BUILD TO RENT
PUSHING THE BOUNDARIES

In association with
hometrack
Our research shows that over half (53%) of all Local Authorities in England have the potential to support viable Build to Rent developments, and of these 139 (43%) are in areas outside of London. The extent of potential viability increases if you take certain measures that reflect how large scale rented developments are currently delivered in more mature overseas rental markets. For instance, if rental unit sizes are reduced by 10% to align to rent price points, then 67% of Local Authorities fall into positive land value territory. Layered on this, if a further 5% delivery cost reduction is secured, 74% of Local Authorities could potentially be viable locations with a development business case.

By measuring Local Authorities for above average socio-economic and demographic demand indicators, further proof can be obtained of a strong investment case for ‘Build to Rent’ in significant parts of England. For example, 5 out of 10 of the viable areas have a higher than average proportion of 25-35 year olds, 6 out of 10 of these areas have better than average employment levels and 4 out of 10 have better than average rental affordability.
Introduction

Over the last five years, the UK housing sector has gone through a major market correction and the stage is now set to see how the industry responds to very different market conditions. The development market is now grappling with a raft of government policies that are impacting both supply and demand. The opportunity to establish a large scale Private Rented Sector (PRS), delivering a proportion of the UK’s housing needs on a long-term basis, has never been greater.

The barriers to institutional investment, beyond the conventional ‘buy to let’ model, have been covered extensively. Part of the solution is structural, requiring possible further government interventions or definitive guidance especially in terms of planning treatment. The key to a sustainable PRS market is to overcome the financial viability issues and make long-term investment into the sector a natural choice alongside other traditional forms of tenure.

It is critical that land, development expertise and investment funding are brought together in a way where everyone is able to achieve what they require and create a deliverable deal map. This represents the value of a sustainable Build to Rent model.

This paper identifies the component parts of driving successful Build to Rent viability and looks at the following specifics:

1) The nature of the opportunity and current activity
2) The mechanics of the development and investment model that underpins viability
3) Where Build to Rent is most viable as a model and the impact of optimisation
4) The Build to Rent viability improvement measures.

This report aims to help developers, investors and land owners understand the real nature of the potential Build to Rent opportunity on a regional level. It intends to inform further decision making, through site specific development appraisal and investment analysis and the employment of specific optimisation techniques.

Through our involvement with much of the emerging Build to Rent activity in the UK we can see the potential to do something different to address the fundamental shortfall in UK housing delivery. We hope this report can play a part in catalysing activity in PRS through identifying the critical drivers and provoking further analysis.

The current market

The current market that underpins viability is difficult to quantify. Through adopting modest assumptions, calculations show that an institutionally backed PRS model has the potential to deliver over 75,000 units in the next 10 years, equating to approximately £8.4 billion of stock. However, there has been significant discussion on whether the UK housing market can nurture and support such an active large scale institutionally backed PRS market like the US multi-family housing market, or whether it will default to “business as usual” with a home ownership driven market and where rented accommodation is the domain of the small scale ‘buy to let’ investor.

Projections about the size and value of a future large scale PRS market in the UK are difficult to quantify. Through adopting modest assumptions, calculations show that an institutionally backed PRS model has the potential to deliver over 75,000 units in the next 10 years, equating to approximately £8.4 billion of stock. However, there has been significant discussion on whether the UK housing market can nurture and support such an active large scale institutionally backed PRS market like the US multi-family housing market, or whether it will default to “business as usual” with a home ownership driven market and where rented accommodation is the domain of the small scale ‘buy to let’ investor.

“70% of new homes currently being developed across the UK are three or four bed houses targeted at existing owners, whereas apartment construction of one and two bed units slowed down during the downturn and has not returned.”

The clamour within the industry for the sector to evolve has never been greater but the reality is that it is impossible to force the market to adopt something simply because it seems the logical thing to do. Furthermore, in a recovering home ownership market, the momentum to initiate large scale Build to Rent might not be sustained.

