of a mature BTR market and limited transactional evidence can create uncertainty for investors. **R13** highlights the importance of a proven track record and established benchmarks in building investor confidence and attracting a wider range of capital sources. As the sector matures and more BTR assets are completed and stabilised, investor confidence and liquidity are expected to improve, further fuelling the sector's growth.

Socioeconomic Impact and Sustainability

Governance and Transparency: Strong governance practices and transparency are essential for ensuring the long-term sustainability and success of BTR investments. This includes clear communication with investors, adherence to ethical standards, and responsible management of assets. **R9** underscores the importance of avoiding ‘greenwashing’ and providing transparent reporting on ESG performance. Investors are increasingly seeking assurance that their investments are managed responsibly and ethically, and that ESG claims are backed by concrete actions and measurable outcomes.

Addressing Social Need: BTR is widely recognised as a crucial solution to address Australia's pervasive housing undersupply. **R3** underscores its potential to significantly increase the availability of rental housing, particularly in high-demand areas where affordability is a pressing concern. By providing a professionally managed and maintained rental product, BTR can help alleviate housing shortages and contribute to a more balanced and accessible housing market.

The scalability of BTR developments further reinforces its potential to make a meaningful impact on the housing landscape. **R7** echoes this sentiment, highlighting BTR's role in delivering much-needed housing supply and potentially preserving affordable housing options through mixed-income developments.

Affordability Contributions: While the current BTR landscape is predominantly characterised by premium offerings, there is a growing recognition of the need for more affordable options (Swanzy-Impraim et al., 2023). **R1** and **R4** acknowledge the potential for BTR to moderate rental price increases by increasing the overall supply of rental housing. **R15** emphasises their focus on the affordable housing segment of BTR, aiming to provide housing solutions for essential workers and low-income earners. As the sector matures and scales, it is expected to cater to a wider range of income levels, contributing to improved housing affordability and greater inclusivity.

The integration of affordable housing within BTR developments is also being explored to enhance social impact and broaden accessibility. **R1** envisions BTR evolving into a more mid-market offering over time, addressing affordability concerns and ensuring that a diverse range of renters can benefit from this housing model.

Community building, and tenant wellbeing are other aspects of BTR that interviewees highlighted. **R6** emphasised on their efforts to foster community within their BTR developments through initiatives such as shared amenities and technology solutions. The consideration of social impact reflects a growing recognition of the role that BTR can play in addressing broader societal challenges, such as housing affordability and social inclusion.

The thematic analysis of interviews also highlights the tension between BTR's potential to address housing affordability and the financial constraints faced by investors. Interviewees express a willingness to include affordable housing components in BTR projects, provided there are appropriate incentives to offset the associated costs. However, the current regulatory framework makes it difficult for developers to incorporate affordable housing without sacrificing profitability.

For instance, while there is strong demand for affordable rental housing, government mandates requiring a percentage of units to be designated as affordable can negatively impact project returns. This presents a challenge for investors seeking to balance social impact with the financial viability of their BTR projects.

Sustainability Considerations: Sustainability factors are rapidly gaining prominence in investment decision making, and BTR is well positioned to align with these evolving priorities. **R2** and **R4** highlight the importance of incorporating sustainable design principles, energy efficiency measures, and community-focused initiatives in BTR developments. **R6** highlights their commitment to carbon neutrality and the removal of fossil fuels from their BTR buildings. **R1** also emphasises the importance of considering 'embodied carbon' in construction materials, recognising the need to minimise the environmental footprint of BTR developments. This alignment with ESG objectives can attract a growing pool of investors who prioritise sustainable and socially responsible investments. Furthermore, sustainability initiatives can enhance the long-term value and appeal of BTR assets, leading to higher occupancy rates, longer tenancy durations, and improved rental growth potential. **R9** notes that 'we're creating a more liquid asset' by focusing on environmental sustainability and climate resilience, suggesting that sustainability factors can contribute to the marketability and attractiveness of BTR investments. The 2023 PwC Emerging Trends in Real Estate Asia Pacific report supports this view, highlighting that ESG factors are increasingly influencing investor decision making and can lead to a 'green premium' for sustainable assets (PWC and Urban land Institute, 2024).

While the benefits of ESG integration are widely recognised, there are also challenges and trade-offs to consider. **R1** points out that 'they're kind of working against each other in a way' when it comes to meeting both building code requirements and investor expectations for embodied carbon. Balancing sustainability goals with financial viability and cost considerations remains a key challenge for BTR developers and investors.

5.1.2 Policy Environment

Three aspects of policy are important for an institutional investor's decision to invest: policy type, the level of support contributing to return on investment, and stability of policy. The policy environment for BTR in Australia has evolved in recent years, reflecting government efforts to encourage institutional investment in rental housing. However, challenges remain, particularly in harmonising incentives across different levels of government and in establishing a more predictable and stable policy environment for investors.

Type of policy support at the federal and state levels

The BTR sector continues to advocate for tax reforms and regulatory support. Specifically, developers and investors are calling for more consistent tax treatments across state borders, enhanced planning incentives, and adjustments to GST policies. The introduction of clear guidelines and streamlined processes would help reduce the risks associated with long-term investments in BTR and support the sector's growth in contributing to Australia's rental housing supply. **R1** suggests that 'a simplified approach to affordable housing would be a really big one', highlighting the need for a more streamlined and efficient regulatory framework.

At the federal level, the Australian government has introduced several initiatives aimed at incentivising BTR projects. Notably, the government has tabled a bill in parliament which proposes a reduction in the Managed Investment Trust (MIT) withholding tax rate from 30% to 15% for eligible BTR projects, aligning the tax treatment of BTR with other property sectors like office and retail. This measure is designed to enhance the attractiveness of BTR as an asset class for global institutional investors and increase the supply of long-term rental housing. Additionally, the government has proposed increasing the capital works deduction rate from 2.5% to 4% per annum for eligible BTR projects, further incentivising investment in the sector. Industry respondents equivocally emphasised the importance of these policy support levels for financial viability of BTR projects.

State governments have also implemented a range of incentives, although the level of support varies across jurisdictions. For example, Victoria and New South Wales offer land tax concessions, while Western Australia has introduced a new land tax relief program for eligible BTR projects. These concessions help lower the cost of development, making BTR projects more feasible. However, the eligibility requirements for these concessions often differ, with variations in the minimum number of dwellings or labour participation requirements (e.g., in New South Wales, where a portion of construction labour hours must be performed by specific classes of workers). **R1** highlights the inconsistencies across different levels of government stating, 'every council and state government and federal government have a different definition of affordable housing, a different cohort they're targeting, and a different method of how they want to apply it'.

