ADDLESHAW GODDARD

BUILD TO RENT

Britain's quality rental market

ADDLESHAW GODDARD *in collaboration with*

BPF BRITISH PROPERTY FEDERATION

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CONTENTS

INTRODUCTION

Britain's quality rental market

Our original report on Build to Rent (BTR), entitled Funding Britain's Rental Revolution and published in 2015, highlighted the significant changes that had taken place in the country's housing market over the previous 15 years, and identified some of the driving forces for further change.

The report's conclusion looked forward five years, and outlined several challenges and issues that would need to be tackled for the BTR sector to continue to thrive, and flourish.

This report looks at the current state of play in the UK BTR market, identifies the progress made against some of the predictions in our original report, and gives an update on how the challenges and issues are changing over time.

Changes in demand for renting

Back in 2015 we said that consumer demand for BTR homes was set to grow substantially, and that supply would need to follow. In the first quarter of that year, Savills had estimated the existence of a pipeline of 16,000 new BTR units, mainly in London but with some in the North West.

Savills estimates that the pipeline of new homes has now grown to more than 132,000 – over eight times what it was only three years ago – with a 50/50 split between London and non-London locations. However, the geographical spread is far wider than the largest conurbations identified in our original report. BTR units are now being planned and built as far afield as Bristol and Fort William, and in places like Reading, Milton Keynes and Stoke-on-Trent.

In addition to the dramatic growth in the total number of units being planned and built, the size of individual schemes is also increasing. Two thirds of planned schemes are now for developments of over 100 units, and there are many that will deliver 500 homes or more.

Individual is king

Our original report identified the increasingly service focused nature of our society – driven by a need for convenience and a desire to save time – and that the bulk of private tenants were under 35, but with 35-49 year olds becoming increasing more likely to rent.

This report includes a contribution from Turley's Amber Morley, who is a member of the British Property Federation's 'Futures' group. As a 'millennial', Amber considers her generation's desire for security and quality in their housing options, with the availability of communal areas and a care for the wider environment. She also recognises that, as millennials grow older and settle down, the demand for family sized BTR homes will inevitably increase.

Sociable housing

We also identified the need for BTR properties to suit people's lifestyles and to provide an array of amenities. Many BTR developments now include concierge and communal facilities, but some are looking further afield to match their amenities to the lifestyles of prospective tenants. We examine the role that hospitality, and particularly the provision of food and beverage outlets, can play in making BTR developments more convenient for, and therefore attractive to, their target markets.

Not all BTR developments have an emphasis on hospitality, however. Some of them are content to offer comfortable and well-located apartments for people who want to pay no more than the market rent and do not want to pay for bells and whistles. This is a growing market.

Delivering political ambitions

Although politicians of all persuasions declared their commitment to deliver more homes, back in 2015 we identified that, to encourage greater investment into BTR, local and central politicians would need to recognise the difference between BTR and traditional house building, and to make changes, particularly to the development tax system, to encourage the former and make it more attractive to investors.

Changes are coming. Earlier this year the government published its new National Planning Policy Framework, which recognises that BTR should be treated differently when assessing affordable housing requirements. In London, the draft new London Plan encourages boroughs to take a "positive approach to the BTR sector", but around the country there is still a dearth of detailed BTR policy in local plans.

Institutional backing

Our original report recognised that the continued backing of domestic and foreign institutional investors was vital for the BTR sector to grow. Developments would need to become bigger to provide the larger income streams required by institutional investors. Fund managers like Legal & General, M&G Real Estate, Hermes and Invesco were taking tentative steps into the sector in 2015, but the list of those involved today is longer and more diverse.

In addition to the British institutions, large non-UK funds are beginning to enter the market, bringing their experience of the huge multi-family market in the USA. British banks, still wary of the sector in 2015, are now much more involved, while banks from Germany, the US and Ireland have begun to enter the field. Private equity funds such as Terra Firma (via Arrington Homes) are also showing an interest in the sector.

There are also new developers coming to the market all the time. These include house builders and others who have only built houses for sale in the past but are thinking about this market for reasons of security of investment and de-risking market sales. There is talk (so far nothing more) of WeWork taking a serious position in the BTR market, although it would probably look a bit different from the norm as you might expect.

Personal finance

However, while there have been significant changes in the last three years in the number of homes planned and built, the size of developments and the range of investors involved, the prospects for individual investors to benefit from the BTR sector are still mixed.

With a few exceptions, the opportunities to buy shares in a BTR landlord remain very limited. Some listed UK property companies are beginning to put their toes into the water, and the range of pension funds involved is growing, so the scope for indirect exposure is increasing, albeit not very rapidly.

Continuing trend?

At the time of writing, the Brexit process is rumbling towards an uncertain conclusion. Views on the likely outcome, and its impact on life as we know it, vary enormously. However, the demand for homes will continue to exist, regardless of the outcome, and the BTR sector will continue to provide an essential, quality housing choice for people of all ages.

BUILDING BTR VOLUMES AND SCALE

Hamish Simmie, Research Analyst, Savills

The BTR sector in the UK is growing, both in numbers of units and in the size of schemes – planned, under construction and completed – and also in its geographical spread.

By the summer of 2018, there were over 132,000 new units at various stages of the planning pipeline, an increase of 26% on the same time last year. The supply is evenly split between London and the regions, with London marginally leading by a few thousand units. Sites under construction in the third quarter of 2018 have a combined capacity to deliver some 42,000 units, up 33% year on year.

More units – bigger schemes

With growing investor confidence in the sector, schemes are getting larger. Of those that have been completed to date, just under half of the schemes have 100 units or more. However, two thirds of schemes under construction or in planning are larger than 100 units. There are a greater number of bigger schemes, too, with 38 of those in the pipeline expected to deliver over 500 units each. Fourteen of these, currently under construction, will together create over 11,000 units.