However, without Build to Rent, the market may struggle to meet the increasing demand for new housing in the UK. Currently there is an opportunity to deliver more housing to meet a wider spectrum of private housing demand and create more choice for local communities. The question is: where are the opportunities and what do developers and investors need to be aware of when considering Build to Rent developments? This paper highlights where it may be feasible to deliver Build to Rent scheme, what makes it work and how a developer or investor can make those “borderline viability” areas viable.

What is the reality of the current housing market?

Since 2011, the market has witnessed some initial PRS activity. This started with some small scale existing stock acquisitions (lead by international capital) and is now beginning to move into larger scale PRS development and investment programmes. Small steps are important but what do the market fundamentals support?

It is becoming evident that the Government “Help to Buy” initiative will boost demand and impact ownership levels. However it is important to note the underlying issues that must be considered when comparing to the option of Build to Rent development.

The open sale market is not catering for the PRS demographic

70% of new homes currently being developed across the UK are three or four bed houses targeted at existing owners, whereas apartment construction of one and two bed units slowed down during the downturn and has not returned. Figure 1 shows that since the start of the recession in 2008, house building for speculative sales has rebounded. Yet for apartment construction, this seems to have levelled out, in particular outside London. The accommodation required for PRS differs to the majority of current housing being developed for sale. A large element of the PRS market is 18 to 35 year olds looking for apartments or flat in urban locations either on their own or as sharers. It is evident that the PRS market demographic, which is predominately supported by urban apartments, is therefore not currently being satisfied.

Mix of housing being built

Figure 1: Hometrack

“70% of new homes currently being developed across the UK are three or four bed houses targeted at existing owners, whereas apartment construction of one and two bed units slowed down during the downturn and has not returned.”

“This report aims to help developers, investors and land owners understand the real nature of the potential Build to Rent opportunity on a regional level.”

4

5
SHOOTS OF RECOVERY IN CAPITAL VALUES

It is evident that capital values have increased in some areas across the UK but the majority of areas are still performing below the 2007 peak (see figures 2 and 3). The average capital values in London have returned to peak levels and beyond but for some other areas, such as Liverpool and Birmingham, this is not the case. This makes it particularly difficult for house builders and developers to ensure a return on their urban sites in regional towns and cities, not least when home ownership demand is also weak. However, it is within these locations that Build to Rent can potentially offer a much more attractive solution.

HOME OWNERSHIP ADOPTION GAP IS STILL AN ISSUE IN THE UK

Although schemes are in place to help with this affordability gap, including ‘Help to Buy’, the average age of the first time buyer is still rising and in the main, the majority of first time buyers still cannot afford to buy. Figure 4 highlights this issue, identifying what proportion of households in different locations can afford to buy. This is also a key driver in underpinning rental demand.

PRS SCEPTICISM NEEDS TO BE OVERCOME

The fundamental test for developers is do they see the Build to Rent market as an attractive option which will ensure a sufficient return. The view is often held that Build to Rent will offer them less in ‘gross’ sales value than they would hope to achieve in the open sales market. However, when accounting for true net sales returns (after deductions for marketing and other sales related costs), the end value of PRS units is often not dissimilar to net open market sales. Furthermore, when considering large scale developments, there is a case to consider Build to Rent to help kick start a location and regeneration, which can lead to immediate occupation and improved return on capital.

For investors, the case for residential investment is strong. Residential rental values are far less volatile than those in commercial property and the peak to trough fall in values during the downturn were significantly greater for commercial than residential.

LONDON ONLY?

Some believe that Build to Rent is only viable in London and the surrounding areas. This is based on two considerations; firstly, that London is considered ‘safe’ in respect of asset values and secondly that whilst ‘net net’ returns may be more modest in London than the rest of the UK, there is more certainty of job security and growth of the London economy. However, the reality is that some regional locations have strong employment rates and the local economies are thriving alongside having lower land values. This is something that we look to test later in the report.

We are currently working with many clients to make Build to Rent a reality.

PRS AS PART OF A LOCAL AUTHORITY PARTNERSHIP

In 2012, Grainger was selected by the Royal Borough of Kensington and Chelsea to develop and manage two mixed tenure housing schemes, including purpose built rental accommodation, on two council owned sites. Grainger will develop and manage both sites under a 125 year lease arrangement and deliver both affordable and private homes for sale of which over 50% will be for the PRS. The scheme will benefit from Grainger’s professional approach to property management and design solutions that will maximise the long-term income of the borough.

