Foreword

Barclays is delighted to support this research, which assesses the further potential of the Build to Rent (BTR) market, given its rapid emergence as an asset class over the past few years.

The research affirms the value of BTR to the UK property industry as it seeks to accelerate new developments to help address the housing crisis, while also delivering broader social and economic benefits to local communities.

Building homes and communities

Decades of buy to let landlord activity have driven an increasingly fragmented private rental sector (PRS), with over 98% of stock currently in the hands of individual landlords and small corporate entities. While much of this stock is of good quality and well managed, there is an element of sub-standard accommodation with tenants receiving a poor service. The link between quality of accommodation and quality of health and education, at a local level, points to the significant social benefits that can be derived from well-thought-through housing schemes. However, these projects require a scale of investment that is unlikely to be delivered by a fragmented market.

By delivering high-quality, well-managed homes and creating new, sustainable communities, BTR will enhance the overall standard of housing in the UK and become woven into the residential landscape. In order to achieve this, it is important that BTR delivers across the residential spectrum, with high-rise schemes complemented by low-rise housing and located in regeneration zones as much as established areas.

Delivery will need to cater for all demographics, with more affordable family units having as much a role in the sector as the high-end schemes providing extensive amenities and services. This will help ensure that, over time, these communities will effectively become blind to tenure.

There is no escaping the old adage of the need to supply the right product, in the right place, at the right price.

Predicted population growth of 9.7 million between 2014 and 2039 indicates that demand for housing in the UK will only increase. If the divergence between median wages and median house prices persists, demand for PRS over the mid to long term would appear robust. Recent history has seen rents enjoy above inflation growth and scale operators should be able to tap economies throughout their supply chain – efficient up-front procurement, coordinated marketing, programmed maintenance and cost-effective daily management. In addition to the financial benefits of the BTR model, there is also an argument that new development in this sector may become less vulnerable to the economic cycle than the traditional build-to-sell model, but there is no escaping the old adage of the need to supply the right product, in the right place, at the right price.

Intuitively, BTR should be an attractive asset class for investors and lenders seeking sustainable returns; however, it is still a relatively young sector. Establishing good quality, transparent information on absorption rates, gross to net costs, occupancy levels, market rents and values will be fundamental to BTR cementing itself as a mainstream asset class. As the sector grows and evolves, increased transactional volumes will not only help set market norms but also encourage more participants, more innovation and more options for tenants.

I hope you find this study thought-provoking and insightful. At Barclays, we are always keen to support the growth of industry and I would like to thank the British Property Federation, Savills and the London School of Economics for compiling a valuable analysis of the sector.

Dennis Watson
Head of Real Estate
Barclays
Executive summary

Despite the significant need for housing in the UK, the supply of new homes is constrained by the build-to-sell delivery model. Our report looks at the potential for larger investors, especially those backed by ‘institutional’ capital, to expand residential supply through Build to Rent (BTR).

This research identifies the benefits of BTR and the potential increase in housing supply it can deliver. It is the first study to quantify the scale of BTR delivery across the country and to identify the nature of schemes in terms of their planning status, scale and delivery approach.

Evidence of the impact of BTR on housing supply has been drawn from consultation with a range of stakeholders. The benefits they identified include:

- As an outcome of accelerated delivery, most notably on larger urban sites, faster market absorption that benefits regeneration and placemaking
- Viability in markets where build-to-sell is marginal
- Improved management and service to tenants
- Additional on-site jobs and the potential to enhance labour mobility.

The research suggests that the most effective policies in overcoming market failures, delivering additional new homes and realising the benefits of BTR are likely to include:

- Clarifying the role of Discounted Market Rent (DMR) as meeting affordable housing requirements for BTR developments
- Changing planning regulations and standards for BTR developments
- Continuation of public sector development loans for BTR
- Extension by time and scope of the PRS Debt Guarantee scheme
- Planning preference for BTR on large sites
- Exempt large-scale landlords from 3% SDLT surcharge
- Zero-rate VAT on repairs and management to make BTR more competitive.

“The BTR sector is a vital part of the solution in tackling the housing crisis. In London, the importance of the sector should not be underestimated, as it currently represents one in five housing starts in the capital, and in cities such as Manchester and Liverpool BTR is gaining momentum. The BPF BTR map shows a significant and increasingly diverse development pipeline across the UK. But, as this report highlights, there are challenges to overcome if this growth is to continue.”