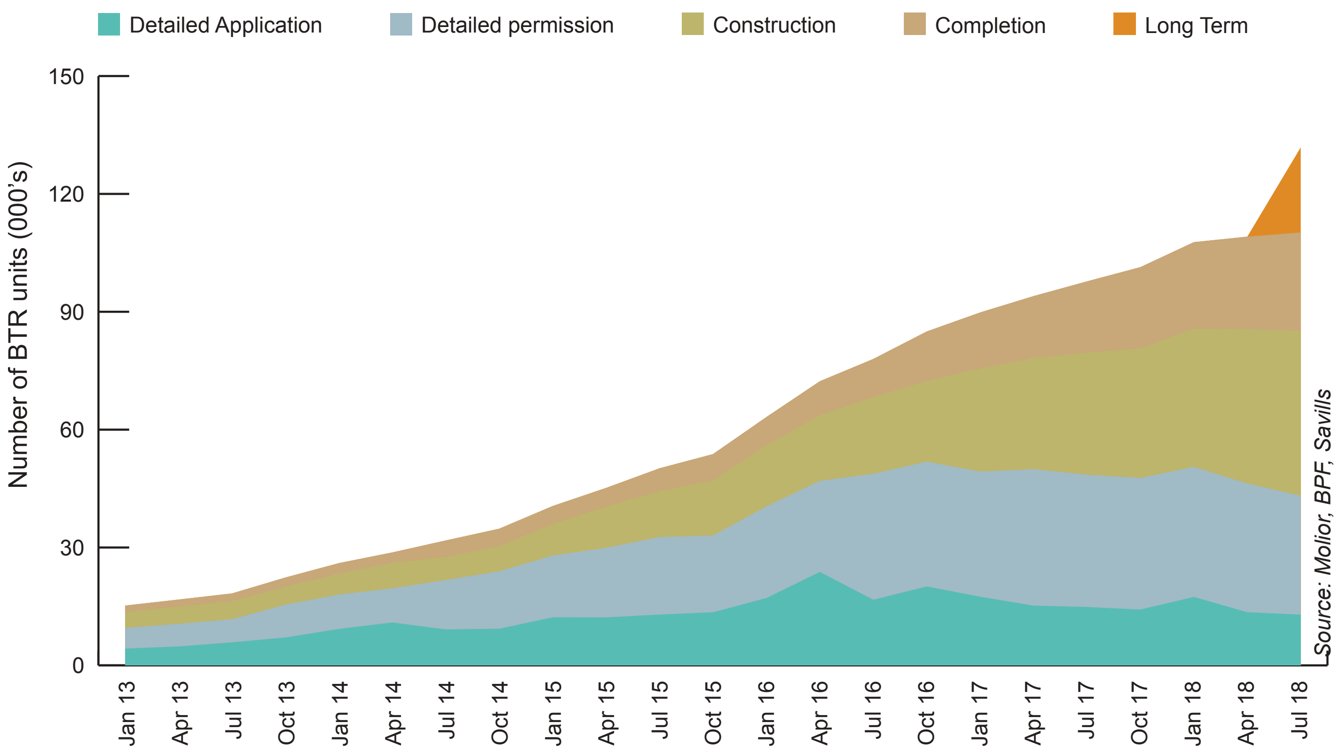
Grainger is just starting to market its Clippers Quay scheme in Salford, the single largest scheme to be delivered outside London. In the longer term, some very large schemes are coming forward in the regions, with Manchester, Birmingham and Leeds all having schemes of over 1,000 units in the pipeline.

Major landlords building scale

The top ten largest landlords of completed and operational BTR units own just under half of the completed stock, with seven of these landlords having operational portfolios of over 1,000 units. Of the top three, Get Living and L&Q have all their completed units in London, while Sigma's portfolio is located across the north, including homes in Liverpool, Oldham, Sheffield, Salford and Manchester. And unlike most BTR landlords, whose stock comprises apartments, the majority of Sigma's portfolio is family housing.

Only half of the BTR units completed to date – around 13,000 units – have been delivered as purpose built rental stock. The remainder has been switched to rental from units that were built for sale, with investors looking to quickly build their BTR portfolios by purchasing blocks on large schemes from house builders and developers. Looking forward, however, there is a significant pipeline of purpose built stock that has been planned and designed for the rental market, with almost 100,000 units under construction or in planning.

The BTR supply pipeline



In terms of the future supply, there are 21 landlords with pipelines of over 1,000 units, highlighting the rapid growth of the sector. Quintain and L&Q have the largest pipelines of new units, at over 4,000 homes each. Quintain's pipeline is focused at Wembley, while L&Q's portfolio stretches across a number of London boroughs.

From London to the English regions and Scotland

To date, London has witnessed the highest delivery of BTR stock, in part because of the heightened affordability pressures and high proportion of rental households in the capital. However, the regions currently have a larger amount of new stock under construction, as investors eye key regional centres that offer good fundamentals at more competitive prices than London.

So far during 2018, construction has begun on a number of major BTR schemes across England. Some of these schemes are in London, but the majority are widely spread, including Newcastle, Leeds, Manchester, Stoke-on-Trent, Milton Keynes, Reading, Kent, Southampton and Bristol.

The most notable recent growth in BTR is in Scotland, where the appetite for large scale rental products has increased significantly over the past 12 months, and where there are currently more than ten BTR developments in planning, mainly in Edinburgh, Dundee and Glasgow. BTR is growing outside these key urban areas, too; Lochaber Housing Association, for instance, is planning 200 rented homes in Fort William, 100 miles north of Glasgow.

In terms of completed stock and units under construction, emphasis remains in the urban centres. Forbes Place, in Aberdeen, is one of LaSalle's most successful ventures into BTR; the scheme, delivered by Dandara and completed over two years ago, boasts almost 300 rental units. Each is provided with high speed broadband, and has a parking space included in the headline rent.

Looking at schemes currently under construction, Moda Living, working with Apache Capital, is currently building over 500 BTR units in Edinburgh. The partnership is no stranger to BTR, with another scheme under construction in Manchester, and three more planned for delivery in Birmingham, Glasgow and Liverpool. Moda Living/ Apache Capital's full pipeline of BTR is just over 2,100 rental units, all of which are being delivered in key urban centres outside London.

So despite a slow start, investor confidence in BTR is growing – so too is the number of investors looking to invest in the sector – the total number of units and the size of individual schemes are increasing, and urban centres across the UK are benefiting from the burgeoning BTR sector.