In addition, Grainger is also investing in a Build to Rent asset of 100 PRS units in Barking, East London, an area with some of London’s lowest residential values.

PRS AS PART OF A LANDSCAP HARD INITIATIVE

The former London 2012 Olympics Athletes’ Village has been transformed into East Village, £20, a vibrant new neighbourhood with high quality homes for individuals, couples and families. There are a range of homes planned from one bedroom apartments to four bedroom town houses, with a choice of private rental homes from ‘Get Living London’ - a residential owner and rental management company established by Qatari Diar and Delancey. East Village will offer 27 hectares of parklands, new retail space, a world-class education campus and state of the art healthcare facilities for residents and the local community to enjoy.

PRS AS PART OF A DIVERSIFICATION STRATEGY BY A REGISTERED PROVIDER

Fizzy Living, the PRS subsidiary of Thames Valley Housing, is now well established with two fully let buildings, Canning Town and Epsom. Its next addition to the portfolio in Poplar arrives in November and another scheme in Stepney should be delivered at around the same time. This will grow the portfolio to over 250 units. Fizzy Living targets new buildings of around 100 units, all within a five minute walk to a tube or commuter station. Each building has a manager and the flats come ready to rent with free wi-fi, a choice of furniture packs and bundles of TV programmes. Fizzy Living is in the process of raising £200 million of institutional investment to grow its portfolio. Currently its preferred area of operation is London and the South East, but there are plans to take the product nationwide in the mid-term.
The Deal Map Challenges

BUILD TO RENT VS. OPEN MARKET SALES

The first challenge is overcoming the presumption that Build to Rent delivers less ‘gross profit’ than the open market sales equivalent. However, there is a growing acknowledgement that there are savings within the Build to Rent option that need to be factored in to make this model more attractive. These include:

• Sales and marketing costs should be significantly lower
• There is potential to drive construction cost economies through standardisation, building efficiencies and specification driven by robustness and not just marketing considerations
• For larger regeneration sites, Build to Rent can be incorporated to help kick-start the site allowing for a shortened delivery programme which improves return on capital employed/ internal rate of return
• Scope for reduction in developer profit margin for those Build to Rent blocks where a purchaser has been identified prior to start to site and hence exit risk is removed compared to open market sales.

Through a combination of all these savings, the value of PRS product is often not significantly different to the true ‘net’ sales value.

DEVELOPER AND INVESTOR NEEDS

Figure 5 and table 1 provide an overview of the challenges that both the developer and investor face to deliver a viable Build to Rent scheme.

Financial viability for the developer relies on a suitable profit return relative to risk and viability for the investor securing an acceptable annual running return, as well as an overall total return for investment. With these competing considerations putting equal pressure on the purchase price, ‘viability’ for both parties is often in tension.

It is vital to consider the priorities and key drivers of the private developer and the investor to ensure a Build to Rent model will work in a given location.

To move a “borderline viability” scheme to a viable one, there will often be some reliance on sustainable local or central government interventions, particularly through the planning process. The key areas that the developer and investor need to consider are outlined below:

DEVELOPER CHALLENGES

Find land at the right value and compete with developers who are building residential for sale.

Optimise the design and understand the associated construction costs such as the requirements from an investor for optimised whole life cycle cost.

Understand and navigate the still emerging UK planning policy approach to PRS.

Understand the difference in the risk and reward model in terms of only holding planning and construction risk, not exit risk.

Identify the investor alignment early enough for it to be factored in to a development strategy, not just a last minute exit risk diversification play.

In light of all of the above, decide if it is viable compared to developing for sale.

INVESTOR CHALLENGES

Understand the fundamentals of the long-term rental demand profile for a given location as a function of demographics, employment and affordability trends.

Outline the appetite to take development risk, share this risk with a developer or self-develop.

Identify the initial transactional net yield that will support the investment business case.

Identify brand strategy and impact on product definition for a developer. This is key to drive price and create long term customer loyalty.

Identify an appropriate operational model and minimise cash flow net yield attrition.

