

Publication Date: 27 October 2020
YSP Podcast Transcript: Episode 237. Will “Build to Rent” Disrupt the Strata Sector?

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Amanda Farmer: Hello and welcome to this week's podcast episode. I am your host Amanda Farmer. And this week I'm bringing you Adam Hirst. Adam is the general manager of Build-to-Rent at Mirvac. He is a property industry specialist with experience across residential development, passive investments, funds management, and agency. Prior to joining Mirvac, Adam worked for AMP Capital across their real estate portfolios, including the global listed real estate team investing in real estate companies globally comprising many of the USA listed multi-family real estate investment trusts. Adam is now one of Australia's foremost experts in build-to-rent and has led the establishment of Mirvac's build-to-rent business under the new LIV brand. He played a key role in Mirvac launch of the Australian Build-to-Rent Club and in transforming Mirvac's pavilions project at Sydney Olympic Park into one of the first purpose-built build-to-rent assets in Australia.

Adam's target is to create a 5,000 unit pipeline for build-to-rent over the next five years. Now, I was really looking forward to this chat with Adam from the time I first heard about this concept coming to Australia and in particular, the LIV development in Sydney, I have wanted to dig a little deeper and find out what it's all about. What is this structure? Why is it different to strata? And is it perhaps alternate offering that we're going to see more and more tenants take up instead of strata title living? Adam and I get into all of that and more, I will take you straight over now to my chat with Adam Hirst.

Adam Hirst, welcome to the show.

Adam Hirst: Thanks for having me, Amanda.

Amanda Farmer: It is a pleasure to have you here with me today. A really interesting topic that we are covering. You've just told me off air that this is something that you've been involved in for about the last four years, but for a number of our listeners, and even me, it is a new concept build-to-rent. Let's dive right in, what exactly is build-to-rent?

Adam Hirst: At its simplest we like to call it the security of home ownership with the flexibility of renting. And what that really means is it's a model that exists in a lot of around the world. And it's purpose-built designed apartment buildings, 100% held for rental owned by an institutional investor, and then professionally managed to weave onsite management and the like to provide a significantly greater customer experience and customer offering than you'd seen a traditional rental model. So it's one of the largest real estate asset classes in the US. It didn't exist in the UK 10 years ago. There's now about 150,000 units going up in this model. It's forming in China. It's been in Japan for a number of years, and now we're really starting to see the merge in Australia and the countries around the world.

Amanda Farmer: And you Adam are with Mirvac and is Mirvac the ultimate owner here, or how does Mirvac structure the ownership of their developments?

Adam Hirst: The long-term aim of this as a business model is similar to Mirvac's commercial office business, where you have Mirvac part owning buildings, alongside large institutional investors like superannuation funds and pension funds in the line. Given the sector is in its infancy in Australia we'd made a call at Mirvac to move ahead in the sector, get buildings built and operating. So we could show institutional investors, show government, show our customers what this offering is. And then in time we'll look to bring in capital partners to invest alongside us.

Amanda Farmer: Okay, interesting. And you've said at the top there that this is the security of home ownership. Does that mean long-term leases or are we still looking at 12 month residential leases for people who are in these buildings?

Adam Hirst: The length of lease topic is an interesting one that comes up a lot.

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Adam Hirst: We're currently leasing or stabilising our first building called LIV Indigo at Sydney Olympic Park. So that's 315 units, 1, 2 and 3 bedrooms that finished on the 1st of September. We're currently about 25% leased out there. And interestingly, no one yet has asked for a longer lease in 12 months.

Amanda Farmer: That's the Aussie culture. There's an assumption there that that's all they can get.

Adam Hirst: So we have the ability and that can provide longer-term leases to our customers. But the interesting, you know, mindset change in this model is because it's owned by an institution for the long-term, a lot of the issues around security of tenure that often come up no longer exists because the unit's not going to be sold, and you're going to have to move out. The owner's not going to move in. The kids aren't going to move in. Any number one of those issues that often comes up doesn't exist anymore. And for us as an owner-operator, the one thing we're focused on is maintaining occupancy for the long-term and maintaining cash flow. And because of that change, what we offer our tenants is effectively it's perpetually theirs to rent for as long as they want. So rents will increase or decrease with market, but while you're a sitting tenant, you can stay there as long as you want.

Amanda Farmer: Okay. And are these strata titled properties?