COMPACT CHOICES

According to Savills, the number of people leaving London reached its highest level for at least five years in summer 2018, particularly those in their 30s. With rents having risen 34% in the last ten years, and with minimal growth in salaries, housing costs are a major factor in whether people can afford to live in the capital.

One answer is to provide what is variously referred to as Compact, Micro or Co-Living – high quality, smaller, cheaper apartments for those for whom a central location and excellent transport links are more important than space.

Aimed at key workers, single people and those wishing to downsize, this additional option for millennials could help to stem the exodus from central London and ensure that the city's core retains a vibrant mix of residents.

Compact living is already seen as an important part of the housing mix in the US, Japan and the Netherlands. But planners and policy makers here are suspicious; concerned that developers see it as a way of extracting more cash from each square metre of floorspace and questioning whether there is demand. They were similarly suspicious of BTR a few years ago, but it's now recognised as a key part of the housing offer.

FUNDING THE GROWTH OF BTR

Peter Hardy – Partner, Real Estate, at Addleshaw Goddard and

Sarah Egbu – Partner, Real Estate Finance, at Addleshaw Goddard

When Addleshaw Goddard first took an interest in the BTR sector on the back of the Montague Report in 2012, there was fundamentally no interest from investors in institutional investment in the BTR sector. Interest has built slowly, and now many major funds and banks are investing in the sector in a wide variety of ways.

Specific requirements of BTR

BTR as a product has particular requirements and implications that need to be considered by funders, including:

1. location and quality of the building – as BTR tenancies are short term, they are fluid and require very active management;

2. importance of provision of services to the property – there is increasingly a two tier BTR market between high levels of service provision and the more basic, affordable rent, scheme involving repairs and little else;

3. tax implications, particularly around the recoverability of VAT, unlike in office or retail investments.

How is funding being delivered to the BTR sector?

Funding largely comes in two forms – debt for development and investment, and institutional forward funding – with a degree of overlap between the two sources of funds.

In addition to banks, debt providers include Homes England for development, and the government backed Venn Partners scheme for the investment phase. Some will only provide investment phase debt; others only development and a few will provide debt for both phases. Inevitably, given the different levels of risk profile, the terms differ quite radically between development and investment phase loans.

Other institutional investment comes via the forward funding of schemes. This differs from debt products quite markedly as it is designed to buy out the initial developer in its entirety, with no route for the latter to retain an interest in the completed property. However, the nature of the BTR sector and its intensive management requirements mean that the developer, as the ongoing manager under a management contract, can take an interest in the scheme's success via incentivised fees.

Some of the BTR brands are also forward funders, providing finance to buy out a development in the same way as broader institutional funders for whom BTR is just part of their portfolio. They can then specify their detailed requirements to their own standards before delivery, tailoring extra facilities to individual sites.

Where does the money come from and who are the active investors in BTR?

The sources of BTR funding reflects the increasing openness of the UK market to funds from a wide variety of places. Mainstream UK banks get their funding from their usual retail and wholesale sources. The same is true of the UK major funds, although some are looking to leverage their forward fundings, with debt going into the forward funding vehicle, often from offshore sources. European banks (especially German) are beginning to look very closely at this sector.

BTR providers who have built themselves up from the ground – such as Essential Living, Moda Living and Fizzy Living – have US and Middle Eastern money behind them. However, the big UK property companies are looking to access this market, if reports that British Land is pursuing Fizzy Living come to fruition. If this happens, they will probably use their normal sources of finance to develop further in the sector. Other long term residential specialists like Grainger and the housing associations (Thames Valley Housing Association set up Fizzy, and Places for People has invested heavily) are obviously active in this sector, as a natural extension of their existing businesses. The ability of housing associations to tap up the bond markets could be a real boon for them in developing BTR products.

Many of the large UK funds have a presence, and those that do not are thinking about it carefully. L&G and M&G are prominent, as is Aberdeen Standard. Hermes has joint ventured with Countrywide to get into the market, and Aviva says it is keen to enter too. These funds largely use their long income funds to set off annuity liabilities, tying into the benefit of a residential income and capital return, which have historically outperformed other markets. Many have owned similar assets in the past, and are having to re-learn the necessary skills. Funds normally outsource management responsibility to independent providers, although they may bring management in-house as they increase both their portfolios and their confidence in managing these assets.

Other large non-UK funds are beginning to enter the market, including Greystar, Realstar and Cortland. They have experience of the huge multi-family market in the USA, the source of much of the thinking for PRS in this country. Whilst the USA is a very different place, where land is plentiful and relatively cheap outside the main city centres, some of the concepts will be transferrable, aiding their progress in the UK markets.

Finally, we are beginning to see the development of the use of REITs as tax efficient structures for the delivery of PRS funding. The first movers in this have been Sigma and Grainger with their respective PRS REIT and GRIP vehicles, and more long term non-institutional holders of BTR stock may join them.