Decide how scale can be leveraged across the development and investment platform.
Our research shows the relative levels of Build to Rent viability across England.

If residual value cannot be created, Build to Rent developments will not be able to compete for land opportunities, therefore once positive land value is identified, there is a need for optimisation techniques to maximise residual value and equalise as far as possible to other uses that compete for that land. Alongside residual land value being maximised, the investment case needs to look at demand fundamentals, which may enable more aggressive initial yield decisions to be made at the point of transaction based on longer-term fundamentals.

We have approached this exercise in four stages and the rationale behind this staged testing of viability was to understand the realities of creating developer led viability, in line with building an investor business case.

STAGE 1
Identifies the Local Authorities that have the potential to generate a positive land value. This is where the investment value is greater than the total cost of delivery, including a development return and is the start point for a high level appraisal.

STAGE 2
Highlights the improvement in viability that can be achieved by reducing unit sizes by 10% from 70m² to 63m² for a notional two bed unit.

STAGE 3
Identifies the further improvements that can be made in viability beyond stage 2, by achieving a 5% reduction in capital delivery cost.

STAGE 4
This stage shows which Local Authorities identified in stage 3 have:
   a) Above average levels of employment
   b) Above average levels of rental affordability
   c) Above average levels of 25-35 year old demographic.

The research is based on the following key parameters:

GEOGRAPHIC SCOPE
Our research is limited, for reasons of appropriate data availability, to Local Authorities in England only.

GROSS DEVELOPMENT COST PARAMETERS
The analysis model factors in construction costs for an apartment type scheme, including notional allowance for site works, and equated back to a cost for delivering a typical two bed PRS unit at 70m². (This is reduced to 63m² as a sensitivity test).

Construction costs are further sensitivity tested for different site density assumptions ranging from low rise (three-four storeys), medium rise (circa 10 storeys) to high rise (20 – 25 storeys). Construction costs have been regionally indexed to reflect differing tender pricing levels across England. Allowances have been made for professional fees, section 106, CIL and financing. Development profit has been set at 15% of cost.

GROSS INVESTMENT VALUE PARAMETERS
The analysis model uses 90th percentile rents sourced from Hometrack data (no additional PRS rental premium is considered). Investment yields have been calculated using open market values sourced from Hometrack, overlaid with a ‘regional discount factor’, providing a base yield position for investment purposes.

SOCIO-ECONOMIC PARAMETERS
As part of our stage 4 analysis we have applied further filters which identify only those Local Authorities that have better than median national average performance for rental affordability ratio, unemployment level and proportion of 25-35 year olds.

ANALYSIS MODEL
Our model follows traditional ‘residual’ development appraisal principles by comparing capitalised investment value for PRS product (excluding land) against the total delivery cost.
**WHERE IN ENGLAND IS A BUILD TO RENT MODEL VIABLE?**

STAGE 1) WHERE IS POSITIVE LAND VALUE?

Our calculations suggest that there is clear potential to make a Build to Rent PRS model viable outside of London and the South East. However it is important to note that there is sensitivity around the type of construction that many of these areas would support. Figure 7 shows where a development appraisal and investment model may create a positive land value. There will still need to be a comparison to market sale residual land value but this filtering of the market starts to narrow down where the basic fundamentals of a Build to Rent model could work.

When assessing whether a positive land value for two bed apartments exists, Table 2 shows that Build to Rent can deliver a positive land value in over half of the Local Authorities. Most of the non-London locations only create residual value for low rise and/or medium rise schemes where construction costs are less. This would suggest a drive towards a lower density or even a housing led Build to Rent model is some areas, which is supported by an efficient operational and management model.

The results for positive land value creation, show a clear focus on London and parts of the South East, but interestingly not all areas within these regions. It also shows ‘hot spot’ areas of viability in the Midlands, the North and the South West.

“Build to Rent can deliver a positive land value in over half of the Local Authorities. Most of the non-London locations only create residual value for low rise and/or medium rise schemes where construction costs are less.”