Level of support and policy stability

Despite these efforts, certain barriers continue to hinder the widespread adoption of BTR in Australia. One key issue is the lack of uniformity in tax policies between states, creating complexities for developers and investors working across multiple jurisdictions. **R13** points out that 'most of the regions are unviable because of build costs', highlighting the impact of inconsistent policies on project feasibility. Moreover, the GST treatment of BTR properties remains a significant impediment, as BTR projects are generally treated as input taxed, meaning developers cannot claim input tax credits for GST paid on construction costs. This increases the overall development cost, reducing project feasibility. **R10** echoes this concern, stating that 'the biggest impediment is definitely the federal taxes, whether that's MIT treatment or GST'.

On the regulatory front, planning systems in Australia still pose challenges. While fast-tracking planning approvals and offering density bonuses for projects that include affordable housing have been introduced in some regions (e.g., New South Wales), the overall development process remains lengthy and uncertain. This has led some developers to express concerns about taking on planning risks, particularly in the face of high construction costs and land values. **R2** points out that 'even with a fast-track approval process in NSW, it still takes the better part of two years to get a development application for a compliant 200-unit project'.

The policy environment also intersects with broader housing affordability goals. Many BTR incentives include requirements for affordable housing components. For example, the federal tax concessions stipulate that at least 10% of dwellings in eligible projects must be offered as affordable housing. While this aligns with social policy objectives, it also impacts project economics, as **R5** notes 'The financial impact of the requirements under the proposed legislation outweigh the benefit, so in reality will drive no outcomes. Focus needs to be on first balancing the policy settings in line with other asset classes, and then incentives for affordable housing must be in addition to that.' Balancing investor returns with social objectives remains a delicate act for policymakers.

Looking ahead, industry stakeholders are calling for further reforms, particularly around planning processes and tax treatment, to fully unlock the sector's potential. As **R3** suggests, 'Something needs to change for it to work because vendors have expectations on residential in Australia, which is a cultural problem that is so high that you can't pay for it.'

5.1.3 Control Variables - Firm Characteristics and Investor Experience

Firms investing in BTR projects in Australia possess a range of characteristics that define their approach to the sector. These characteristics significantly influence their investment strategies, risk management, and operational choices, thereby shaping the overall development of the BTR market. This section discusses the key characteristics of firms involved in BTR, expanding on aspects such as size, capital base, organizational structure, international experience, and risk appetite, among others.

Size and Capital Base

The size and capital base of firms are critical in determining their capacity to engage in BTR investments. Larger institutional investors, such as superannuation funds and global investment managers, typically have substantial financial resources, enabling them to pursue larger-scale BTR projects and absorb associated risks. **R2** highlighted their firm's size, mentioning, 'Globally now I think (we have) around 120 billion under management, (and) locally in APAC (we have) around three billion.' This vast capital base gives such firms a competitive edge in the capital-intensive BTR sector.

R8 also noted that large funds with access to substantial capital have an advantage in BTR projects as they can fund longer development periods and absorb the higher costs of constructing rental assets. These large firms are generally more resilient to market fluctuations, providing them the ability to undertake projects with longer payback periods. As **R17** points out, 'We're fortunate that we have ongoing (contributing) member growth. So even if our (percentage) allocations (to property asset classes) may move down, generally speaking, there's still opportunities to deploy.'

In contrast, smaller firms often face capital constraints and may find it challenging to scale up or diversify within the BTR sector. While nimble, smaller developers must adopt innovative strategies or partnerships to enter the BTR market. **R1**, for example, focuses on 'midscale built to rent' projects ranging from 150 to 300 units, recognizing the financial constraints associated with larger developments.

Investment Focus and Diversification

Firms in the BTR sector often vary in their investment mandates, which influence how they allocate capital across real estate asset classes. Some firms have a broad mandate to invest across various asset classes, while others may have a more specialized focus on specific sectors. The investment mandate can influence the firm's risk appetite, return expectations, and the types of BTR projects it pursues. **R8** notes that their investment fund, for instance, has historically focused on office, retail, and industrial investments, with limited exposure to BTR due to perceived challenges in achieving desired returns.

R3 elaborated on the importance of a diverse investment portfolio, noting that their firm balances exposure between BTR, commercial real estate, and logistics sectors. This diversification helps mitigate risk and ensures balanced returns, especially as BTR is still an emerging sector in Australia. **R6** further emphasises this point, stating that their firm's strategy involves a 'significant re-weight' towards the living sector, including BTR, to enhance portfolio resilience and capitalize on the sector's growth potential.

Risk Appetite and Return Expectations

Risk appetite plays a crucial role in determining how firms approach BTR investments. Some institutional investors are more comfortable with development risk, seeking higher returns through the creation of new BTR assets. **R2** discussed the firm's willingness to 'take development risk, (and) we'll take leasing risk,' acknowledging that these risks are balanced by a desire for 'defensive assets, (and) defensive structures'.

In contrast, some firms are more risk averse and prefer investing in stabilised assets. **R6** indicated a preference for projects with lower development risk, emphasizing that their firm focuses on assets that already demonstrate stable cash flows, such as existing rental properties. This is particularly important in the current market environment, where rising interest rates and construction costs have made new developments more uncertain. **R17** also notes that 'the challenge is just returns,' highlighting the need for BTR projects to offer competitive risk-adjusted returns to attract investment.

Return expectations also vary, with some firms setting high thresholds for BTR investments. **R11** highlighted that Australian super funds, in particular, tend to avoid development risks and instead focus on core, stabilised investments. This conservative approach is driven by the need to achieve predictable returns for their members. **R2** also mentions that their firm has accepted lower hurdle rates for BTR compared to other sectors, recognising the potential for long-term growth and stability in the sector.

Organizational Structure

Firms investing in BTR projects typically have specialised teams or subsidiaries dedicated to managing this asset class. The complexity of BTR developments, from acquisition and construction through to leasing and management, requires a comprehensive and integrated approach. **R1** described their firm's structure as having 'acquisitions team, development team, property management team that's doing leasing, maintenance, operating the actual assets and then a funds management team', emphasizing the need for a holistic approach to BTR.

R7 provided similar insights, noting that their firm had to build up internal expertise across development and operations, especially as they expanded into BTR from other real estate sectors. This structure ensures that firms can effectively manage the lifecycle of BTR projects, maintaining high levels of control over operational outcomes, which are crucial for long-term success. **R6** further emphasises the importance of an integrated model, stating that their firm is 'completely integrated model' provides a competitive advantage in accessing the BTR market.

International Experience

International experience is a common trait among firms investing in the Australian BTR market. Many of these firms have gained valuable insights from more mature BTR markets, such as the US, Canada, and the UK, and are now applying this knowledge to the Australian context. **R2** mentioned that their firm has large ‘pipeline in the UK’ and has worked on projects in Canada, which has informed their strategies in Australia.

R13 also emphasised the importance of international benchmarks, particularly the US multifamily housing market, which serves as a model for what the BTR sector in Australia could eventually become. Firms with this international expertise are often better equipped to navigate the complexities of the nascent Australian BTR market and understand the long-term potential of the sector. As **R3** notes, ‘a lot of the capital that's been raised has been for the premium product’, reflecting the influence of international models on the Australian market.

