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ULI UK Residential Investment Roundtable

Michael Cochran, Chair of the ULI UK Capital Markets Forum hosted a UK residential investment roundtable in May 2016 at the Arts Club, London. This invitation-only discussion leveraged the expertise of the ULI UK Residential Council around the emerging Build to Rent sector as well as the experience of many participants from the US multifamily industry, where professionally managed rental accommodation is already an established asset class.

The key themes discussed at the roundtable are summarized below – all quotations are anonymous in accordance with the Chatham House rules nature of the discussion.

Establishing a professional rented sector in the UK

Availability of land is the perennial issue and is still high up the agenda but most participants agreed that sites were coming forward at a reasonable pace. There was some frustration about delays around accessing public sector land, with many participants critical of the frequently protracted approach taken by the public sector to find partners. One participant felt that 'best consideration' too often translated to 'lots of cash upfront!'. Another reiterated that exactly how those partnership deals between public sector body and private developer are structured is crucial and that too long a procurement process risks slowing everything to a halt.

Discussing the challenge of establishing a professional rented sector in the UK, participants noted that the UK's cultural obsession with home ownership was historically around it being a way to build equity and secure a long-term financial future. Participants discussed the extensive research demonstrating a generational shift, particularly around the 'mobile Millennials' (under 35s) for whom buying a house in one place is likely not a smart move for flexible lifestyles. It's an outdated concept for some and simply out of reach for many others given the stratospheric rise in house prices, particularly in London.

"We think that the demographic who demands to rent is changing. They won't see it as a failure not to own but an advantage. If you're providing the service culture then that will be self-fulfilling that Build to Rent will succeed."

One participant noted that:
"We've only had a proper protected rental system since 1988 so there are still planning issues, Local Authority issues and a strong habitual preference for commercial rather than residential. Those are falling away – and I think Build to Rent is really helping – it's an easier sell."

Participants noted that public sector bodies are generally relatively asset rich so the future income potential of Build to Rent is quite attractive. Build to Rent presents the opportunity to engage with Local Authorities in a much more meaningful way. The faster absorption rate compared to for sale means that Build to Rent has enormous potential in regeneration areas or as part of a larger scheme, helping to create a sense of place and a real community more quickly.

Others noted that affordable housing is best delivered through supply: providing stock that doesn't compete with home ownership and is targeted for a different sector. This is best underlined by investors - the wall of money willing to invest, even in the wake of the referendum vote for Brexit. One US investor noted that the UK was now 20% cheaper for them!

'The delivery of housing in the affordable sector is being decimated because the model doesn't work – the major problem is finding land. The SMEs and small developers who were very good at land assembly and putting in time and effort to get planning consents are no longer there. They don't have any support in the market."

All agreed that we needed some landmark UK case studies to point to as proof of concept:

"We've got to prove the additionality that Build to Rent can provide for housing supply – over and above same sites being for sale only. We have to show government the great examples like Greystar Greenford, to win that argument because that will help influence measures that can help us build the sector further."

One participant criticized the industry for being too timid in the face of a government so publically committed to home ownership:

"At the moment we are unambitious – we need a large-scale, professionally-managed rental sector – there is no silver bullet but we are getting towards an understanding that it's not all about home ownership. Achieving rental at scale is crucial."

Others urged caution, noting that Build to Rent is an emerging industry and a 'small fish' in reality. Another were more optimistic and pointed out the significant progress in recent years:

"I thought it would take ten years and we're at about year five. We started with the Montague Review, then the ULI Guides, the IPF report, the IPD index and the Build to Rent funds. If we can keep going for 3-4 years we will have an asset class."

What's in a name?

Some participants expressed frustration in the lack of clarity around sector terminology and policy, which potentially hindered its progress:

"One thing that really frustrates me at the moment is how we term this sector. Is it Build to Rent, PRS, Multifamily, Private Rented Communities or something else? It is crazy that we cannot have one common term and get that clear so we can talk to government, Local Authorities and be consistent!"

Some participants felt confident that the term 'multifamily' would become more common as existing investors from other markets came to the UK.

"When we have tens of thousands of delivered rental product we'll have a mature established new sector that won't be Build to Rent – it will be multifamily."