Duncan Salvesen
Chair, British Property Federation Residential Board
Director – Residential, Dorrington
The evolving Build to Rent sector

The UK needs to increase housing supply from 200,000 to 300,000 homes per year in order to meet a backlog of housing need. However, the supply of new homes is constrained by the build-to-sell delivery model.

Typically, this model will deliver homes at the speed at which the market will absorb the new supply, usually with no incentive to accelerate delivery.

BTR – the UK term for multi-unit blocks of purpose-built private rented housing in single ownership – has the potential to make a significant contribution towards reaching housing targets.

The benefits of Build to Rent

BTR offers an additional sales outlet to the build-to-sell model. It provides an alternative end buyer for housing developments, which helps to de-risk schemes.

It is especially helpful on larger sites, where there are multiple phases of development. In these circumstances it can often accelerate delivery because a developer or house builder can deliver stock for both open market sale and market rent at the same time.

BTR also provides benefits such as creating footfall and diversity of occupiers for non-residential uses on mixed-use sites, underpinning placemaking and regeneration.

Build to Rent: where have we got to?

ThePRS in the UK is worth over a £1tn, with the vast majority (98%) tied up in the hands of small individual and small corporate landlords (IPF, 2015). There is a significant lack of aggregated investment stock available for institutional investors to acquire, with many new investors focusing on the development of new BTR assets.

New stock gives investors the opportunity to influence the design, mix and specification in an effort to ultimately enhance investment returns from completed and operational stock.
In its broadest sense, the Private Rented Sector (PRS) incorporates all things privately rented and BTR is a small but important subset of the wider market. Looking at what investors in residential invest in, there is a wide range of different types of market rented housing, such as:

- Buy to let – mortgaged assets
- Rental units in houses of multiple occupation (HMOs)
- Single family dwellings
- Student housing (purpose built, institutional grade)
- Build to Rent, i.e. bespoke designed, developed directly by investors
- Build to Rent delivered by house builders/investors, forward funded by investors
- Build to Rent acquired as a going concern (stabilised assets) by investors
- Traditional housing stock, i.e. turn the sign round from ‘for sale’ to ‘to let’ forward purchased by investors
- Traditional housing stock forward funded by investors
- Traditional housing stock acquired as a going concern (stabilised assets) by investors.

BTR is a new product for the UK, particularly in the mainstream markets. On schemes of over 50 units there are currently c.55,500 new PRS units completed, under construction, or with planning permission in the UK. There are 32,785 units in London and 22,686 elsewhere. Not all of this is ‘pure’ BTR, but BTR has become synonymous with the delivery of new-build rented housing.

The types of Private Rented Sector

Planning portals such as Molior (London) and Glenigan (UK) include descriptions of the type of residential stock delivered.

In terms of PRS, the four most commonly used types include stock that is:

- retained by the deliverer for the PRS
- purchased for the PRS
- built using the Homes and Communities Agency (HCA) BTR Funding
- designed and purpose built for the rented sector, often using a forward funding approach.

Size of market rent sector


PRS units by development status and PRS type, England and Wales

Source: Molior, Glenigan, BPF, Savills.

BTR and traditional forms of PRS

At this point in the market, more traditional approaches to PRS are still the most prevalent forms of delivery. Of the c.7,800 units completed, about 40% have been retained for PRS by the deliverer (not BTR) and 40% have been purchased for PRS or forward purchased by the investor. Schemes purchased for PRS are considered BTR because of the funding structure or source of funding used.

Many of these schemes have not been designed specifically for the rental market and in most cases were originally intended for the build for sale market. There have been c.1,300 units (20%) delivered using a BTR approach (i.e. purpose built and intended for PRS use) including those funded by the HCA BTR Funds.
Forward purchased stock includes schemes that were not specifically designed for the rental market and schemes where the design has been altered for the rental market. Stock purchased for PRS has contributed over 3,000 units to the rental market. In total, when considering BTR as both purchased stock and purpose built stock, delivery is in excess of c.4,500 units.

**New Build to Rent**

Many commentators on the market refer to new PRS stock as BTR. This is mainly because the stock is owned by a single entity, operated as a single investment and professionally managed. BTR is not just related to the physical form or the type of stock, it also refers to an operational model.