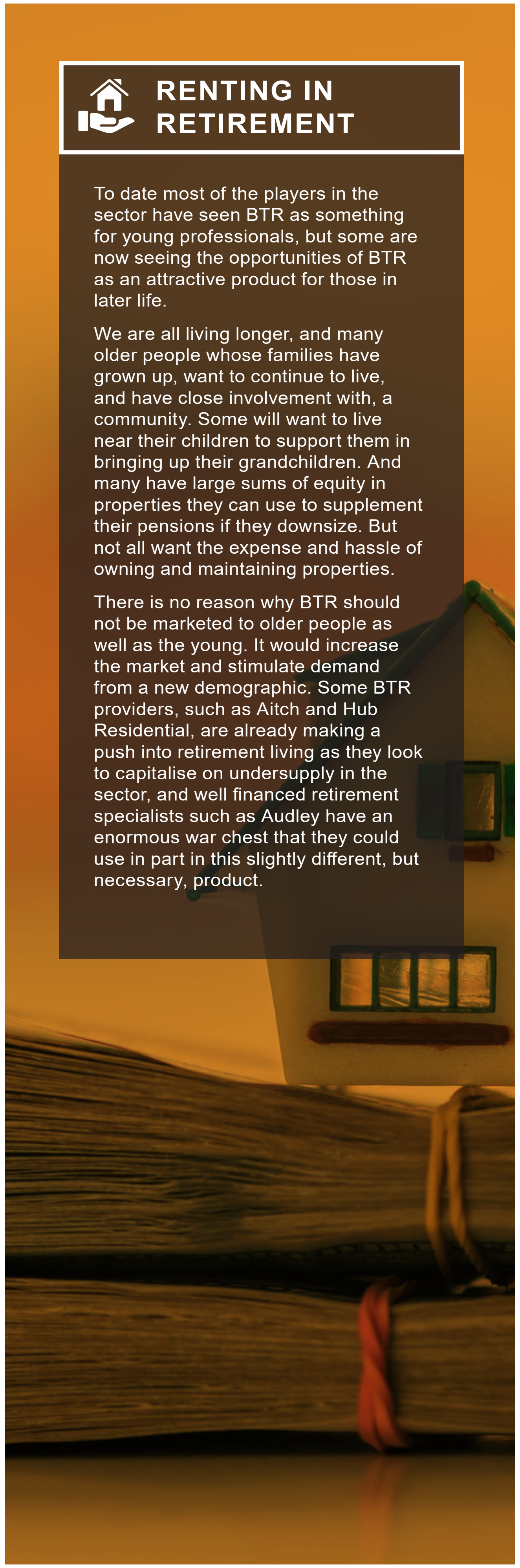
Banks in the market

At the time of our original report, the big four UK banks were venturing tentatively into the BTR sector. It is now a hot topic for the majority of banks operating in UK commercial real estate, and for the debt funds that have entered the market in recent years. Those not already in the BTR sector are looking to enter it.

Bank funding into the BTR sector started, and has remained, at the development through to investment/stabilisation of asset stage, including providing development funding to the equity forward funders. The influx of banks into the sector has made for a competitive field. The German lenders, including Deutsche Pfandbriefbank, Deutsche Bank and Helaba, have established their positions in the UK BTR market. Wells Fargo has funded a number of UK schemes, including the original development of what is now Lonestar and Quintain's Wembley scheme (with AIG and CPPIB). Irish banks, Bank of Ireland and AIB, have also entered the sector and are looking to make their mark.

The regulatory capital requirements applicable to banks play into short-medium term lending, so providing development funding flipping to investment funding for the asset stabilisation period is the current sweet spot for banks. Four to seven year funding is common. The low yielding, long term nature of the operational assets, however, suits capital markets and institutional funds more than banks. The government backed Venn scheme, which provided up to 30 year money against stabilised assets up to 80% and has been the main source of funding for the investment/stabilised asset phase, came to an end in December 2018; what, if anything, will replace it, is currently being debated. Whilst there is plenty of long dated liquidity in the market, leverage models for the sources of that long dated liquidity are challenging when taking out bank funding.

Banks are looking for ways to be able to fund these low yielding long term operational BTR assets without having to fund over longer periods than their cost of capital can justify. Perhaps with an ever increasing number of stabilised assets in the market beginning to change hands, a market for shorter term investment lending will emerge, and some of the historic challenges around limited data on the marketability and operational costs of BTR assets will be overcome, easing the way for bank liquidity to enter into the operational phase of BTR assets.



RENTING IN RETIREMENT

To date most of the players in the sector have seen BTR as something for young professionals, but some are now seeing the opportunities of BTR as an attractive product for those in later life.

We are all living longer, and many older people whose families have grown up, want to continue to live, and have close involvement with, a community. Some will want to live near their children to support them in bringing up their grandchildren. And many have large sums of equity in properties they can use to supplement their pensions if they downsize. But not all want the expense and hassle of owning and maintaining properties.

There is no reason why BTR should not be marketed to older people as well as the young. It would increase the market and stimulate demand from a new demographic. Some BTR providers, such as Aitch and Hub Residential, are already making a push into retirement living as they look to capitalise on undersupply in the sector, and well financed retirement specialists such as Audley have an enormous war chest that they could use in part in this slightly different, but necessary, product.

THE MILLENNIALS' VIEW

Amber Morley – Consultant, Economics at Turley

Millennials are a politically and economically engaged generation. We are 25 to 34 year olds who tend to prioritise flexibility at work, take pride in financially astute decisions and choose products based on quality. As a generation we value the innovation of traditional products.

Millennials and home choices

Millennials currently account for 14% of the UK population and up to 35% of the workforce with the largest concentration living in London . Being a millennial is not just a demographic concept, but also a consumer market taken seriously in research from KPMG, Goldman Sachs, Deloitte and Accenture. This information rich generation believes 'quality is king' and spending is often directed towards cultivating self-image. However, despite being budget savvy and conscious of financial responsibility, rising housing costs and competition for rental properties has meant that millennials are increasingly losing control over their choice of home.

Renting is now the most common option amongst this generation (59% of 25 to 34 year olds rent) and it is predicted that this trend will continue. While options from help-to-buy mortgages to shared ownership exist, home ownership is still not an option for many. Many rent from private landlords without a problem, however, over a third of private rented homes often fail to meet the Decent Homes Standard and rogue landlords are still a source of complaint. The lack of security in tenancy, hidden agency costs and variable quality have made this generation curious to find an alternative.

Security and quality in BTR

Known for more secure tenancies, onsite amenities and longer term investment in the surrounding environment, BTR offers an appealing alternative to private landlords. For many, its longer term and guaranteed tenancies are an important selling point. Schemes such as Get Living's East Village provide three year tenancies and tenants are able to give two months' notice after six months, retaining the valued option for flexibility. Grainger's Abbeville Apartments in Barking adopts a similar approach by offering flexible and long term tenancies for up to three years, with no administration or renewal fees. More than half of the development's tenants have taken up this option .