<table>
<thead>
<tr>
<th>REGION</th>
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<th>HIGH RISE</th>
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<td><strong>Total</strong></td>
<td><strong>172</strong></td>
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<tr>
<td>% of all Local Authorities</td>
<td>53%</td>
<td>35%</td>
<td>15%</td>
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Table 2.

STAGE 2) WHAT IS THE IMPACT OF REDUCING THE UNIT SIZE?

The map in Figure 8 shows that if the total two bed unit area is reduced by 10% to 63m², the number of Local Authorities that drive a positive land value increases to nearly 70%. This reduction in size decreases the construction costs through gross unit area efficiency and is tested whilst assuming that the level of rent is unaffected from the 70m² start point. It is worth noting that US multi-family housing units tend to be markedly smaller than market sale equivalents so this analysis is relevant to how other mature markets have segmented product standards. This does not equate to lower quality space but better internal configuration including open plan living.

This measure creates more positive land value in London and South East locations but there is also a greater number of Local Authorities in the East, East Midlands and West Midlands that can then also support Build to Rent, across varying height categories. For Local Authorities outside London and the South East, this number has increased from 78 to 119.

Table 3 provides a breakdown of the Local Authorities by region. There is an 11% increase in the total number of Local Authorities that can support medium-rise development.

“Decreasing the unit size results in an 11% increase in the total number of Local Authorities that can support medium-rise development.”

<table>
<thead>
<tr>
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<th>HIGH RISE</th>
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<td>East</td>
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<td>Yorkshire and Humber</td>
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<td><strong>Total</strong></td>
<td><strong>219</strong></td>
<td><strong>149</strong></td>
<td><strong>66</strong></td>
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<tr>
<td>% of all Local Authorities</td>
<td>67%</td>
<td>46%</td>
<td>20%</td>
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Table 3.

Where is Build to Rent viable with reduced unit size?

Where is Build to Rent viable?
WHERE IN ENGLAND IS A BUILD TO RENT MODEL VIALBE?

STAGE 3)
WHAT IS THE IMPACT OF REDUCING DELIVERY COSTS?
As an additional optimisation layer on the results of Stage 2, we looked at the sensitivity of reducing capital delivery costs by 5%. This target could perhaps reflect the net effect of a programme wide procurement or design standardisation approach being applied after a whole life cycle cost optimised design is identified. The former can reduce costs whilst the latter may increase initial capital costs. Therefore a 5% net reduction would appear a sensible target from the early work we are doing in this field.

The results show 240 (74%) of Local Authorities will realise a positive land value for low rise developments. More than one in five areas will also potentially support a high rise development.

“74% of Local Authorities could realise a positive land value for low rise development.”

<table>
<thead>
<tr>
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<td>Yorkshire and the Humber</td>
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<td><strong>Total</strong></td>
<td><strong>240</strong></td>
<td><strong>176</strong></td>
<td><strong>73</strong></td>
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<tr>
<td>% of all Local Authorities</td>
<td>74%</td>
<td>54%</td>
<td>22%</td>
</tr>
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</table>

STAGE 4)
WHERE ARE THE BEST RENTAL DEMAND FUNDAMENTALS?

A) EMPLOYMENT LEVELS
Looking purely at employment levels, we filtered the fully optimised positive land value areas from stage 3 for those Authorities that have better than UK average levels of employment. This resulted in the number of positive land value Local Authorities reducing from 240 to 142 which equates to 44% of all English Local Authorities. It is worth recognising that this is a macro measure which takes the average total level of employment rather than the specific profile and characteristics of the workforce within a Local Authority. Also it does not highlight specifics around major employers in the area which might be seen as a positive or a risk, depending on perceived longevity of employment in that locality. It is however, a useful primary indicator tool.

“44% of all Local Authorities have a positive land value and a better than average employment level.”

<table>
<thead>
<tr>
<th>REGION</th>
<th>NUMBER OF LOCAL AUTHORITIES WITH OPTIMISED POSITIVE LAND VALUE AND BETTER THAN AVERAGE EMPLOYMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>East</td>
<td>29</td>
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WHERE IN ENGLAND IS A BUILD TO RENT MODEL VIABLE?

STAGE 4)
WHERE ARE THE BEST RENTAL DEMAND FUNDAMENTALS?