**Build to Rent can make up c.27,500 of c.32,500 units being delivered in the longer term.**

BTR, as an operational model, is becoming more of an accepted form of delivery in the UK housing market. Many more schemes have been identified as pursuing a BTR approach, assuming the delivery strategy does not change. In terms of stock under construction, BTR units make up c.9,900 of the c.15,100 units coming forward. Longer term, BTR makes up c.27,500 of c.32,500 units being delivered.

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**Approaches to delivering PRS**

<table>
<thead>
<tr>
<th>Retained for PRS</th>
<th>BTR (HCA Funding)</th>
<th>Purchased for PRS (inc. forward purchase)</th>
<th>BTR (inc. forward funding)</th>
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<tbody>
<tr>
<td>New multiple units</td>
<td>New and quality purpose built</td>
<td>New multiple units</td>
<td>New multiple units</td>
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<tr>
<td>No minimum size</td>
<td>Large scale</td>
<td>No minimum size</td>
<td>No minimum size</td>
</tr>
<tr>
<td>Large-scale investor</td>
<td>Long term and attractive to institutions</td>
<td>Large-scale investor</td>
<td>Large-scale investor</td>
</tr>
<tr>
<td>Not necessarily purpose built</td>
<td>Clear exit strategy</td>
<td>Not always purpose built</td>
<td>Purpose built for PRS</td>
</tr>
<tr>
<td>Could be multiple units in different blocks/phases of development</td>
<td>Single or multiple sites</td>
<td>Generally blocks and unbroken investments</td>
<td>Blocks/groups of houses and unbroken investments</td>
</tr>
<tr>
<td>AST contracts with potential to offer longer tenancy options</td>
<td>100 unit minimum size</td>
<td>Single phase of development</td>
<td>Single phase of development</td>
</tr>
<tr>
<td>Private rent at market rents only</td>
<td>Risk sits with deliverer</td>
<td>Risk sits with deliverer</td>
<td>Risk shared between deliverer and funder</td>
</tr>
<tr>
<td>AST contracts with potential to offer longer tenancy options</td>
<td>Little control over design and product</td>
<td>Little control over design and product</td>
<td>More control for funder over design and product</td>
</tr>
<tr>
<td>Purchased before or during construction</td>
<td>AST contracts with potential to offer longer tenancy options</td>
<td>AST contracts with potential to offer longer tenancy options</td>
<td>AST contracts with potential to offer longer tenancy options</td>
</tr>
</tbody>
</table>

**Source:** Savills, Molior, Glenigan, BPF.

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**Approaches to delivering purpose-built BTR**

As more and more purpose-built PRS stock emerges, we can expect to see a shift in the key deliverers and funders in the market. Analysis of the planning and supply data shows that investors are using a variety of approaches to build up scale in the rented sector.

The table above sets out the delivery approaches that have been used. The common factor across the different types of stock is that the rental supply is all new multiple units, in single ownership and professionally managed.
PRS delivery schemes underway

Some examples of PRS schemes are set out in the table opposite that have been included in the planning and development databases against the descriptions given.

Many of these schemes are considered BTR but they have not been described as BTR in these databases. For example, a well-known scheme was purchased by Delancey & Qatari Diar for PRS. When the village was developed by Lend Lease for the Olympics, it was not designed for the PRS market post-Olympics, but following the acquisition it was retrofitted for the PRS market.

Completed BTR schemes

There are a total of 12 completed purpose-built BTR schemes across the UK, comprising c.1,300 units. In London these schemes comprise a total of 555 completed purpose-built BTR units largely in East London and Barking. Outside London, delivery of PRS units as purpose-built BTR amounts to 775 units.

There have been a further 30 schemes in the UK purchased for PRS, delivering c.3,200 units under what is considered the BTR operational model.

East London has emerged as a strong rental market over the course of the last 10 to 15 years. The increase in the number of PRS households between the 2001 and 2011 census was a result of new housing development being skewed to the east during this period, with many of these units acquired by buy-to-let landlords. More recently, large-scale landlords have delivered rental stock into the East London market because good transport connections and renter appeal have generated high rents in proportion to capital values. This makes PRS schemes more viable than in other parts of the capital.

In addition, Delancey, backed by Qatari Diar, purchased the Olympic Athletes Village for PRS and it is now being run and managed using an integrated management model.

The remainder of completed PRS schemes have been delivered for different uses and retained for PRS. There have been c.3,300 units completed as part of 26 development sites across the UK, which have been retained for PRS by the deliverer.