Operational Capabilities

Firms investing in BTR often possess significant operational capabilities, whether in-house or through partnerships. The ability to manage rental properties efficiently is critical to the success of BTR projects, particularly as operational costs and tenant satisfaction directly impact returns. **R1** highlighted their firm’s capability as a ‘build-to-rent developer, owner, and operator’, demonstrating the importance of having integrated operations.

R10 echoed this sentiment, noting that firms with experience in property management and leasing have a significant advantage, as they can maintain occupancy levels and manage properties to ensure long-term profitability. **R6** also emphasises the operational intensity of the BTR sector, stating that their firm had to make ‘a significant investment in the operating platform that performs all of the management services’.

Adaptability and Innovation

Given the challenges of entering the Australian BTR market, firms need to be adaptable and innovative. **R1** discussed the use of ‘modular construction’ to address rising construction costs and accelerate project timelines. Similarly, **R12** mentioned that their firm is exploring new financing structures and partnerships to manage the capital-intensive nature of BTR investments. Firms that can innovate in areas like construction, financing, and tenant services are likely to succeed in this evolving market. **R1** also highlights the importance of flexibility in amenity design to adapt to changing tenant needs and preferences.

The characteristics of firms involved in BTR investments in Australia are diverse, ranging from large institutional investors with significant capital base to more specialised developers. The most successful firms often exhibit a combination of substantial financial resources, international experience, integrated operational capabilities, and an innovative approach to addressing market challenges. These characteristics shape their investment strategies, risk management practices, and overall ability to navigate the nascent and evolving Australian BTR sector.

5.1.4 Risk Attitude

The risk attitude of firms investing in BTR projects in Australia is a critical factor shaping their investment strategies. The emerging nature of the BTR sector in Australia, coupled with macroeconomic challenges such as rising construction costs and interest rate volatility, means that firms must carefully balance potential returns against the risks inherent in such developments. Risk attitudes can vary widely depending on the size, capital base, investment mandate, and experience of the firm, as well as the specific dynamics of the Australian real estate market.

Willingness to Take Development Risk

One of the primary risks in BTR investments is the development phase, which includes land acquisition, planning, construction, and leasing. Firms differ in their appetite for this kind of risk. Some, like **R2**, express a clear willingness to 'take development risk, we'll take leasing risk' because they anticipate high returns from being involved in the entire development cycle. This approach is more common among larger institutional investors or firms with substantial experience in real estate development, who have the financial resources to absorb potential setbacks and the expertise to navigate regulatory and market challenges.

R5 also highlighted that development risk is manageable if there is confidence in the long-term demand for BTR assets. They noted that larger firms with deep capital bases and international experience are more inclined to engage in these higher-risk projects because they are better equipped to handle the complexities associated with development. As **R1** puts it, 'you need the right level of government policy to support any investment', suggesting that a favourable policy environment can mitigate some of the development risks and encourage greater investment.

Aversion to Development Risk Among Smaller Investors

In contrast, many smaller firms and institutional investors exhibit a more cautious approach. **R11** emphasised that 'Australian super funds tend to not like development risk', reflecting a preference for investing in stabilised, income-producing assets rather than engaging in new developments. This risk-averse stance is driven by the need to deliver consistent and predictable returns for their members, particularly in uncertain economic conditions. Smaller firms, with more limited capital resources, also tend to avoid taking on the full development cycle, preferring to acquire completed BTR assets once they are operational and generating cash flow. **R3** notes that 'investors are being asked to take on very much development risk to build this stock because it doesn't exist anywhere else', highlighting the challenges faced by smaller players in the market.

Development risk discourages foreign and domestic institutional capital from investing in the Australian BTR market. **R10** stated that 'domestic super funds will start to invest if there is no development risk' and recommends that local developers devise innovative mechanisms to take away such risks. For example, by buying the land and getting development approval for BTR before offering this package to investors bridges the gap between land acquisition and construction, offering very low development risk or by offering the approved land one month to construction.

Risk Perception Due to Macroeconomic Uncertainty

The macroeconomic environment in Australia has introduced additional risks for BTR investments, particularly in relation to rising interest rates and inflationary pressures on construction costs. As **R8** noted, 'investors are becoming more and more global', and they are benchmarking Australian BTR opportunities against more mature markets like the US, where yields may be more attractive. Firms must factor in both construction cost inflation and interest rate increases, which can significantly impact the viability of BTR projects. For many firms, this has increased the perception of risk and tempered their appetite for new developments, particularly as borrowing costs rise.

R3 also discussed how fluctuating interest rates have affected investment decision making, stating that 'the interest rate environment has forced us to reconsider certain projects due to tighter margins.' For firms already involved in BTR, these changes necessitate a more conservative approach to financing and cost management. **R17** echoes this sentiment, stating that 'in the current environment, it doesn't actually stack up anymore' for some projects due to the increased cost of debt.

Market-Specific Risks

The Australian BTR market presents several unique risks that firms must navigate. These include planning and regulatory hurdles, particularly in cities like Sydney, where obtaining approvals for residential projects can be notoriously slow and challenging. **R16** noted that planning regimes, particularly in Sydney, involve long planning processes that can extend project timelines and increase costs. The lack of standardised regulations and consistent definitions of affordable housing across different jurisdictions further adds to the complexity and uncertainty.

The nascent nature of the BTR market in Australia means that liquidity remains a concern for some investors. **R10** remarked that 'the liquidity of BTR assets is still being tested' in Australia, making it difficult for firms to predict exit strategies or anticipate the resale value of BTR developments. This contrasts with more established BTR markets, such as the US, where there is a larger pool of institutional buyers and more robust secondary markets for rental properties. The lack of a mature secondary market can impact investor confidence and limit the attractiveness of BTR as an asset class.

Investors perceive inherent risk in the current macroeconomic environment**.** The interviews highlighted the significant impact of rising interest rates on BTR investment decisions. Higher interest rates translate to increased borrowing costs, which can erode profit margins and affect the feasibility of new developments. **R4** notes that hurdle rates have risen in response to rising interest rates, making it more challenging for BTR projects to meet the required return thresholds. This sentiment is echoed by **R17**, who states that 'in the current environment, it doesn't actually stack up anymore' for some projects due to the increased cost of debt. The sensitivity of BTR investments to interest rate fluctuations underscores the importance of careful financial modelling and risk management in this sector.

Inflation presents a double-edged sword for BTR investors. On the one hand, rising construction costs can erode profit margins and increase development risks. On the other hand, inflation can also benefit BTR investors by increasing the value of their assets and rental income over time. **R6** acknowledges the potential for rental growth in the BTR sector but also notes the need for caution in managing rental escalations to maintain affordability and social license to operate. The ability to pass on some of the inflationary pressures to tenants through rental increases can help protect investor returns, but it must be balanced against potential tenant backlash and regulatory constraints.