B) RENTAL AFFORDABILITY
Looking purely at rental affordability ratios, we have filtered the fully optimised positive land value areas for those that have better than average rental affordability (measured against a notional one bed unit rent). Applying this filter shows that the number of positive land value areas that display this characteristic falls from 240 down to 92. This equates to 28% of all Local Authorities across England. It is clear that rental affordability is a key tension in the demand side analysis and has a particularly significant impact in London and the South East.

However, this is an averaged measure and does not reflect the detailed distribution of income within an authority, relative to private rental demand.

“28% of Local Authorities have a positive land value and a better than average rental affordability.”

Table 6.

<table>
<thead>
<tr>
<th>REGION</th>
<th>NUMBER OF LOCAL AUTHORITIES WITH OPTIMISED POSITIVE LAND VALUE AND BETTER THAN AVERAGE EMPLOYMENT</th>
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</thead>
<tbody>
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<td>East</td>
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<td>Yorkshire and the Humber</td>
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<td><strong>Total</strong></td>
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</tr>
<tr>
<td><strong>% of all Local Authorities</strong></td>
<td><strong>28%</strong></td>
</tr>
</tbody>
</table>

What areas show optimised viability and better than average rental affordability.

STAGE 4)
WHERE ARE THE BEST RENTAL DEMAND FUNDAMENTALS?

C) AGE DEMOGRAPHIC
The research has filtered the fully optimised positive land value areas for those that have a greater than average proportion of people within the 25-35 year old age band. Applying this filter shows that the number of positive land value areas falls from 240 down to 115. This equates to 35% of all Local Authorities. Although PRS is not just about young professionals, there is a correlation to targeting those people that are in employment but have not yet been able to save for a deposit or secure a mortgage to access home ownership, and who also sit outside access to affordable housing.

“35% of Local Authorities have a positive land value and an appropriate PRS demographic.”

Table 7.

<table>
<thead>
<tr>
<th>REGION</th>
<th>NUMBER OF LOCAL AUTHORITIES WITH OPTIMISED POSITIVE LAND VALUE AND BETTER THAN AVERAGE EMPLOYMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>East</td>
<td>25</td>
</tr>
<tr>
<td>East Midlands</td>
<td>3</td>
</tr>
<tr>
<td>London</td>
<td>33</td>
</tr>
<tr>
<td>North East</td>
<td>1</td>
</tr>
<tr>
<td>North West</td>
<td>5</td>
</tr>
<tr>
<td>South East</td>
<td>33</td>
</tr>
<tr>
<td>South West</td>
<td>6</td>
</tr>
<tr>
<td>West Midlands</td>
<td>5</td>
</tr>
<tr>
<td>Yorkshire and the Humber</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>115</strong></td>
</tr>
<tr>
<td><strong>% of all Local Authorities</strong></td>
<td><strong>35%</strong></td>
</tr>
</tbody>
</table>

What areas show optimised viability and suitable demographics.

“35% of Local Authorities have a positive land value and an appropriate PRS demographic.”
In addition to rental affordability ratios, and local employment statistics there are a range of other local socio-economic metrics that can be referenced to help judge the economic prosperity and investment business case for PRS. These include percentage change in household, job density, disposable income levels, average property prices, demand vs. supply of rented accommodation, regional statistics on availability of jobs in the public sector and average annual wages.

GROSS VALUE ADDED DATA

A further set of statistics of interest to investors is the Gross Value Added annual data of 99 ‘unitary districts’ across England. This identifies those areas that have sound economic markets on a micro level. Whilst this limits a more micro analysis of the economic performance of a Local Authority, it does nevertheless provide a meaningful insight into the economic performance of the regions.

From the analysis of the data from 1997 to 2011, the top 5 districts according to GVA data are:

<table>
<thead>
<tr>
<th>Region</th>
<th>In Top 5</th>
<th>Out of 99</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inner London - East</td>
<td>6 11 55%</td>
<td></td>
</tr>
<tr>
<td>Inner London - West</td>
<td>6 11 55%</td>
<td></td>
</tr>
</tbody>
</table>

Table 11.

Of the top 50 districts from 2008 - 2011 the balance between the regions is as follows:

Table 12.