The range of onsite amenities and social spaces are another key benefit for millennials. Communal areas provide social spaces and can accommodate flexible working patterns. At the Argo Apartments by Grainger, communal spaces can be booked for outside parties and used for organised social events. Bookable meeting rooms also benefit freelance and home workers. The careful design of communal space creates a highly personalised atmosphere for residents; high quality, unique products are considered an important branding strategy for this generation .However, it is important to recognise that these amenities come at a premium and it has been shown that tenants' enthusiasm for additional facilities is still largely dependent on income .The issue of affordability is being considered in policy and those working within this market are keeping abreast of these debates.

The long term stewardship of a place is a unique contribution of the BTR sector and, for me, is the most important element of the model. Developers and asset managers have recognised that investment in the wider environment is increasingly vital for securing rental contracts. The experience of the development is as much about a safe and pleasant journey from station exit to the front door, as it is the onsite design. Greystar is careful to adopt this place making approach at its scheme at Greenford, Ealing. The scheme acted as an anchor for regeneration on a former industrial site, incorporating the waterway in the public realm design. A well designed and liveable neighbourhood can make a positive contribution to the millennial's experience of a city.

A growing market

While BTR is a viable alternative now, how do we ensure that it remains relevant over the longer term? There also needs to be a range of options as the generation requires additional space for growing families. Currently 35% of millennials are parents , and the number of households with children renting privately in England has tripled in the last 13 years, from 600,000 to 1.8 million . Rental properties need to be available to serve this population, which is a particular policy concern in London. Essential Living's Creekside Wharf in Greenwich, is a good example of a family focussed building, containing buggy storage, extra acoustic insulation and an onsite nursery.

While there are still deep rooted systemic challenges to address in the housing market, BTR provides another immediate housing option for the millennial generation. Whether as a response to changing lifestyle choices or burgeoning house prices, renting is here to stay and a diversity of housing products is needed to keep pace with this generation's changing circumstances.

As a millennial, I remain an optimist; I believe BTR has an important role to play in meeting this generation's demand for high quality, safe and well-designed homes. And above all, the interest in legacy will help to create the communities in which we want to live.

BTR AND HOSPITALITY

Lucy Sturrock – Partner, Real Estate at Addleshaw Goddard

As home ownership becomes a less viable option for many, there is an increasing opportunity for the BTR sector to thrive. It can do this by differentiating its offering from the wider private rented sector (PRS), using innovation to provide a space residents want to call home and take some ownership over, and to create a community atmosphere within each development.

Hospitality – such as the provision of concierge, leisure and entertaining facilities – is increasingly being used to differentiate BTR from the general PRS. As recognised by Allsop Partner Paul Winstanley, "the notion of having a customer rather than a tenant is very important". Providing desirable homes, and longer tenancies of up to three years – commonplace in BTR – are both being used to make residents want to stay.

Hospitality facilities are also being used on larger multi building schemes to encourage community interaction within the development, including the provision of food and beverage (F&B) outlets. Millennials account for a large chunk of BTR's target market, and they also account for 29% of revenues for restaurants. The savvy BTR operator should therefore aim to cater to what millennials look for in F&B.

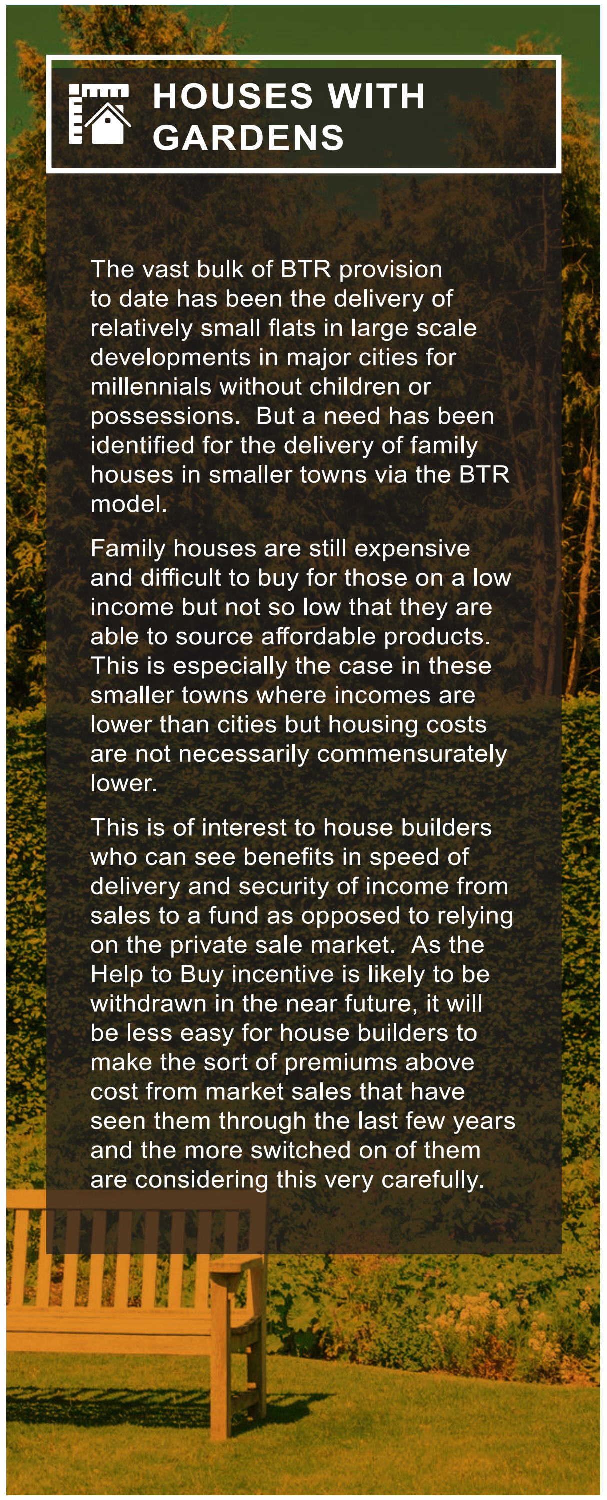
Providing new F&B facilities in London

Priding itself on 'reinventing renting', Fizzy Living recognises that the community atmosphere so important to the BTR sector is bolstered by the inclusion of a strong F&B offering, which in turn must be underpinned by a hospitality-led service. One of Fizzy's developments, The Gatefold in Hayes, West London, will include on-site restaurants to serve the 133 homes in the scheme.