The cyclical nature of the property market, coupled with broader economic fluctuations, can create uncertainty and impact investor sentiment. During economic downturns, demand for rental housing may decline, affecting occupancy rates and rental income. Conversely, periods of economic growth can lead to increased demand and rental growth. **R1** highlights the importance of considering macroeconomic factors in investment decisions, stating that 'you're at the start of a new real estate cycle' and anticipating changes in interest rates and market conditions. The ability to navigate economic cycles and adapt investment strategies accordingly is crucial for long-term success in the BTR sector.

In response to these market risks, investors may adjust their BTR investment strategies. This could involve shifting their focus towards stabilised assets with predictable cash flows during periods of uncertainty or increasing their allocation to development projects when market conditions are favourable. **R1** discusses the potential for shifting capital-raising strategies depending on market conditions, demonstrating the importance of adaptability in navigating the evolving BTR landscape. Investors may also explore innovative financing structures or partnerships to mitigate risks and enhance returns in a volatile market environment.

Risk Adjusted Return Expectations

Return expectations are closely tied to the level of risk that firms are willing to take on. As discussed by **R2**, some firms with higher risk appetites expect higher returns in exchange for the uncertainties involved in development and leasing. In such cases, firms target double-digit Internal Rates of Return (IRRs) to justify the risks involved. For instance, **R6** mentions targeting an IRR of 12-15% for the development phase of BTR projects.

The thematic analysis also highlights the complexity of investment strategies within the BTR sector. Although BTR is perceived as offering stable and secure cash flows, particularly in comparison to more volatile sectors like retail and office, investors have had to adjust their return expectations. Given the nascent stage of the market and the rising costs of construction and interest rates, investors are accepting lower hurdle rates for BTR projects compared to other real estate asset classes.

Investors are typically targeting yields on cost of around 5.5% to 6.5%, which is lower than what might be expected in more established asset classes like office, retail, and industrial real estate (which range between 7-9%). However, the stability of rental income and the potential for long-term growth are seen as compensating factors for the lower initial returns. In particular, the ability to adjust rents annually in response to inflation provides BTR with a built-in inflation hedge, making it an attractive asset for long-term institutional investors.

While the returns for BTR are more modest, as **R19** explains, the sector's resilience and potential for steady rental income make it an appealing option for investors seeking long-term stability in an uncertain economic environment.

Australian super funds have invested in BTR internationally but show very little appetite for investing in the asset class within Australia. The reasons for this reluctance are many but a more resounding reason is the lack of track record of BTR asset performance in Australia. Multifamily investments are more established in the US, Canada, and the UK. These countries have a greater backbone of institutional capital, transactions and government support, and record spanning several decades. There are historical performance data on risk and return of the asset class within an institutional portfolio. Few Australian super funds want to lead in investing in BTR in Australia; the rest see it as a gamble. **R17** notes that their firm is comfortable with lower returns in the US multifamily market due to the perceived lower risk and established track record of the BTR asset.

ESG Considerations and Risk Management

ESG considerations are becoming increasingly important in shaping the risk attitudes of firms investing in BTR. **R6** emphasised the role of ESG in managing long-term risks, particularly in relation to sustainability and energy efficiency. Firms that prioritise ESG factors tend to adopt a more conservative approach to risk, ensuring that their developments meet high environmental standards and are socially responsible. This may involve additional upfront costs, but it also helps mitigate long-term risks related to regulatory compliance, tenant demand, and operational efficiency.

Firms with strong ESG commitments are also more likely to benefit from government incentives and funding opportunities, which can offset some of the risks associated with BTR developments. **R1** highlights the importance of ESG in meeting investor and council requirements, focusing on electrification, energy efficiency, and reducing embodied carbon.

The evolving nature of the BTR market, coupled with ongoing policy discussions and the increasing importance of ESG considerations, suggests that risk attitudes in this sector will continue to evolve. As the market matures and more evidence of successful BTR projects emerges, investor confidence is likely to grow, leading to a broader range of risk appetites and investment strategies. Understanding these diverse risk attitudes and their underlying drivers is crucial for navigating the complexities of the Australian BTR landscape and fostering its continued growth and development.

Over a short period of time, returns and ESG scores are looked at simultaneously in investment decision making. Sustainability vis-à-vis ESG has become an important metric. **R4** explained the prevalence of ESG credentials in global investment markets in Europe, the UK, America, and Asia Pacific, stating further that the nitty gritty differs from fund to fund and the developments in the respective local markets. **R5** stated that institutional investors do not treat ESG requirements for BTR differently from other property assets, although closely related assets, like build-to-sell (BTS) housing, are not given the same level of attention. BTS investors are interested in getting the projects up at the cheapest cost and then selling them to individual investors/owners. BTR is compared to grade-A office properties as they both offer a different level of quality and management.

ESG investment in BTR is exposited from three main standpoints. The first and most discussed justification is the need for high-quality rental dwellings. All respondents, **R1-R20**, stated the need to increase high-quality rental housing. Within the conversations on quality, ESG investments are included. Within a typical property portfolio, BTR assets are favourably positioned to attain high ESG investment scores because they are mostly brand new and ESG goals are often integrated within the planning stage. This is apart from value-add BTR, which are few in the Australian market. Secondly, there are calls to translate sustainability goals into standards and ratings against which projects would be measured. **R1** explained how the local government councils enforce certain standards. They expect property portfolios to include good heating and cooling, solar panels and embedded networks with green-generated electricity. The third trend is the requirement of BTR investors to have ESG components as a measure of social responsibility and acceptability. Institutional investors are beginning to pay more attention to ESG investment scores than in previous years. **R6**, a BTR investor, offered similar thoughts as **R4** and **R5** on how critical ESG has become for investors, reinforcing that some of their investors have developed ESG policies that promote a carbon-neutral approach to development and a gradual transition to green active transport.

5.2 Investment Decision-Making Process

The four enablers discussed above constitute the environment within which investors make investment decisions. However, the decision framework has two components: investment strategy and due diligence process. These are firm specific and are governed by internal policies of the firm and investor mandates.

5.2.1 Investment Strategy Formulation

The investment strategy for BTR assets in Australia is embedded within a broader asset allocation framework used by institutional investors. Property serves as a crucial component in the diversified portfolios of institutional investors, especially those with long-term liabilities such as pension funds and superannuation funds. Within real estate allocations, investors are increasingly considering alternative residential sectors, such as BTR, for portfolio diversification. As **R2** mentioned, 'property is a core part of our long-term strategy', reinforcing the importance of this asset class in achieving stable returns.

BTR is often seen as a sub-sector within the overall real estate portfolio, and investment strategies are shaped by a variety of factors such as risk-return trade-offs, market maturity, regulatory landscape, and investor mandates.

BTR as a Sub-Sector of Real Estate in Investment Portfolios

Institutional investors typically do not approach BTR in isolation but rather as part of a broader real estate allocation strategy. **R2** confirms this approach, explaining 'we have capital (that we can allocate to property), we don't have to go raise (specifically for BTR)', and BTR competes with other real estate assets such as office, retail, and industrial for capital allocation.