Adam Hirst: No. So we're holding them in one line, similar to an office building. And then the idea is if they're to be sold and traded, they traded one line, just like an office building. So it's interesting when we first started out in this space four and a half, five years ago, we were designing every building with the ability to strata subdivide in the event that the sector didn't form or for whatever reasons, Australians didn't want to rent off a corporate landlord or any number of reasons. But that obviously has some limitations in particular the way you design services and the way you design the building as comfort in the sector begins to exist, as more buildings start to appear and more capital starts to come into this space. We're slowly kind of morphing into a design that will likely forego that ability to start to subdivide in the future. Because from a design perspective, there's other benefits of looking at it slightly differently.

Amanda Farmer: Yes. Oh, okay. That is really fascinating. Did you say LIV Indigo? Is that the first one that we have seen here in Australia?

Adam Hirst: There's a couple of examples that are referenced occasionally. The capabilities to rent is purpose built and designed. The Commonwealth Games Village in Queensland is often talked about in the Gold Coast that was obviously built for the athletes in the Commonwealth Games. And it's subsequently been converted to a build-to-rent offering. So that one is often seen as the first one. There's a small one over in Perth of about 90 units. But in terms of at scale purpose built and designed LIV Indigo is the first that's operating, and there's now we've got another four buildings in the pipeline and there's other operators like Corecon and Greystar out of the US and a few others that have got buildings going up at the moment.

Amanda Farmer: So over 300 apartments in LIV Indigo, who are the type of people who are taking up this offering, who's moving in there?

Adam Hirst: Yes, it's been really interesting. The demographics of the residents have been much broader than we felt. And I mean, this is similar feedback to what we've heard in the UK as the sector is formed. So when you talk about this product, people instantly think of young professionals can't get into the housing market, saving their first deposit, a good product for them to get security of tenure while they either save for their deposit or want to rent long-term. And that's definitely a part of it, but we're also seeing it be a lot broader. So we've got a lot of families that have moved into the building. We're also got quite a decent cohort of downsizers who were seeing this as a kind of equity release type product. You can sell your house, you can go and stay somewhere for the long-term and get security of tenure. So that's been interesting.

And then the other thing that's been interesting is where the residents are moving from. So we had a view that 80% of residents would come from a 10 kilometer radius of LIV Indigo. But what we're finding is almost 50% of our residents coming five minutes. We've got people moving from the Northern suburbs, Eastern suburbs in a city from Southwest into Sydney Olympic Park.

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Adam Hirst: So the offering and the customer value proposition is clearly resonating with people because it's drawing from broader than we normally would have thought.

Amanda Farmer: And tell us a bit about that building in particular, I've read a few things in the media and had a look at the website. There are some pretty cool facilities there.

We're not talking about perhaps your typical apartment building attracting your typical renter. You are targeting a particular market at a particular price point too. Tell us what's so great about LIV Indigo.

Adam Hirst: Yes, so the way we look at the whole model is that there's kind of five factors that come together to make a build through an offering. And they're all obviously within LIV Indigo. First one is the design. I mean, you touched on the amenity piece, which is often what is referenced when people talk about build-to-rent.

Adam Hirst: So in these buildings were incorporating significant additional amenity relative to a normal building. So things like virtual fitness rooms, cinema rooms, work from home facilities, boardrooms, communal kitchen areas, lounge rooms, obviously full gyms. And the whole idea is that you've got that additional convenience onsite, and that's really resonated with people in COVID and particularly having a space that you can get out of your apartment, but still within your apartment building. Product is then slightly different. So things like we include all white goods. So fridges, washing machines, dryers, microwaves, all included.

There's a technology backbone throughout the whole building to enable both communication between the onsite team, which I'll get to and residents, but also things like resident apps, where you can do parcel locker collection. You can book the amenity spaces, we put on resident events and the like, all incorporated within. You've then got the service offering. So LIV Indigo has six full-time onsite staff. They're really in three broad buckets maintenance. So there's onsite maintenance there seven days a week. So if you've got issues with any of the white goods, for example, you can log it straight on the app. You can go to work, but if you allow access then that day we've got spares downstairs, it'll get fixed right away and you can come home and it has no impact on you. Customer service, what we call 'Resident Service Ambassadors'.