Completed PRS schemes by type of deliverer, England and Wales

Examples of schemes by typology
Build to Rent schemes in the pipeline

In terms of scale of delivery, few completed PRS schemes have had more than 250 units. Developments under construction and in the planning pipeline are beginning to get larger, with developers and regeneration specialists starting to allocate blocks and phases to PRS. All developments looking to bring forward over 1,000 PRS units are located in London, although Manchester is also set to see some significant PRS developments.

There are currently over 44 BTR schemes under construction, delivering over 9,900 PRS units within the next three years. Of these, 21 are believed to be institution-backed, with companies like Westrock and Criterion Capital funding schemes in London and the South East. The largest volume of BTR is coming through in urban city centres with c.2,700 units currently under construction in Manchester alone. Developers are the key deliverers of PRS units in schemes currently under construction.

There are a total of c.27,500 units currently in the planning pipeline being brought forward as part of 71 BTR schemes across the UK.

The largest proposed volumes of BTR units sit within wider strategic sites like Barking Riverside, Brent Cross, Cricklewood and East Village. While many of these units are delivered as new build properties, a large number of the units will be completed as part of a change of use to existing commercial property. In total, 12% of all PRS units completed, under construction or in the planning process are delivered through Permitted Development Rights (PDR). In London, this figure rises to 14%.

Source: Molior, Glenigan, BPF, Savills.
Key landlords

The key landlords of completed schemes include registered providers such as Fizzy Living, L&Q, Places for People, A2D and Notting Hill Housing Association and property companies such as Criterion Capital, Grainger or Delancey. Registered providers such as L&Q have purchased several hundred units across many of their own schemes and other developers’ schemes in Southwark, Wandsworth and Tower Hamlets. These units have been purchased to expand the L&Q portfolio of PRS.

Developers are the leading players in the delivery of PRS, having supplied almost half of all completed schemes.

Developers leading the way

Developers are the leading players in the delivery of PRS, having supplied almost half of all completed schemes. The majority of these schemes comprise units originally planned for market sale, which were then purchased for the rented sector. More traditional approaches to PRS have allowed developers to play a key role in the sector.

Looking ahead, there are a much higher number of units planned as BTR, with registered providers and contractors delivering on behalf of investors.
The benefits of Build to Rent

Our researchers consulted a range of stakeholders, including interviews and round-table discussions with those involved in the delivery of BTR from both the private and public sectors.

The research helped to draw out evidence of the impact of BTR on housing supply and demonstrates its ‘additionality’ characteristics. The research found that BTR has additional benefits:

- Accelerated delivery
- The ability to unlock sites
- Intensification of sites
- Accelerated market absorption on large sites
- Placemaking and regeneration benefits
- Improved management and service to tenants
- Provision of on-site jobs and enhanced labour mobility.

The key aim of the research was to understand the future growth potential of BTR supply. We have taken precedents from the growth trajectory of institutional investment in the US multi-family REIT market and the UK Purpose Built Student Accommodation (PBSA) market. The US multi-family market grew from a market worth US$1bn in 1992 to over US$80bn in 2016. Over the 25-year period, a simpler planning system, less competition from other residential uses, zoning of regeneration areas in urban markets and higher demand for city-centre living have enabled the multi-family market to grow to one of the largest investment sectors in the US. At a national level, however, the multi-family market represents just 20% of all private rented housing, while the buy-to-let sector (commonly known as the mom and pop market in the US) is still the largest sector with 80% of the stock.

During the same 25-year period, the UK student housing market has grown to a sector worth over £15bn, or 240,000 units, based on an average bed space value of £60,000. Expansion of the student sector has been significantly helped by universities lowering occupier risk through nomination agreements when the market was immature. Furthermore, it has developed outside the C3 residential use planning category, which has meant that it does not have to compete for land with higher value residential uses.

If the BTR market is able to mature and reach a similar scale of investment as the US multi-family market or the UK PBSA market, it would create around 15,000 new homes per year in the period to 2030. If these are built in the right locations on the right sites, there will be relatively little displacement of homes built for sale.

240,000 units could be delivered by 2030 and provide a sector in value of £60bn.