Several respondents highlighted that BTR forms part of a broader property allocation. For instance, **R1** explained that 'BTR is part of our diversification within the real estate portfolio, complementing traditional sectors like office and industrial'. This multi-sector approach allows funds to manage risk across different market segments while capitalising on long-term trends in rental demand. **R8** further elaborates on this, stating that their investments span across 'retail assets as well as a couple of office buildings and more recently in some industrial sites'.

R10 highlights that their firm evaluates BTR within the broader context of long-term real estate investments. This approach allows firms to remain flexible in adapting their asset allocation based on changing market conditions. As **R7** points out, 'We look at real estate not just for high returns but for stability and diversification, and BTR fits into that framework.' **R13** observes that 'where returns from build to rent sit in relation to other asset classes' is a key consideration for investors. The ability to benchmark BTR against other asset classes is crucial in evaluating its competitiveness and justifying its inclusion in a diversified portfolio.

Given the nascent nature of the BTR sector in Australia, the overall exposure to this asset class remains relatively small compared to more mature real estate segments. However, there is growing interest in expanding BTR allocations due to its defensive qualities and the potential for stable, long-term income. **R17** noted, 'We're looking at increasing our exposure to BTR, but it remains a small part of the overall property allocation, which is still dominated by office and industrial assets.' This sentiment is echoed by **R6**, who states that their firm is aiming for a 'significant re-weighting of the balance sheet towards the living sector, including BTR'.

The strategic allocation to BTR, is often driven by the search for stable, long-term returns that can act as a hedge against inflation. **R1** highlights that BTR is 'bringing a more stable, long-term capital source into residential, which has a lot of great benefits for residents'. **R1** further notes that, 'the cash flow out of multifamily is by far the most secure cash flow'. This is because BTR properties rely on diversified rental income streams from multiple tenants, which tends to be more stable compared to sectors like office or retail, where tenant demand can be more volatile, particularly during economic downturns. This perspective is shared by **R5**, who notes that their organisation is aiming to grow their BTR portfolio, indicating a significant long-term commitment to the sector.

However, despite its stability, BTR investments often come with compressed return expectations. **R2** points out that their firm 'accepted lower hurdle rates in BTR' due to the perceived long-term security of the asset class. This sentiment is echoed by **R1**, who highlights that the high costs of construction have made it difficult to achieve the same level of yield as other real estate sectors. This challenge aligns with the a priori belief that BTR returns may be lower compared to other asset classes, particularly in the early stages of market development.

In terms of operational complexity, BTR assets require more intensive management compared to traditional commercial properties. **R4** emphasises that successful BTR projects demand ongoing tenant engagement, property management, and community-building efforts to ensure high occupancy and tenant satisfaction. This operational intensity is a notable challenge for investors used to more passive real estate investments like office or retail, which typically require less hands-on management.

Valuation challenges also arise when comparing BTR to more established real estate sectors and this poses challenge for developing investment strategies. With relatively few stabilised assets in the Australian market, valuing BTR properties can be difficult. As **R1** points out, valuers often base their assessments on current rents, which may undervalue properties with strong rental growth potential. This is compounded by the lack of comparable transactions in the market, which **R3** mentions as a key obstacle in determining accurate valuations.

Strategic Diversification and Long-Term Focus

One of the factors influencing BTR investment strategies is the desire for strategic diversification. As **R1** mentions, 'It's bringing a more stable, long-term capital source into residential,' which positions BTR as a defensive asset class. The long-term nature of BTR investments makes them attractive for institutional investors seeking stability and predictable cash flows, particularly in contrast to more volatile sectors like retail and office.

R9 emphasises the importance of diversification within real estate, noting that their firm is investing in BTR to hedge against potential downturns in other sectors such as retail. Similarly, **R8** explains, 'We are diversifying our portfolio with BTR because it offers resilient rental income streams, especially in uncertain markets.' These sentiments reflect the broader trend of institutional investors using BTR as a tool to diversify their real estate portfolios and reduce risk exposure.

Risk Appetite and Return Expectations

A key consideration in investment strategy formulation for BTR is balancing risk and return expectations. The interviews reveal a range of risk appetites among firms, with some more willing to take on development risk in pursuit of higher returns, while others favour stabilised assets with predictable cash flows.

R11 provides a clear example of this: 'Our firm is cautious with BTR, especially in Australia where the market is still developing. We prefer to focus on stabilised assets and avoid development risk.' This cautious approach contrasts with **R5**'s perspective, who highlights that their firm is willing to take on development risk, stating: 'Development risk is something we accept because of the potential for higher returns.'

In terms of return expectations, several respondents mentioned the need to adjust hurdle rates due to the nascent nature of the BTR market in Australia. **R4** notes that 'previously targeting 12% IRR when interest rates were 1%, now seeking at least 15-16% IRR as interest rates rise', reflects the need for higher returns to compensate for rising capital costs and increased risks in the development phase.

Global investors compare investment opportunities across many countries and their return requirements are benchmarked accordingly. **R5** explains that 'It's (Investment is) increasingly becoming global. We've noticed when we go to global investment companies with a living sector opportunity in Sydney, we're getting compared to returns that they can generate on a living sector opportunity in Spain (another country). They're saying well, we can get 15% in Spain (another country). We kind of want 15% in Sydney as well.'

What investors are looking for is the best locations for their expected risk adjusted returns which is surprising as the markets can be fundamentally different in terms risks. Comparisons appear based on nominal returns.

Another nuance is that other funds/institutions were willing to lower IRR (mid double digits) as a trade-off for the long-term stability performance of BTR assets. What is surprising is that despite taking on development and leasing risks, as **R13** explained, 'Occasionally investors forward fund developments depending on the opportunity. This tendency appeared linked to the source of capital which enjoyed tax rebates locally. For example, Canadian pension funds are generally exempt from paying income tax on their investment earnings. Thus, capital from such countries have advantages over funds including pension funds (with defined benefit plans) without such benefits'.

Interest rates have a significant influence on the hurdle rates investors expect. According to **R10**, 'In 2019-20, one respondent mentioned that they would accept 7 to 10 year (holding period) returns on a post-tax basis of about 9% IRR. But for a similar project currently, (the expected IRR is) above 13%.' With the decline in interest rates, the situation might change. As **R10** explains, 'The other essential consideration is the spread of bond-styled products (in investment portfolios of funds due to high interest rate regime of the last few years). The implication is that investors are likely holding a significant share of dry powder waiting for interest rates to decline before looking favourably at BTR projects. But whether they will eventually allocate to BTR also depends on the composition and performance of their existing portfolio.'