So they're doing leasing and property management and community curation, and they're just to help residents out and then a property GM. And then the final bit kind of over the top of all this is the kind of the model. So there's a lot of pain points in traditional rental that through scale and institutional lens where we're able to fix. So security of tenure, we've talked about bond free. So there's no bonds for our residents when they move in. Pet-friendly, so we allow pets within the building. We actually have facilities like dog wash and things like that that are built into it. And other measures like that provide that kind of extra overlay where we really want people to feel like this is their home and that they can stay there for the long term.

Amanda Farmer: And residents are just paying, they agreed rental amount, then not contributing extra towards these facilities. This is all covered by the owner of the building.

Adam Hirst: Correct. So it's just you to pay your rent. You obviously pay your electricity and internet on top of that, but everything else, that's it.

Amanda Farmer: Wow. What happens when the person in apartment 23 has a fight with the person in apartment 24, because they're super noisy?

Adam Hirst: So all the leases are under the Residential Tenancies Act as a starting point. So still under the same laws and legislation from that perspective. There's obviously residents by-laws that people sign up to, and one of them is you need to allow quiet enjoyment for everyone else within their unit. To the extent that there's bad tenants or bad eggs that repeatedly do the wrong thing, just like any other process would be through residential tenancy tribunal type process. Whereas, the owner manager would have to deal with. I think what's interesting today and it's still early days is because you're onsite and there's people there all the time, the relationship and interaction between the residents and our onsite team. It's kind of hard to explain it. It's just such a different environment than a traditional rental.

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Adam Hirst: I mean, I was out there last week and Lisa, one of our Resident Service Ambassadors, she's pregnant at the moment and I was there for an hour and three different residents came down and they'd baked her stuff and they just came in and had a chat and sat down in the leasing office and just talk for a bit.

So it's a very different environment to you go home and you go to your apartment and you shut your door and that's it. But they still have people are people and issues will happen and we just have to deal with them as they come.

Amanda Farmer: Okay. So you don't have a strata manager per se. This is not strata title, but you have these resident ambassadors building managers. Do these people have... What kind of experience or qualifications do these people have?

Adam Hirst: Often what we're hiring for here is a behavior set rather than a background. And what we're really looking for is that customer service mentality. So a lot of the team there have come from hospitality, hotel, type backgrounds. So the GM was at Shangrila and then Meriton Suites. Head of maintenance similar he's come from that kind of background. And then sales retail type roles is where the leasing type piece is coming from. But it's really about the behavior set is what we're looking for.

Amanda Farmer: Yes. As I think it should be, especially when you're removing the governance issues if you like, the legal issues, that complexity that comes with strata title that our strata managers must be across. Do you see this as a significant disruptor to strata title living in the strata sector?

Adam Hirst: No. If you think about Mirvac, Mirvac's 47 years been building and delivering strata title, apartment buildings, and this is by no means a replacement. This is an additional business line for Mirvac. If you look at the US build-to-rent, it's called 'Multi-Family' whatever that means, but it means the same thing, has been around for about 50 or 60 years. And it's 15% to 16% of the rental market. The rest of it is all condos or what we would call strata titled apartment buildings. So it's just another offering, another choice for residents. It won't suit all people, but it will suit some. And is there as another offering. And there's obviously that the customer side of it and the customer offering, which we've talked about, the other interesting side of it that's really come forward through COVID is the government side of it and the ability for it to provide through cycle supply.

Obviously to deliver off the plan apartments can be quite cyclical as you need to be out of sale. Often 60% or 70% of the building to actually get the finance put in place, because of the nature of this model is you can't lease until you're six weeks away from finishing. And the funding model is different. It's institutional capital invested for long periods of time for income returns. You can actually commence construction a lot quicker because you don't need that pre-sale process. I mean, environments like this where governments are looking for activity in residential construction and the like, it's a good model to have both working and operating in this type of environment.

Amanda Farmer: And are there government incentives there for this kind of development, I'm not sure.

Adam Hirst: Where there has been some changes in looking for equalisation of build-to-rent relative to build yourself and also equalisation of build-to-rent relative to how it's taxed relative to office industrial and retail properties, because that's where the capital will come from.

So at the moment, it's disadvantaged from an income tax perspective relative to office retail and industrial, because it's taxed at 30%, rather than 15% for foreign investors. And that's an ongoing discussion with the federal government and at a state level, the issue to date has been two fold. One's been around planning that it hasn't actually been recognised as a separate type of asset class with separate planning regulations and land tax. So because you're aggregating all of the land value together, you'll immediately take over the land tax threshold and land tax was a significant impost on the viability of the sector. So New South Wales has recently put forward a policy around land tax and planning for build-to-rent, Queensland government it's at one of the items as part of the election going on at the moment. And Victoria is looking at doing something similar as well.