The evidence gathered in this project shows that on large urban sites, well connected to employment markets, BTR can accelerate build out rates three-fold. If this can be achieved on say 20% of the large sites that are currently delivering, that equates to additional delivery of 6%. Relative to the 164,000 new homes completions in England in 2015/16, this is around an additional 10,000 homes per annum. If this delivery is combined with the level of supply expected to be completed over the next three years, this would take delivery to c.15,000 units per annum. In number terms, this would result in 240,000 units delivered by 2030 and provide a sector comparable in value to the US multi-family market (£60bn).
Accelerating delivery

It is important to recognise that the relationship between accelerating housing development and generating additional housing is not straightforward. Speeding up development can bring a given number of units into use more quickly but does not necessarily increase the total number built. For BTR to generate increased output, the acceleration in development must lead to a sustainable step change in completions.

Acceleration and PDR

Most stakeholders involved in the research considered residential supply delivered through PDR as ‘wholly additional’. Whether this means that there is no need to offset reductions elsewhere in the development chain is not clear, but it is certain that PDR increases opportunities.

The delivery speed of PDR units is due to a simpler and faster planning process.

Analysis of the BTR supply pipeline shows that 12% of units (8,000) are linked to PDR. Clearly there’s also additional rental supply entering the rented sector through buy to let sales on PDR schemes that have sold into the open market, so PDR is an important contributor to rental supply.

Stakeholders considered that the delivery speed of PDR units is due to a simpler and faster planning process. PDR is not constrained by design standards such as minimum unit sizes or the provision of affordable housing. This means that, as schemes don’t go through lengthy negotiations and viability assessments for affordable housing, they can be delivered more quickly.

Examples of PDR in action

Westrock

Westrock has planned investment of £300m in 1,000 BTR units under its branded operator, PLATFORM_. Currently, it has c.600 BTR homes under construction across five PDR schemes in Bedford, Crawley, Bracknell, Stevenage, and Exeter. All Westrock’s schemes are office to residential conversions developed under PDR. “PDR allows Westrock to bring forward more homes faster, as it does not have to engage in lengthy Section 106 negotiations.” The company considers that all the homes that it is developing are additional as it is not delivering market sale product – it is aggregating residential units for long-term investment.

Miflats

Miflats is Criterion Capital’s PRS brand. It currently has 11 schemes in its portfolio located around the London commuter belt, with around 700 units completed and a development pipeline of 1,700. All Miflats schemes are former offices being converted to rental units under PDR. This allows the company to design units suitable for the rental market without constraint from design guides, planning restrictions or space standards.

Acceleration on house builders’ sites

Sigma

Sigma, the PRS specialist, developed a partnership with Gatehouse Bank plc for the delivery of large-scale PRS portfolios. Since construction began in December 2014, Sigma has completed its 1,000th unit. By November 2016, Sigma is delivering in excess of 2,500 new rented homes.

Because Sigma is not reliant on sales rates, it can deliver units much faster as the absorption of rental units is higher. This approach to delivery has allowed Sigma to build up significant numbers of assets at a faster pace than seen previously.
Sigma is delivering rental homes on sites being developed out by Countryside, which is building homes for market sale and affordable use, while also acting on a design and build basis for Sigma on these sites. As it does not compete for sales with Countryside, the rate of delivery is much faster. Acting as an end user, the company is also de-risking an element of delivery for Countryside.

Countryside has delivered 543 market sale units on these sites. This means that total delivery has been three times faster as a result of BTR. Sigma has used an alternative source of funding from Countryside through its partnership with Gatehouse, which has permitted faster as a result of BTR. Sigma has used an alternative source of funding from Countryside through its partnership with Gatehouse, which has permitted

The strong demand for rented housing and scarcity of new supply means that units can be delivered faster.

**Acceleration and faster market absorption**

Market absorption of rented homes is significantly faster than for open market sale. Typically, house builders deliver stock to meet a projected monthly sales rate, which is adjusted depending on market conditions. The strong demand for rented housing and scarcity of new supply mean that units can be delivered faster.

**Quintain**

Quintain manages the redevelopment of Wembley Park in north London. Emerald Gardens was the first of many residential phases, comprising 473 homes, of which 141 were built for private rent.

Quintain sold 332 homes in two years, but leased 141 in six months, so roughly twice as fast. Its experience suggests leasing 415 units in 18 months and selling the same number within three years.

The company’s view is that rental demand is much more constant than buy-to-let investor demand, and much less affected by market conditions. Building for the rental market is considered less risky than delivering into the sales market.