Alignment with Investment Objectives

Ensuring that potential investments align with the broader investment objectives and mandates of the organisation or fund is crucial. This involves considering factors such as investor objectives, target returns, risk appetite, investment horizon, and any specific sector or geographic preferences. **R4** notes that their investment decisions are 'largely driven by our relationship with certain equity providers', highlighting the importance of understanding and aligning with investor objectives. **R19** highlights that 'Australian super funds are hesitant to invest in the BTR sector due to preferences for international asset diversification and concerns about overexposure, as many super fund members are homeowners.' The investment analysis process must therefore consider not only the financial merits of a BTR project but also its fit within the overall portfolio strategy and its ability to contribute to the fund's long-term goals.

Market Maturity and Regulatory Considerations

The maturity of Australian BTR sector has a significant impact on investment strategy formulation. **R14** points out, 'The BTR market here is not as mature, so we need to be careful about the regulatory landscape and planning risks.'

Regulatory challenges shape BTR strategies. **R1** mentions, 'The MIT rate for build to rent is double the MIT rate of industrial retail, or office, which has kept a lot of core investors on the side.'

R15 highlights the influence of regulatory frameworks, noting that 'tax incentives and planning reforms would be a major factor in unlocking BTR potential in Australia'. This suggests that investment strategies are often shaped by the evolving regulatory landscape, and firms are likely to adjust their approaches based on changes in tax policies and planning regulations.

Data-Driven Decision Making and Adaptability

Another critical element in BTR investment strategy formulation is the use of data and analytics to inform decision making. Several respondents, including **R1** and **R6**, emphasize the importance of data-driven insights in determining site selection and project feasibility. **R1** describes a 'data-driven' approach that ranks suburbs based on 26 factors influencing rental demand and growth, while R6 highlights the use of 'census and forecast data' to inform their investment strategies.

R13 further elaborates on the importance of data, stating, 'We rely heavily on demographic data to guide our investments in BTR, particularly looking at urban migration patterns and rental demand forecasts.' This reliance on data allows firms to make more informed decisions, reducing risk and increasing the likelihood of success in BTR investments.

In addition to data-driven decision making, adaptability is key in navigating the evolving BTR market. **R2** explains that their firm has shifted its capital-raising strategies based on market conditions, noting that 'flexibility is essential in this space as market conditions can change rapidly'. This ability to adapt to market dynamics, regulatory changes, and investor preferences is crucial for success in the BTR sector.

Collaboration and Partnerships

Collaboration with experienced partners is important component of BTR investment strategies. **R15** highlights the use of partnerships to leverage the expertise of developers and operators, stating, 'Most super funds use partners even for seemingly direct investments.' These partnerships help mitigate risks and facilitate access to development opportunities that may otherwise be out of reach for institutional investors.

R17 emphasises the role of joint ventures in BTR investments, noting that their firm 'partners with experienced developers to share risks and align interests'. This collaborative approach enables firms to take advantage of the specialised knowledge and experience of their partners, particularly in navigating the complexities of the BTR sector.

5.2.2 Due Diligence Process

The due diligence process for BTR investments that institutional investors undertake is particularly rigorous in the context of Australia's emerging BTR sector, which requires investors to carefully assess various aspects ranging from market dynamics and financial viability to ESG and legal compliance.

Market Analysis and Site Selection

A critical component of the due diligence process is an in-depth analysis of local market conditions and site selection. Given the nascent nature of Australia's BTR sector, investors often rely on data-driven approaches to predict market dynamics. **R1** explains that their firm uses a data model that ranks suburbs based on 26 factors influencing rental demand and growth, such as proximity to transport hubs, educational institutions, and employment centres. This granular analysis ensures that projects are located in areas with strong rental demand. **R7** highlights the importance of understanding local vacancy rates and housing supply shortages when selecting a site, stating that 'in some markets, the vacancy rates are incredibly tight, under 1%, which indicates a significant opportunity for BTR growth'.

Market analysis also includes benchmarking against other real estate sectors and international markets. As noted by **R2**, 'We have significant exposure to multifamily housing in the US and the UK, which gives us useful comparables when assessing Australia's market potential.' By comparing domestic BTR opportunities to more established international markets, investors can better gauge potential long-term performance.

Financial Feasibility and Sensitivity Analyses

Through thorough financial modelling investors assess a project's potential returns, capital requirements, and cost structures. Investors scrutinise project budgets, construction costs, projected rental income, operating expenses, and exit strategies to evaluate the financial viability and potential returns of a BTR investment. Given the large capital outlays typical of BTR projects, firms employ sophisticated financial models to project cash flows over extended time horizons. **R1** mentions, 'We run 15-year financial models that include development costs, operational expenses, and projected rents.' These long-term models provide a holistic view of the asset's financial performance through various stages, including lease up, stabilization, and eventual sale. **R5** highlights the importance of accurately underwriting projects, considering factors such as rental growth, operational costs, and exit cap rates. **R5** adds, 'We also run sensitivity analyses to assess the impact of fluctuating interest rates, inflation, and construction costs. For instance, with interest rates rising, our IRR targets have shifted from 12% to 15-16%.' **R16** emphasises the need to assess the project's ability to meet or exceed the investor's hurdle rate, which is often influenced by the prevailing interest rate environment and perceived risk levels.

Financial feasibility analysis is also closely tied to exit strategies. Investors aim to ensure that the returns generated by the BTR project justify the capital invested and provide flexibility for various exit scenarios, such as selling to other institutional investors or converting the asset into another use.

Legal and Regulatory Compliance

The regulatory environment plays a pivotal role in the due diligence process. **R2** underscores the importance of understanding tax implications: 'The MIT rate for BTR is currently double that of other real estate sectors like industrial or office. This has made some investors hesitant.' **R14** emphasises the need for careful review of planning approvals, stating that 'planning regulations vary significantly across states, and BTR faces unique challenges in securing favourable zoning approvals.'

Legal due diligence extends to reviewing title deeds, land ownership issues, and environmental approvals. Firms often engage third-party legal advisors to ensure that projects meet all regulatory requirements and mitigate potential legal risks associated with zoning or environmental restrictions.

Construction and Development Risks

Due diligence includes a thorough assessment of the construction process, as BTR projects often involve high capital expenditures and extended development timelines. **R4** highlights the importance of selecting reputable contractors and ensuring tight control over construction timelines. 'Given the current climate of rising construction costs and supply chain issues, it's essential to have robust contingencies built into the project budget', they stated.

Construction risks can significantly impact project profitability, with investors paying close attention to cost overruns, delays, and the overall quality of construction. **R16** notes, 'We ensure that our development partners have a proven track record in delivering projects on time and within budget, reducing our exposure to construction-related risks.'

ESG and Sustainability Factors

Increasingly institutional investors are incorporating sustainability into their investment mandates. **R6** states, ‘We assess each project on its ESG merits, particularly its environmental footprint and social impact. This includes factors like energy efficiency, carbon neutrality, and community building.’ Similarly, **R9** highlights that ‘Tenants are increasingly looking for sustainable living options, which makes it imperative to integrate green building technologies and energy-efficient designs into our BTR projects.’ Integrating ESG factors not only aligns projects with global sustainability goals but also enhances long-term asset value by meeting tenant demand for eco-friendly living spaces.