Quintain's Wembley Park project, with 5,000 homes completed by 2024, makes it currently the UK's largest BTR development site. Management is carried out by Tipi, its own 'Build to Rent Management Brand', which boasts 24 hour hotel inspired services.

Harnessing existing F&B facilities in Manchester

GreenGate, on the Salford/Manchester border, endeavours to create "a place that residents are proud to call 'home'", with residents encouraged to spend time together enjoying the complimentary tea and coffee available in the Residents' Lounge. Residents are offered discounts so that they can go to restaurants in the surrounding area and eat at discounted prices, rather than including a restaurant in the development.



HOUSES WITH GARDENS

The vast bulk of BTR provision to date has been the delivery of relatively small flats in large scale developments in major cities for millennials without children or possessions. But a need has been identified for the delivery of family houses in smaller towns via the BTR model.

Family houses are still expensive and difficult to buy for those on a low income but not so low that they are able to source affordable products. This is especially the case in these smaller towns where incomes are lower than cities but housing costs are not necessarily commensurately lower.

This is of interest to house builders who can see benefits in speed of delivery and security of income from sales to a fund as opposed to relying on the private sale market. As the Help to Buy incentive is likely to be withdrawn in the near future, it will be less easy for house builders to make the sort of premiums above cost from market sales that have seen them through the last few years and the more switched on of them are considering this very carefully.

References to information provided: Housing of Commons Library (2017) Briefing Paper: Millennials // Turley, London First, London Councils (2017) Everything you need to know about build to rent. // Deloitte (2017) Bling it on – What makes a millennial spend more? // Savills (2018) Spotlight on London Demand: What do London tenants want? // Get Living (2017) Millennial Living in 2018: Insights for the UK Build-to-Rent Sector. // The Resolution Foundation (2017) A New Generational Contract.

Such a scheme capitalises on the fact that the target millennials tend to be loyal to the casual dining chains they know and love. Indeed, a recent survey found that, despite food delivery apps like Deliveroo and Uber Eats, millennials dine out more than ordering in, and tend to choose casual dining chains.

Moda Living has partnered with Uber to offer residents of Angel Gardens in Manchester monthly credits for Uber rides, and this approach could be used to partner with F&B operators to offer residents non-discount perks, such as a certain number of free meals per month or year. Alternatively, if tenants prefer dining in, a subscription service could be offered to deliver meals to their door.

Food or beverage

Although there can be a tendency to focus on the eating element of F&B, wet-led concepts seem to be enjoying a renaissance after lagging behind casual dining brands for many years. It seems that we could be experiencing the return of the pub.

There could therefore be some merit in incorporating a pub into a BTR scheme to bolster the community atmosphere so integral to the BTR sector. Indeed, there has already been some uptake of wet-led schemes within the BTR sector; the Ferry Lane BTR development in Walthamstow includes 2,000 square metres of commercial and community space, including a microbrewery, alongside its 440 residential apartments and townhouses.

While F&B within BTR is not yet considered essential, as the BTR sector matures, providing F&B on site is becoming an increasingly compelling slice of BTR operations. Operators should therefore look to incorporate restaurants and pubs into their offering to entice, and cater, to the rental generation.

Legal structure

F&B within BTR is not yet so commonplace that a uniform approach to the legal structure incorporating F&B has emerged. The table below sets out the advantages and disadvantages for a BTR operator of three different methods by which a F&B operator could potentially occupy BTR space.

	LEASE	AGREEMENT	MANAGEMENT AGREEMENT
Advantages for BTR operator	Greater security of income. There is a known risk/ reward profile in standard leases.	Opportunity for economies of scale across a BTR operator's developments. Opportunity to develop brand.	Day to day running controlled by the F&B operator.
Disadvantages for BTR operator	If the leaseholder F&B operator goes into a CVA or similar, the BTR operator is stuck with a lease. Stifles the ability to 'swap in, swap out' F&B operators which would provide flexibility.	Greater asset management time. Less certainty of income.	Lack of input to F&B operation. Careful drafting is required to ensure that the management agreement does not bear the hallmarks of a lease.

POSITIVE PLANNING DEVELOPMENTS

Marnix Elsenaar – Partner, Head of Planning at Addleshaw Goddard

It's not so long ago that many local authorities simply did not get BTR. They treated it in the same way as build for sale and expected the same amount and type of affordable housing delivered by a registered provider in the traditional way. The result? BTR developments were not viable and did not get built. Fortunately we've come a long way since then.

Central government has helped. The new National Planning Policy Framework, published in July 2018, recognises that BTR should be treated differently when assessing affordable housing requirements. The Glossary to the Framework, in defining "Affordable housing for rent" states that "for Build to Rent schemes affordable housing for rent is expected to be the normal form of affordable housing provision" and must be at least 20 percent below local market rents. It adds that for BTR, the landlord of the affordable units need not be a registered provider.

National Planning Practice Guidance adds that 20 percent is "generally a suitable benchmark" for the level of affordable private rent homes to be provided in a BTR scheme and advises local authorities that, if they wish to set a different proportion, they should "justify this using the evidence emerging from their local housing need assessment, and set the policy out in their local plan". The guidance on viability allows developers to make a case for a lower amount of affordable units and in our experience the challenge of making the development viable means a viability appraisal is usually provided.

In London, the Mayor's draft new London Plan exhorts boroughs to take a "positive approach to the BTR sector" and recognises the positive contribution it can make to the delivery of new homes. It also accepts that the affordable provision can be entirely Discounted Market Rent (what the NPPF calls affordable rent) managed by the BTR operator without grant. It adds that DMR units should be fully integrated into the development with no differences between DMR and market units.