When reviewing the ‘top 50’, through their relative performance between 2008 and 2011, it is interesting to note that outside of London and the South East, the South West performs well, as does the East Midlands and East of England. This shows that there is economic growth outside of London and the South East so PRS could succeed on a wider regional basis. With the rising levels of renters in the UK and ever increasing average age of first time buyers coupled with expectations that these are trends which will not reverse (even with ‘Help to Buy’), the analysis of such statistics is important in supporting investment decisions.
The route to maximising the viability of Build to rent schemes

Outlined are three key areas that should be considered to improve Build to Rent viability:

**THE MANAGEMENT CONSIDERATIONS**

**CONSIDER THE TENANT EXPERIENCE AND THE GENERAL MANAGEMENT**

During the design stages, a review of the design in respect of the tenant experience, as well as general management considerations should be undertaken. This includes areas such as:

- **Building managers on-site:** This will include the potential requirement for on-site space for building managers and potentially a letting/marketing office.
- **Maintenance and management:** Day-to-day property management considerations for example, the use of bikes, refuse, postal delivery is imperative, as is annual maintenance considerations (internal and external).
- **Staged delivery of PRS units:** Delivery of units on time is critical, not least if early marketing has taken place and some pre-lets have been secured. This will include consideration around the potential staged delivery of units, detailed handover schedules, testing, commissioning and building manager training and information packs for units.
- **Construction competition timings:** Most lettings markets peak from the spring through to the autumn, with some sub-markets being particularly strong during the summer, i.e. when there are many graduates looking for accommodation close to their new jobs. Therefore, working to a spring practical completion date provides the development with the optimum chance of securing the best possible rent as well as maximising the number of lettings.
- **Marketing before completion:** In advance of the practical completion date, the marketing of the development should commence to ensure voids are as limited as possible. Subject to feedback from local lettings agents to the most appropriate forms of marketing and timetable considerations, this should commence around three months prior to practical completion. This would be on the basis that the notification period to vacate for most assured shorthold tenancy leases is between one and two months. Therefore, for those future target customers whose lease is due to expire, the decision to move or stay will be made around three months prior to the expiry of their lease.

**A FOCUS ON SCALE AND SIZE**

An appropriate target for gross to net rent attrition will be in part influenced by the size of portfolio and whether lettings and other services are contained in-house or not. The IPD has been tracking and publishing investment data for the UK residential investment sector for 12 years. They report that the average loss of gross to net income ranges typically from 33% to 35%.

When establishing whether to keep management of the property in house, it is important to note that efficiencies and cost savings can obviously be achieved once a portfolio is of a suitable scale and size, of say 500+ units. However, this is not to say that efficiencies can’t also be gained in smaller blocks as well where concierge facilities or daily on-site presence is not required.

**DRIVE ADDITIONAL REVENUE FROM AMENITIES**

Driving additional revenue streams can add value to the overall PRS offer but these need to be driven by a cost vs. revenue analysis. In some instances, the location of the development will deliver a basic level of amenity, an adjacent gym and fitness facilities, restaurants, serviced offices etc but the difference in costs / H² to insert a leisure facility (especially with a pool) catering or restaurant facilities into the development itself, should not be underestimated. Therefore the real impact on revenues needs to be understood and reflected in the investment business case. The US market for instance requires many schemes to have expensive leisure amenities included to differentiate from other schemes despite there being significant under-utilisation of them. Similar conscious decisions might still be made here in the UK to de-risk occupancy but a solid understanding of capital and operational expenditure impact relative to revenues is critical.

**THE DESIGN CONSIDERATIONS**

**OPTIMISE THE DESIGN**

There is an increasing wave of design-led knowledge and understanding in the UK, most of which has been influenced by learning from the North American market. The real challenge is to find developers and investors who recognise the financial benefits of bespoke Build to Rent design as opposed to coalescing to a conventional “for sale” product approach.