Operational Due Diligence

The operational model of a BTR project is critical to ensuring its long-term success, particularly as it relates to tenant retention and property management. Investors must assess the experience and capability of the property management team responsible for day-to-day operations. **R1** mentions, ‘Our property management team plays a pivotal role in ensuring that our assets remain competitive in the market. This includes offering amenities like gyms and communal spaces, which need to be of high quality to attract long-term tenants.’ Effective operational management is necessary to maintain high occupancy rates and minimise tenant turnover, thereby ensuring stable and predictable cash flows.

Risk Management and Stress Testing

Investors undertake rigorous stress testing as part of the due diligence process to assess how a BTR project would perform under various economic scenarios. This includes modelling the impact of economic downturns, changes in interest rates, or fluctuations in rental demand. **R11** emphasises, ‘We stress test every aspect of the investment, from construction delays to rental growth assumptions, to ensure that our projects can weather economic volatility.’ Stress testing allows investors to understand the downside risks associated with their investments and take proactive measures to mitigate these risks.

Partnership and Joint Venture Structures

Given the capital intensity of BTR projects, many institutional investors enter joint ventures or partnerships with experienced developers or local operators. This collaborative approach helps mitigate risks and provides access to specialised knowledge. **R15** mentions, ‘Super funds, in particular, often rely on joint ventures to share both the risks and the returns. These partnerships are structured to ensure that we have decision-making control over critical aspects like site selection and development milestones.’ Joint venture structures allow investors to leverage the expertise of development partners while maintaining control over key investment decisions.

6. Policy Environment for the BTR Sector in Australia

‘Although growth has been slow, BTR in Australia has the potential to become a stable investment with risk-adjusted returns and could form a significant part of the Australia's residential asset landscape, provided key issues like tax reform and investor education are tackled (**R19**).’

Using the conceptual framework as the basis and drawing on insights from the discussions above, lessons for supportive policy environment for the BTR sector can be identified. Key elements of a supportive policy environment are presented below:

Innovative Financing Models

One of the most pressing implications for the BTR sector is the need for innovative financing solutions that can reduce development costs and mitigate investor risks. The US model of government-backed long-term debt for multifamily housing could be adapted for the Australian market. Government supported agencies like Fannie Mae and Freddie Mac have enabled access to fixed-rate, long-term debt in the US, which offers stability to investors. **R19** mentioned that 'the lack of long-term interest rate lock-in options, which are available in the US, makes BTR less appealing to investors in Australia.' Adapting a model that could provide long-term, fixed-rate debt in Australia could significantly reduce financing costs, provide long-term liquidity, and make BTR projects more viable.

Equity instruments through the development of BTR-specific Real Estate Investment Trusts (REITs) or other equity investment vehicles could also attract a broader range of investors, including retail investors. These instruments would provide liquidity to the BTR sector, which is perceived as illiquid compared to more mature real estate asset classes. The securitisation of rental income, as seen in the US, can be another method to attract capital by bundling rental income streams into tradable securities.

Planning and Development Innovations

The slow and often complex planning approval processes in Australia represent a major barrier to scaling BTR developments. BTR-specific planning reforms, fast-track approval processes, streamlined approvals can accelerate project timelines and reduce uncertainty for developers. Moreover, providing zoning density bonuses for BTR developments that include affordable housing could serve as an additional incentive.

There is also potential for reducing construction costs and timelines using innovative methods such as modular and prefabricated construction. These techniques have been successfully applied in several markets to lower development costs while maintaining quality. As **R1** mentions, such methods could help Australia address high construction costs and mitigate delays caused by labour shortages and supply chain issues.

Tax and Regulatory Reforms

Policy makers need to address the regulatory and tax hurdles that are currently hindering BTR's growth. Aligning the GST and MIT rate for BTR with other real estate asset classes, such as industrial or office, would level the playing field and attract more institutional capital. Further, providing tax credits or exemptions for affordable housing units or ESG-compliant projects could incentivise more developers to enter the BTR market.

Fast-tracking planning processes for BTR developments and offering density bonuses for projects that include affordable housing or meet ESG standards would help reduce barriers and accelerate the growth of the sector. A streamlined planning framework would also provide greater certainty for developers and investors.

Focus on Affordable Housing and ESG

Investors should prioritise projects that incorporate affordable housing and meet ESG criteria, as these factors are becoming increasingly important for institutional capital. Government policies that offer incentives, such as subsidies or grants, for BTR projects that meet affordability and sustainability targets would encourage more developers to participate in these initiatives.

Developers can also explore partnerships with community housing providers or adopt tiered rental structures to ensure that their projects contribute to affordability goals while maintaining profitability. Moreover, investors should prioritise projects that demonstrate strong ESG compliance, as this will attract impact-driven capital and align with global sustainability trends.

Encourage Regional BTR Growth

Policymakers and investors should consider expanding BTR developments into secondary cities and regional areas, similar to the approach taken in the US regions outside of the major urban centres, such as Canberra, Adelaide, and regional Queensland, could offer attractive growth opportunities due to lower land costs and increasing migration to lifestyle regions. Expanding BTR to these areas could also alleviate housing pressure in Australia's largest cities and create a more balanced housing market.

7. Conclusion

The BTR sector in Australia is at an intriguing juncture, underscored by significant potential for growth, yet facing considerable barriers that shape its current trajectory. The research conducted here draws on qualitative interviews with key stakeholders in the sector to understand the implications and opportunities available to develop this nascent asset class in the country.

The *a priori* belief that the BTR sector could play a crucial role as a stabilising asset class for investment portfolios of institutional investors in Australia, similar to its role in the US and UK, has largely been supported. Throughout the interviews, respondents highlighted the ability of BTR to offer stable, diversified cash flows, particularly in times of economic uncertainty. This sentiment was echoed through frequent use of terms like 'stability' and 'resilience,' positioning BTR as a potentially dependable real estate asset. However, the interviews also revealed that achieving attractive returns is a significant challenge due to the high construction costs, current inflationary environment, regulatory barriers, and lack of favourable tax treatment. The stability of BTR as an asset is clear, but its ability to provide high returns in the current context remains uncertain, requiring some modification to the initial belief.

The analysis further highlights that for BTR to effectively realise its potential, a supportive regulatory and policy environment is essential. Interviewees consistently pointed to regulatory challenges as a key barrier, particularly in terms of unfavourable MIT rates, complex planning processes, and a lack of dedicated government incentives for the sector. Comparisons with the US and UK Piy revealed that these markets benefited from favourable government-backed schemes, long-term debt markets, and tax advantages, all of which have facilitated their growth. Therefore, if Australia is to harness the same level of success, it is critical for policy makers to consider reforming these aspects to provide a more favourable playing field for institutional investors. This highlights the need to evolve the initial assumptions about policy support by integrating specific calls for MIT reform and improved planning processes.