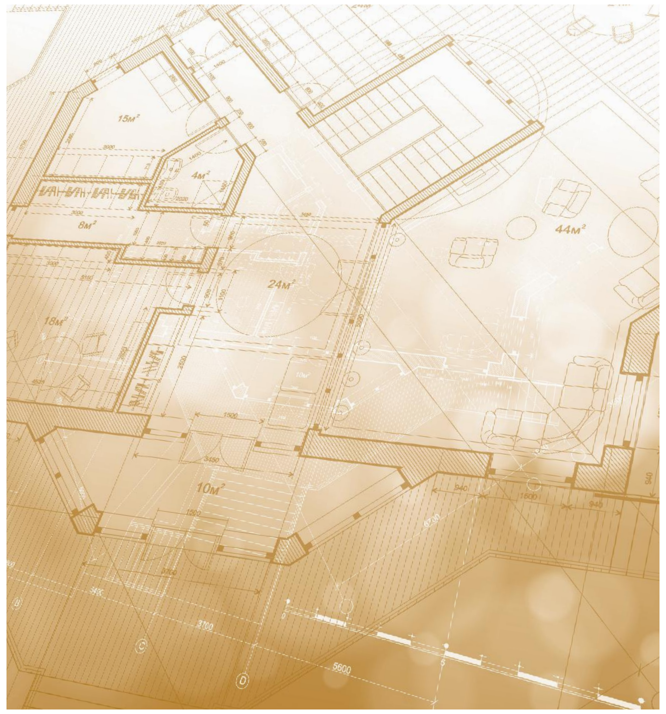
The Mayor's Housing SPG (August 2017) states that the fast track route (where 35% affordable without public subsidy is provided, meaning no viability appraisal and no questions asked) is not suitable for BTR, and that the viability of each scheme and the amount of affordable homes it can provide must be assessed, although that approach is not maintained in the draft London Plan which does allow a fast-track for BTR. In addition, an early stage viability review is required after two years from the date of the permission if an agreed level of progress hasn't been made with the development.

The policy also requires a late stage review following occupation of at least 75% of the market units, although that policy is now subject to intense negotiation with the boroughs following the judgment of the High Court in McCarthy and Stone v. GLA that was handed down in May 2018. The judge found that the extant London Plan only allowed a late stage review if the development would take many years to complete, so that the trigger for a late stage review should be defined in terms of a time period specified in the section 106 agreement, and not in terms of the number of units sold, regardless of how soon that trigger has been reached. A clawback payment is triggered if BTR units are sold on the open market during the covenant period. Negotiating the detail of the viability formulas is now often the biggest obstacle to getting a permission granted quickly.

In local plans, there is still a dearth of detailed BTR policy. A notable exception is the Hammersmith and Fulham Plan, which recognises that "BTR is different to traditional, private market housing" with separate viability concerns. It adds that affordable housing for such schemes may be delivered using the London Living Rent as the council's preferred benchmark, and that covenants will be required to ensure developments are rental for at least 15 years, with a clawback mechanism that applies if units are sold as market units during the 15 year period.

So the BTR policy vacuum of a few years ago has largely been filled, but getting planning is still not plain sailing. BTR applications are not immune from the planning challenges that apply to all applications – under-resourced local authority planning departments, debates about need and housing land supply, and local objectors.

Planning is never simple!



FACING FUTURE CHALLENGES

Ian Fletcher – Director of Policy at the British Property Federation (BPF)

We've only just begun!

The evolution of the BTR sector is just exiting its pioneering stage. For many, it has been a passion, but hard work to get to this stage. The good, or bad, news is that there is so much more to do. The best or worst of opportunities and challenges have yet to come. So, what does the future hold for BTR?

Building customer demand

Residents are almost universally positive and love what the sector is delivering, and some have given fantastic feedback on the developments delivered thus far. But beyond existing residents, how many potential customers know about the sector? Apart from the efforts of individual BTR suppliers in their local markets, the sector hasn't really been actively marketed to potential customers.

There is a delicate balancing act, however. Should the players in the sector collectively market BTR and drive customer demand for a product that isn't yet there in sufficient quantity, or should it wait until the supply is available to meet the increased demand? And should the sector have a name – other than BTR – that is more customer focused and appealing?

If you're going to market BTR as a specific entity, you've got to be able to define what it does, and doesn't constitute. Purists say it's something that is purposely designed and built for renting, but should it include units that were designed for sale, perhaps having been tweaked during construction, or have simply been sold to an investor? The definition that probably matters most is the planning one, contained in the draft National Planning Policy Framework (NPPF), which includes "housing that is typically 100% rented out", "comprising either flats or houses", offering "longer tenancy agreements of three years or more", and "will typically be professionally managed stock in single ownership and management control."

If the sector does decide to undertake collective marketing to customers, it will need to consider the risk of reputational damage. No sector can protect itself 100% from bad publicity, but there are ways and means of putting in firewalls (codes of practice and self-regulatory schemes specific to BTR) that prevent contagion.

Building the BTR customer offer is one of the most fascinating aspects of the future of the sector. At this stage of the sector's evolution, less glamorous aspects of service delivery – security, good storage space, indoor/outdoor amenities with opportunities to network with neighbours, a welcoming face at the front door – are some of the things residents value most. The service ethos will not go away. And you can see the sector being an early adopter of Proptech, with a community of customers that are tech-savvy taking advantage of all manner of apps and service tie-ups.

Easing planning permission

A primary focus of the BPF in recent years has been the encouragement of national and regional planning guidance so that the sector can compete and grow. The unrelenting need to educate planners and council members what BTR is, and how it differs from 'for sale' developments, remains a key task, but it should become easier as the sector grows, and its attributes become more tangible.

In the near future, the most exciting political opportunities might emanate from Sir Oliver Letwin's Review of Build Out Rates. Having looked in detail at housing delivery absorption rates, the broad prescription seems to be to deliver a more multi-tenure approach on large strategic sites. In theory, this should be a boon for the BTR sector, but how can such an outcome be delivered, and what are the practical steps Government can take to insist on, or incentivise, multi-tenure delivery on large sites?

Encouraging political support

BTR transcends party politics and has support from all sides of the Houses of Parliament. If anything, there is a frustration that the sector has taken so long to take off. Mechanisms, such as the BPF/Savills BTR map and quarterly statistics, are therefore important to illustrate the sector has arrived, and that 'there is a development near you'. Such transparency goes down well with politicians.