### East Village

Another example of high levels of market absorption through the delivery of rented homes is at East Village in Stratford, East London. This is the largest BTR scheme in London and emerged following the 2012 Olympic Games. The village comprises 2,818 homes, of which 1,439 are market rent homes owned by clients of Delaney, Qatari Diar and APG, operated by Get Living London (GLL).

GLL reports that East Village is fully let and that, on average, during the let up phase (one year and 10 months) it saw c.15 units absorbed each week. Delivering the same number of homes as open market sale would have taken about eight years.

### Accelerated market absorption at East Village

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<thead>
<tr>
<th></th>
<th>BTR</th>
<th>Build to sell</th>
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</thead>
<tbody>
<tr>
<td>Number of units</td>
<td>1,439</td>
<td>1,439</td>
</tr>
<tr>
<td>Let up rate</td>
<td>15 per week</td>
<td>15 per month</td>
</tr>
<tr>
<td>Delivery period</td>
<td>95 weeks</td>
<td>95 months</td>
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</tbody>
</table>

### Acceleration and unlocking development

Stakeholders suggested that the provision of large volumes of rented homes can help to unlock sites that have previously remained undeveloped. An example is the former GlaxoSmithKline and Sunblest Bakery site in Greenford, which was acquired earlier this year by Greystar, who is the largest US multi-family operator.

The site in Greenford was acquired by Greystar with an outline planning consent for 593 homes. By delivering a mixed-use scheme that largely comprises rented homes, rather than open market sale, Greystar has made an updated planning submission for a much larger scheme of 1,965 units. A delivery strategy that is focused on rental housing has led directly to a planning application for an additional 1,372 homes that would otherwise not have been built.
The new rental neighbourhood is also expected to be delivered significantly more quickly than a corresponding for-sale development. The recent planning application also includes provision for a proportion of rented units to be delivered at a discount to the market rent level.

**Accelerating build out rates**

Build out rates are constrained by the rate at which developers can sell their units to individual buyers, particularly on larger schemes. BTR can help accelerate housing delivery because letting up rates are faster than sales rates. Comments suggest that build out rates on BTR schemes could be between three and five times faster than on for-sale schemes.

Build out rates are relatively similar across all types of market on smaller sites of less than 50 units. However, on larger sites build out rates are much higher in stronger markets, in which more large sites are brought forward.

On large urban sites, well connected to employment markets, BTR can accelerate build out rates threefold. If this can be achieved on, for example, 20% of the large sites that are currently being delivered, this would equate to additional delivery of 6%. This is around an additional 10,000 homes per annum.

**Job creation**

The job creation benefits of BTR are illustrated by the Ferry Lane scheme in Walthamstow. Plans for the development include new cafes, a food store, communal working spaces, open landscaped areas and communal leisure spaces for residents. This is expected to create up to 100 long-term local jobs as well as 3,000 temporary roles over the lifetime of the development. Within the scheme, a proportion of affordable units will be let on a discounted market rent basis.
The challenges of Build to Rent

Our research also identified the challenges holding back the sector. A key conclusion from the stakeholder engagement is that policy requires a clear planning definition of BTR to help provide certainty for planning negotiations and for investors (used in its broadest sense) to compete for opportunities.

Definition of Build to Rent

A key finding from the stakeholder workshops was that policy requires a clear definition of BTR to help provide certainty for planning negotiations and to ensure certainty for investors bidding for opportunities.

Stakeholders were clear that if there were certainty that the affordable requirement for a BTR scheme would be discounted market rent (DMR), as opposed to other forms of Section 106 (S106), this would greatly improve the viability of the scheme and their ability to be more competitive on bidding for potential opportunities.

A clear definition of BTR can help provide certainty for planning negotiations and to ensure certainty for investors.

Since the publication of the Greater London Authority’s Supplementary Planning Guidance, there are a number of precedents of BTR being delivered with DMR instead of traditional forms of S106 affordable housing, which allows investors to manage schemes holistically. Public authorities have used covenants to ensure that the schemes built in their boroughs and the discounted rental units remain in the rental market for a defined period.

This approach helps rental schemes compete with the values derived from market sale. It also means investors can value the investment over its lifetime, programme repair and maintenance of a building without having to negotiate with a third party and, most importantly, quantify the cost of repaying any preferential treatment that the scheme has received.

The covenant period is only relevant to the repayment of the affordable units should there be a case for recovery. The mechanism works in the US, where the restriction or covenant is linked to the finance, so investors can quantify the cost of any concessions.