Another key theme that emerged is the alignment of BTR with long-term rental demand, particularly in high-density urban areas like Sydney and Melbourne. This *a priori* belief was thoroughly validated by the interview data and the recurring emphasis on demand-driven factors such as low vacancy rates and strong rental growth prospects. However, a crucial point that has surfaced is the need for BTR to extend beyond the current focus on premium rental products to cater to a broader demographic. The experiences shared by stakeholders, along with data from the US and UK, suggest that BTR has significant potential to serve different market segments, including affordable housing and specialised rental models (e.g., for young professionals or seniors). This diversification could be key to both meeting public demand and establishing a stable revenue base for investors.

From an operational perspective, the *a priori* belief regarding the need for efficient property management and tenant engagement was reinforced by the research. The BTR sector is inherently different from other real estate asset classes in that it requires intensive property management, ongoing tenant engagement, and regular upkeep of amenities. Multiple respondents pointed out the importance of tenant experience, indicating that successful BTR operations are reliant on how effectively the needs of tenants are met, not just during lease-up phases but throughout the rental term. As such, property managers must be agile and responsive, which is reflected in the emphasis on operational sophistication and flexibility seen in other successful markets like the US.

The research has also shed light on the evolving investor strategies that are being formulated to navigate the challenges associated with the Australian BTR market. Investors are actively seeking ways to balance the trade-off between the lower yields that are currently typical for BTR projects and the longer-term security these investments offer. Innovative financing models, such as the adoption of US-style, government-backed, long-term debt and the development of BTR-specific REITs, could help in reducing financing costs and increasing liquidity. The importance of scale in achieving cost efficiencies was another recurrent theme that emerged during interviews, indicating that for BTR to thrive, investors need to pursue large-scale developments that can achieve operational synergies and offer competitive returns. This pushes forward the belief that scaling up operations, and building critical mass, are essential strategies for the sector's sustainability.

Sustainability and ESG considerations have become significant themes within the BTR sector, reflecting the growing awareness among institutional investors of the importance of environmental and social governance. The research reaffirms that, while there is a clear recognition of the value of ESG compliance, integrating these requirements into BTR development has been challenging due to the high upfront costs. However, there are also opportunities for BTR to contribute positively to urban regeneration and sustainable development, as evidenced by examples from the UK. Respondents emphasised the importance of embedding sustainability into the core design of BTR projects, from energy-efficient building materials to community-focused amenities, to ensure alignment with broader institutional mandates on ESG.

One of the conclusions that can be drawn is that the Australian BTR sector must evolve towards a more diverse product offering, inclusive of affordable and mid-market segments, to make the investment model more viable while also fulfilling broader societal needs. The tension between providing affordable housing and achieving adequate returns was a recurring theme in the interviews, with respondents indicating that government incentives and supportive tax treatments are key to closing this gap. Therefore, for BTR to successfully address Australia's housing affordability issues, there needs to be a collaborative approach between the public and private sectors, with clearly defined incentives that make such projects feasible without compromising returns.

The comparative analysis of the Australian market with mature markets in the US revealed critical insights that can help shape the direction of the BTR sector in Australia. In these more mature markets, dedicated government support, a favourable regulatory landscape, and the availability of long-term debt have enabled the BTR model to flourish. Such structural components have allowed for a consistent expansion of BTR into different segments of the population, driving market stability and confidence among investors. To replicate this success in Australia, a similar concerted approach involving targeted policy reforms, incentivization, and streamlined regulatory processes is necessary.

The outlook for the BTR sector in Australia is both challenging and promising. On one hand, the existing barriers, including high construction costs, regulatory hurdles, and a lack of comparable market benchmarks, pose significant challenges that will need to be overcome to unlock large-scale investment. On the other hand, the growing demand for rental housing, demographic shifts towards renting as a preferred option, and the increasing emphasis on sustainability all present compelling reasons for optimism about the long-term potential of BTR in Australia. In the next 5-10 years, we can expect a gradual increase in BTR's market share, especially if favourable reforms are enacted and institutional investors adjust their strategies to include innovative financing mechanisms and more diversified offerings.

Lastly, this research has highlighted a few limitations that are worth noting. The BTR sector in Australia is still relatively immature, and the lack of stabilised assets means that historical data to benchmark performance is sparse. This has created challenges in making definitive statements about the future viability of BTR compared to other real estate sectors. The interviews also revealed varying perspectives based on stakeholder roles—while developers are optimistic about growth potential, investors remain cautious about the returns considering current conditions.

In conclusion, the BTR sector in Australia represents a compelling opportunity that is yet to be fully realised. The sector's success depends largely on addressing the regulatory, financial, and operational challenges identified in this study, while also learning from the experiences of mature markets abroad. With the right policy framework, innovative financing, and targeted investment strategies, BTR could become a significant player in the Australian real estate landscape, providing not only stable returns for investors but also addressing critical housing supply challenges. This conclusion serves as both a call to action for stakeholders and a reflection of the journey the sector needs to undertake to realise its full potential.

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Appendix 1: Semi-structures survey questionnaire

A: Respondent's Background Information

1. What is your professional background and role within your institution?
2. How many years of professional experience do you have in property investment?

B: Background Data on Institution/Fund

3. Could you tell us a bit about your fund (incl. total value of assets under management, asset allocations, property-specific assets, countries where the assets are located, if direct investments, etc)?
4. Has your institution invested in the BTR sector? What are your primary drivers/objectives for these investments? (skip to Q6 if 'no')
5. In which countries have your institution invested in BTR projects?

C. Property Investment Strategies and Decision-making

6. What are your funds' strategic investment objectives/goals? Balanced, opportunistic, growth etc?
7. Does your fund have preferences for specific investment assets and vehicles? What are they?
8. How do you view property assets relative to other assets in terms of your risks/return and investment objectives profile?
9. Within property as an asset class, how does BTR compare to other property assets in terms of risks/return profile, investment objectives, etc? Does BTR make it easier to invest in residential assets?
10. Could you give an insight into how the fund examines/analyses assets for investment? What are the important considerations? Fund's goals, ESG, Social responsibility, local community development, return, shareholding interest, etc – do these play a role?
11. What is the decision-making structure for new investments/allocations?
12. What drives your investment objectives, and what's the influence of stakeholders' interests – are they considered (e.g. government, board, unit holders, etc)?
13. How does your fund's membership and history affect your investment objectives and asset allocations/investment style?
14. At which level are these considerations made, fund-level, organisational level?
15. What is the composition of the board of directors in terms of professional background (finance, economics, real estate etc?). Are there requirements to include specific expertise or representatives?
16. How do macroeconomic changes, e.g. changes in cash rate, affect your hurdle rate?

D. Future and outlook

17. What will make BTR assets attractive beyond direct government interventions e.g. tax concessions?
18. In your opinion, what should happen to make BTR more investible (e.g. investible vehicles, tenant demand, financing structure, asset management)?
19. Within the next five years, is your fund seeking to increase, maintain the allocation or decrease exposure to property as property assets and why?

RESEARCH

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