Amanda Farmer: Okay. Interesting times ahead then, when I first mentioned this, I think I might have posted it on our Facebook page when LIV Indigo was marketing.

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Amanda Farmer: The questions that came up were of course, oh, well, if we've got a rental only apartment buildings, are we going to start to see owner occupied only apartment buildings? Are the tenants all going to shift over to this build-to-rent model, which does indeed look very attractive?

I suppose putting my strata law hat on their owner occupied buildings as we've talked about, Adam, are developed under the strata title structure so that you can own these separate parcels of airspace. And we are under our strata legislation across the country. You're restricted from passing by-laws, if you like that would prevent tenants from moving into apartments. So I suppose my answer to that is not unless the law changes, but perhaps the market will change these.

If we see tenants more attracted to the build-to-rent offering, rather than the strata title offering, maybe there'll be a natural progression over to owner occupied apartments in the strata title context. I'm not sure. What do you think?

Adam Hirst: Yes, it'll be interesting to say. I mean, personally, I think the residential strata market is so large in Australia already that even if the sector grows at a rapid pace, it might be 2% or 3% of the market in 10 or 15 years.

So I think it's a very long pathway before that's even a consideration. I also think as an investment, Australians will still want to invest in individual apartments and they like the tangibility of that and investing in that and getting some rental income makes sense. So I don't think fundamentally that will really... I don't think you'll see a big shift that way, but it'll be interesting to see. And I think environments like this that we're in at the moment always create different innovations and different products. And there's lots of different housing models being looked at across the spectrum at the moment. I'm sure you'll start to see different versions, both for owner occupier and rental and everything in between starting to form.

Amanda Farmer: Yes. Which I think is a good thing. Can you tell us where we might see other Mirvac build-to-rent offerings cropping up soon?

Adam Hirst: Yes. So our next one is under construction next to the Queen Victoria markets in Melbourne. So that's 490 apartments going up at the moment. We didn't have another 2 in planning in Melbourne. We just announced our fifth project, which is up in Queensland, Newstead in Brisbane and we're actively looking for more projects throughout Sydney, Melbourne, Queensland, and beyond. So it's an exciting space and there's plenty of opportunity in it.

Amanda Farmer: I think so too. I'd be very interested to say, as these buildings stop cropping up, whether our strata managers who might be looking to work a little bit differently, looking for a change perhaps become attracted to getting involved in these buildings from the management perspective and whether you can see a use for that skillset there, building managers as well and service providers of all types who are used to working with strata buildings, I'm sure those skills carry cross quite well.

Adam Hirst: Yes. I think an interesting intersection where we're already seeing it and then I think it will happen more and more as you get more and more mixed use buildings is there will be no doubt stratum of build-to-rent in larger buildings where there'll be BMCs. And even at Sydney LIV Indigo, for example, it's a build-to-rent stratum, and then it's to build to sell stratas and then a common podium with a BMC managing it. So it gets quite complex there, but there's a lot of interaction there.

Amanda Farmer: I like it. You can the smile on my face. My palms are rubbing together here, get my hands on those documents.

Adam Hirst: Yes. So it's inevitable all these areas interact, I think.

Amanda Farmer: Yes. Exciting times ahead indeed. Well, let us know Adam, where our listeners can go to find out more about build-to-rent or LIV Indigo if they're interested in checking it out and about you and Mirvac generally?

Adam Hirst: Yes. So you can jump onto the Mirvac website and go through there through to build-to-rent, or you can go to livmirvac.com, which is LIV as the customer facing build-to-rent brand for Mirvac.

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Amanda Farmer: And that's L-I-V.

Adam Hirst: L-I-V. Or just simply search LIV Indigo in Google and it will come up and direct you to the page

Amanda Farmer: Perfect. Well, thank you so much for joining us today, Adam, and filling us in on this exciting new development structure that we have here in Australia, or I will be watching it closely and seeing how it evolves and no doubt chatting to you again sometime in the future. So get your wrap up after maybe 12 months of LIV Indigo and others where we think we're headed from there.

Adam Hirst: Sounds great. Thanks a lot for having me, Amanda.

Amanda Farmer: Thanks Adam.

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