The Government may or may not achieve its target of 300,000 homes being built per annum by the mid-2020s, but the aspiration is helpful in 'upping the ante'. All political parties subscribe to that magnitude of need and, helpfully for BTR, it reinforces the view that the larger the aspiration, the greater the need for a multi-tenure approach.

The sector needs to illustrate the variety within BTR to counter its political detractors. The sector will have a range of units that cater for different incomes, but most will be aimed at the mid-market. There will be apartments, but with a constrained buy-to-let market, very few housebuilders are willing to take on the risk of apartment building at present. The likes of Sigma and Grainger are producing rental homes that are low rise, including houses, and one provider is even looking at a modern take on the maisonette.

And while there will be BTR stacked with amenities, the experience so far is that providers are taking a hard headed and flexible approach to these, based on whether they are adding value and can be changed if not well used.

Attractiveness to investors

BTR is innovative, and what it is doing on modern methods of construction, service standards and management are all very exciting, but investment is the fuel that powers the sector and without it our aspirations will not be achieved.

There are challenges in building the infrastructure that will support the sector as a well-functioning investment asset class. Benchmarking data on investment performance and operational efficiency is keenly sought, but work is in hand.

Few BTR assets are traded at present and the development of a market in second hand stock is something that will truly mark the arrival of the asset class. The indications are that BTR assets will be traded, rather than being broken up and sold unit by unit, and lead to a market that is hopefully large and liquid. Valuation methods will no doubt evolve.

More investment has generally led to a sector that better serves those in need of housing. The greatest challenge to investment, however, may ironically come from politics, through clumsy policies on rent control, taxation policies, or regulation aimed generally at the private rented sector. Politicians sometimes go for populist decisions over what makes common sense. Our job at the BPF, and that of the sector, is to continue to lead by example, and to demonstrate and talk about the fantastic sector we are creating for the benefit of the nation's renters.

INCREASING SCOPE IN SCOTLAND

David Melhuish, Director, Scottish Property Federation

From a slow start, recent development and investment decisions indicate that BTR is taking shape in Scotland, and the sector is on the way to achieving its potential as a new asset class for long term real estate investment in the country, delivering thousands of new homes.

The upside for Scotland's private renters is potentially significant. Large scale, professionally managed and often conveniently located properties in city centres, or close to public transport and wider amenities, offering convenience suited to modern lifestyles and demands, and the flexibility to move from city to city as careers develop.

Yet if BTR only delivers for young professionals seeking flexibility and choice, it will not have achieved its full potential. Companies like PlaceFirst and SIGMA Capital are demonstrating that it is possible to deliver family homes using a BTR model. However, the initial focus of investment on large scale, mixed-use developments is helping breed confidence and commitment to the sector, allowing major development lenders to more readily understand and price the market.

A successful BTR sector has major benefits for policy makers within the Scottish Government and local authorities, particularly BTR's quicker rate of production compared to traditional house building. It is vital for developers to complete and quickly let their schemes, and economies of scale and new modular building techniques allow this to be done quickly and efficiently.

BTR around Scotland

Glasgow is currently the leading area for BTR in Scotland, with consents, planning and in some cases building warrants for 3,000 units, mostly in the city centre. A range of developers are involved, including MODA/Apache Capital, Get Living, Peel and inhabit. The new units will help achieve the city's desire to increase living in its core central district, currently estimated to be only 30,000 residents out of a population of 600,000.

Edinburgh is a little behind its western city neighbour in terms of the scale of BTR development, but it has recently attracted Aberdeen Standard Investments to invest in a 113 unit development at Lochrin Square. This type of investment is critical for the development of the sector, as are the entry of LaSalle Investment Management (understood to be on behalf of the British Coal Pension Fund) and ASI.

Aberdeen also has proposals for BTR development, with a view to boosting city living, choice and supply for residents. In Dundee, Whiteburn has exciting proposals to redevelop a former college within a BTR led scheme, and there are proposals to include BTR in the city's Waterfront project.

Regulatory changes in Scotland

There have been notable developments in the Scottish proposition for BTR in recent years, including some key positive differentials with the wider UK. The 2016 Private Residential Tenancies (Scotland) Act introduced two highly controversial measures, which came into effect on 1 December 2017. In the first, local authorities now have the power to apply for Rent Pressure Zones to cover areas where market evidence suggests rents are overheating. If successful, the authority may declare an RPZ as 'low' as CPI+1% (plus an amount for maintenance and repair). Initial feedback and wider market evidence suggest that this would not deter most landlords and investors, and would be an improvement for many landlords.

In the second, all new leases from December 2017 are on a lifelong security of tenure basis, shifting the balance of risk from tenant to landlord. Tenants can now give notice of 28 days, while landlords have a specified list of triggers to seek repossession of their property. The crucial difference is that there is no longer a 'term' for the lease, and 'no faults' grounds cannot be used to end residential tenancy agreements, as in England.

A new tax incentive has been introduced for large scale PRS investment in Scotland, whereby six or more dwellings can be treated as non-residential, making them exempt from the 3% slab 'second homes tax' in force under SDLT (LBTT in Scotland) in other parts of the UK. In addition, the Scottish Government has introduced bespoke planning guidance on BTR for planning authorities, and has introduced a rental income guarantee scheme for eligible developers and investors.

The future

BTR in Scotland is at a crucial stage of its development. If the Glasgow projects come forward, this will boost confidence and understanding of BTR, and help sustain and build momentum for the sector. It will also encourage several commercial real estate investors who are willing to commit to the sector.

However, there are three key challenges to address. First, affordability and diversity of ownership. While the early developments tend to be targeted at professionals, Scottish and UK Government policies will be aimed at supporting family based living. Second, quality of management and customer care. One of the main arguments for BTR is to improve management and services for the 'customers' of these schemes; it will be vital to deliver on these aspirations. Third, as BTR becomes a larger part of the housing offer, it will inevitably need to address the wider questions of place making and infrastructure provision. The real estate sector is well placed, with its public sector partners, to take a lead on these issues.

The BTR sector is new and still finding its feet in Scotland, but it has great potential and with support and time, will become a key part of Scotland's housing supply.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