Some investors have concerns that bespoke design may damage investment exit value if units are not suitable for open market sale in the event that a portfolio needs to be broken up. However, the reality
is that there are few things that would need to be done to create an optimised PRS scheme that would render a unit unsaleable. Key features of optimised Build to Rent designs should include:

- Highly efficient spatial planning – 85% - 90% net to gross ratios
- Maximised units per floor/per core
- More money spent on amenities rather than optional ‘sales differentiators’ in the units themselves
- Unit sizing absolutely aligned to rental price points and functionality of space (i.e. generally smaller units)
- Standardisation of components to repeat within and between projects linked to direct programme wide procurement arrangements
- Intelligent decision made on the use of prefabrication supported by full analysis, not an estimate
- Specification driven by whole life costing considerations, the hot spots for capex / opex trade-offs are:
  - Floor and wall finishes
  - Kitchen and bathroom fittings
  - Joinery and ironmongery
  - Engineering services
  - Building fabric
- DESIGNING FOR A NEW PRODUCT

A key issue that warrants attention is the establishment of specific PRS design standards. The commercial market has BCO and BCSC technical guidelines that have meaning in terms of institutional acceptability, but the residential market is devoid of an appropriate asset standard outside of HCA Design & Quality Standards, Code for Sustainable Homes and Building Regulations, etc.

There is a real case for a new ‘gold standard’ for PRS design, which enables developers and investors to optimise products relative to a different end user market, capturing issues such as building efficiencies and whole life costs. This will drive confidence by creating ‘investment grade’ stack.

THE PROGRAMME AND COST CONSIDERATIONS

OCREATE A MARGIN, NOT JUST A REDUCTION IN CAPITAL EXPENDITURE

Many assumptions are currently made on what the capital construction cost differential is between a conventional sale scheme and an optimised Build to Rent scheme and a 10% notional achievable saving is often quoted. The reality is that although straight cost reduction should be a target to lift pressure on the developer’s viability, some optimisation drivers act to increase cost in the pursuit of increased revenues or reduced running costs. Some of these include:

- Decisions to reduce whole life cost over a minimum 10 year investment horizon will increase initial capital cost. There needs to be an appropriate handshake between the developer and the investor to agree this trade off.
- The introduction of communal amenities will often act to drive cost upwards as the fit out cost is more than the residential space.
- The drive to minimise unit sizing (subject to space standard compliance) to reflect rent price point and demand may increase unit density, pushing average cost upwards.
- Certain provisions linked to the operational performance of the building will drive additional costs relative to open market sale equivalent. These include dedicated goods lifts, unloading bays, building maintenance and management facilities.

However, all of these choices should be driving a greater than equivalent increase in capitalised revenue. The exercise is margin creation not just capex reduction.

LARGE SCALE BUILD TO RENT INVESTMENT IS A PROGRAMME, NOT A SERIES OF PROJECTS

One of the major opportunities created by large scale funding of Build to Rent is the ability to leverage the scale of delivery. A portfolio approach to development can drive unit cost and programme efficiencies that can benefit the viability equation.

In a period when some parts of the UK construction tender pricing market are projected to rebound back after nearly five years in a deflationary or flat cycle, there is a need to secure the right supply chain at the best price, whilst safeguarding quality. More strategic procurement thinking should be employed to drive direct second and third tier supplier engagement and this should be linked to the standardisation of design. The creation of brand standards can embrace a spectrum of issues going to the heart of the client vision and strategy, the tangible elements of specification choice, generic cost modelling and purchasing frameworks can improve cost and programme performance.

Alongside this, organisational delivery models need to be developed to enable scalability. Many of the emerging PRS Build to Rent initiatives are starting with just a few sites and development opportunities but need the ability to grow and deliver a development portfolio of scale and substance. The building blocks of this start early to establish functional responsibilities, understand what is in-house or outsourced and building standard processes, project controls and procedures to give investment funds the confidence in the delivery model is crucial.

IN SUMMARY

This research indicates that Build to Rent PRS developments do have much wider potential across England than perhaps previously thought. Although the distribution of viability is skewed towards London and the South East it is not exclusive to these areas. There is a large proportion of the geographic market in England that could potentially be unlocked through creating viability by adopting specific optimisation measures, whilst still robustly testing the investment case.
If you would like to discuss the findings further or understand how we can help you assess or improve the viability of your scheme, please contact us:

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