Planning and affordable housing

Many interviewees highlighted the constraints of the planning system for BTR and the relative lack of experience and knowledge across local authorities of BTR, compared to build for sale.

Many stakeholders believe that BTR needs a different approach from a planning perspective.

Although there is some guidance for the BTR sector set out in National Planning Policy Guidance (NPPG), it was felt by respondents to the research that there are a lack of clear policies. The current planning policy framework is seen as favouring the delivery of owner occupation and affordable housing. Many believe that BTR needs a different approach from a planning perspective.

Problems with traditional forms of S106 affordable housing were also highlighted by stakeholders. There is general consensus that discounted market rent works well for BTR and investors are keen to provide it alongside market rent units. In particular, DMR units could be tenure blind within schemes, ‘pepper potted’ among open market rental units.
DMR is considered the best affordable product to sit alongside BTR because it delivers a tenure-blind product for occupiers and a development that can be managed seamlessly by the investor. In cases where a covenant is given, keeping a development as rental for a significant number of years, DMR is regarded as the affordable housing provision. The units in the development remain at DMR for a defined period and may revert to being a PRS at full market rent.

DMR is more flexible than other options as it enables tenants to ‘staircase’ between rents. For example, this might involve a tenant’s salary being reviewed every five years. If the tenant has moved income bands, he or she would also move between the rental discount brackets. In some circumstances, a tenant might also ask for their rent to be reviewed if their circumstances change.

This method also benefits the local authority – if a tenant on DMR moves up to market rent, a separate unit becomes the DMR unit and so the percentage of units at DMR remains at 25% for the whole of the agreed covenant.

The need for covenants to ensure homes remain in the PRS for a minimum amount of time is widely recognised. Without covenants, it is difficult to get the support of local politicians, who would fear the potential risk of people taking advantage of the system.

Planning and regulations

A lack of flexibility in planning regulations can be the barrier to BTR housing development, in particular car parking standards, design and space standards, and unit mix. For example, unit mix BTR operators report that demand for PRS units differs from that for units to be delivered for open market sale. In particular, policy requirements to deliver three- and four-bedroom units are not always appropriate for BTR schemes.

Engaging with local residents, particularly on parking and traffic, is also highlighted by stakeholders. BTR schemes tend to be situated near public transport and require less car parking and this space could be put to more effective use for additional rental income, whether through more residential units or amenity space for tenants to use.

Pricing and valuation

Many interviewees commented that BTR schemes tend to put a lower value on development sites than for sale appraisals. Residential development is different to commercial in that it has two potential end users – owners and renters. Where developers can sell on a retail basis to owners (or investors paying retail prices, i.e. buy-to-let investors), this has been the preferred route to market. Values tend to exceed institutional investment pricing, which is based on a multiple of the rental income.

BTR is very much a yield-based pricing model. Investors stated that their bidding price reflects the target yield they require. A 20% discount is typically required from the values that could be achieved from sales to retail investors.
However, house builders state that the 20% discount which investors are looking for is too high. One of the house builders interviewed suggested: “In the current market it doesn’t make any sense, but in a weaker market we can potentially support a discount from 7% to 10% of market value. Given that house builders often offer incentives to buyers, wiping off this level from the retail sales prices brings the two in line.”

Other stakeholders stated that discounts reflect the difference in management costs – the buy-to-let model involves lower management costs and therefore gross to net leakage is around 12%, while BTR is usually backed by a bank and requires professional management. Leakage is much higher at around 25–27%. Managers also require a sinking fund for reactive repairs, which means that BTR investors are unable to compete with the prices that buy-to-let investors are willing to pay.

**Financing Build to Rent**

PRS investment and BTR development is funded in a variety of ways. Passive capital investors such as institutional investors are less reliant on debt markets and fund investment with equity from their investors. However, active capital investors, operators and developers are much more reliant on development debt to deliver schemes, many of which are very cash intensive and large.

Four key problems relating to finance are identified in the research:
- Capacity of the debt markets to lend
- Immature market
- Track record of borrowers
- Scale of the assets.

Given the nascent nature of BTR and the fact that schemes are often very large, requiring very large loans with limited information to underwrite the deals, lenders attach a higher risk weighting to these loans. This means they need to hold more cash on their balance sheet and restricts access to development finance for BTR developers.

The government has sought to overcome some of these barriers with the introduction of two funding schemes for BTR – the HCA Build to Rent Funds and the £3.5bn Prudential Regulation Authority (PRA) Debt Guarantee Scheme. The Build to Rent funding scheme is now part of the larger ‘Home Building Fund’ which comprises £2bn of infrastructure funding and £1bn of development finance for housing.

A number of stakeholders noted that the HCA and the Debt Guarantee Scheme are amassing vast amounts of information, which could be aggregated and used by lenders and others seeking to work with the new BTR sector, helping to reduce their risks.

**Tax issues**

Stakeholders also noted that “a definition would be beneficial for tax purposes”. There are a number of tax issues that disadvantage BTR, including VAT on repairs and maintenance and higher rates of SDLT. VAT on repairs and maintenance acts as a disincentive for landlords and investors to undertake maintenance and repairs because, unlike commercial markets, they cannot recover the VAT.

The research highlights that the higher rates of SDLT compared to owner occupier buyers effectively means that an owner occupier can pay more for a property. This in turn is one reason why build-to-sell schemes can bid more for the land. For example: “The stamp duty surcharge effects the economics of the scheme as they are not on a level playing field with owner occupiers,” and: “Defining BTR will help create a level playing field on competition for land.”

Stakeholders discussed whether the definition of BTR should relate to scale. Various stakeholders were keen to set a minimum size for schemes to qualify as BTR for planning and tax purposes. Comments ranged from: “Scale is fundamental within the definition because there are different levels of risks associated with different sized schemes” to others saying: “Scale comes into the definition of BTR when you start thinking about Affordable Housing.” and: “A scheme should have at least 50 units to qualify as BTR.”

**A clear definition of Build to Rent would be beneficial for tax purposes.**

Others stated that the definition of BTR should be based on management and operational structures and ownership, not physical attributes such as size, scale or property types. “BTR is professionally managed stock in single ownership, which could be covenanted and could include discounted market rent as part of the investment.”

The stakeholders discussed the idea of imposing covenants on BTR developments to ensure they remained in the PRS market. There was a general consensus that covenants are a good idea. Making BTR more competitive in circumstances where the covenant (a restriction on use) brings with it other planning concessions would enhance viability.

One point that has emerged from the interviews is that a unit that is covenanted, such that it cannot be sold separately, may cease to be treated as a dwelling for VAT purposes and will incur irrecoverable VAT on construction. This is a potential stumbling block for rolling out covenants. House builders recover any VAT paid on construction because they sell the assets.
What’s next?

Although it is still in its early stages, the BTR market is rapidly developing as a significant asset class.

This research demonstrates its increasing importance to the UK property industry, both as a way to address the lack of housing supply while delivering social and economic benefits to local communities.

It is estimated that for every 500 BTR units, approximately 15 long-term jobs are created.

These include regeneration benefits, with residents creating greater local spending power, as well as placemaking benefits brought about by high absorption rates, especially on large multi-phase regeneration schemes.

It is estimated that for every 500 BTR units, approximately 15 long-term jobs are created, in addition to construction jobs. These jobs will generate wider economic benefits which are not priced into the narrower commercial incentives relating to BTR schemes and alternative competing potential uses of possible BTR development sites.

Consultation with industry stakeholders has identified a number of factors that need to be addressed to help the BTR market fulfil its true potential.
Design and space standards
National policy and guidance promote greater flexibility on design and space standards in high-density town centre locations with good access to transport. Local authorities need guidance on key factors (car parking, unit mix/size, single aspect and units per core) that can impact on BTR viability.

Home Builders Fund
The Homes & Communities Agency (HCA) could use an explicit tranche of the Home Builders Fund for PRS to demonstrate the government’s continued commitment to delivering good quality rented housing that is owned and managed by professional investors.

SDLT amendments
Exempt large-scale investors from the 3% SDLT surcharge. There appears to be precedents set by the Scottish government’s decision to exempt institutions when the surcharge was introduced and this can be investigated further.

Government Debt Guarantee for PRS
The government should consider extending the £3.5bn Debt guarantee for PRS in terms of time and scope to give confidence to lenders in the space that there will be investment or end-buyer finance available to help the market scale up and mature.

Market information and transparency
Both the HCA and Venn have access to a useful range of information and data on the new BTR sector, which would be helpful to lenders underwriting transactions if the data were made available in aggregate form.

VAT amendments
Changes to the VAT regime in terms of zero-rating the cost of repairs and maintenance would improve the viability of a large number of BTR sites.

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