Others agreed that this terminology clash was affecting progress with the ongoing debate on use class vs. covenant for Build to Rent. The Housing Minister is on record as seeing the property industry as fractured and disparate and this is not enabling the greater delivery of supply for this new product for the UK market.

The post-Brexit referendum Cabinet has taken a less strident approach towards home ownership, although the SDLT surcharge announced in the March Budget looks set to stay. In May participants were pressing the need to push for SDLT relief for REITs, and planning in principle and flexibility on space standards for Build to Rent. All agreed that persuading government to focus more on supply was crucial.

"We should be standing up and talking about building significant new housing stock, not least because that's what government wants and be clear that it's for rent, high quality and a long-term option."

One participant raised a glum consensus when he pointed out a recent Estates Gazette article that had listed 21 separate government interventions in the residential sector over just 4 years. The frequent changes to the regulatory framework are potentially off-putting for investors and so clarity of voice is even more crucial than ever.

"Now is the time – we need to grab the money that is interested NOW – it could go into infrastructure / student housing etc. I am positive about where the market is – I am less positive about what government is doing around the messaging."

London

"London has 33 boroughs with 33 different agendas and requirements. One size fits all doesn't work here!"

Participants in May shared some nervousness around the newly-elected Mayor of London, Sadiq Khan, given election promises around rent stabilisation or even the return of rent controls, but all were keen to take the opportunity to engage with the new administration and maintain the GLA support for the emergence of Build to Rent in London.

"We all know that he is going to challenge and bring in some schemes. As a developer I have concerns on schemes underwritten on prior terms and see a risk of greater stalled sites. We have to keep repeating the fact that supply measures are more effective."

Subsequent announcements around London Living Rent have generated further concerns in the industry press, with Property Week declaiming it as the death knell of Build to Rent in London. However, James Murray, Deputy Mayor for Housing and Residential Development, and many of the senior GLA policy staff continue to be very supportive of Build to Rent, particularly if a Discounted Market Rent model can be adapted and implemented on larger schemes. In addition to the long-trailed amendments to the Affordable Housing SPG, there is potential for more supportive policy tweaks here.

Rent controls

Last seen in London in the 1970s, and blamed by many for killing off the development of rental housing in the UK at the time, rent controls have resurfaced as a serious policy consideration. Whilst participants acknowledged the public popularity of rent controls in the overheated property market, particularly given the pressures and low-quality stock available to 'Generation Rent', all agreed that this type of rigid pricing policy presents major issues from an institutional perspective.

"We've all seen different around world of successful and non-successful rent controls. As it stands, if you are investing in a Build to Rent model your forecasts for future growth are based on market expectation rather than regulation. It can have dramatic effect on affordability of the model. It's not how much it goes up every year but how you calculate the base price – where you start from. Rent controls are a slippery slope so starting rent in relation to market rent is crucial."

Participants from Scotland noted that the private sector there is already working closely with the Scottish government on the new Tenancy Act:

"It's inevitable that some form of rent control will come through – what Scotland have actually proposed is vaguely workable. It's essentially CPI increases, capped and collared, which we're comfortable with in lots of commercial investments so I don't see it would be so hard for residential."

The roundtable consensus was that for Build to Rent, in particular, it was too early to implement rent controls on a still emerging and evolving sector, but that delivering at scale should enable a better mix of tenures to be offered within individual developments.

Valuations and investor appetite

Long-term ownership for institutional investors means it has to be valued regularly but participants noted that the main valuers are not consistent on where this is heading, with pricing at the moment referenced to open market value rather than a discounted cashflow model.

There were mixed opinions around the valuation issue. Despite the strong appeal of Build to Rent fundamentals some felt that the need for an exit 'just in case' was preventing the groundswell that has been anticipated for so long:

"Everybody gets the investment thesis here now, lack of supply, better offer, lifestyle renters etc. It's all hugely appealing but pension funds are very low risk investors – if you have a market that isn't effectively pricing for 3-5 years then even if they love the prospect of Build to Rent then it's still seen as too risky to invest in."

"It's very hard to persuade investors to invest in an asset class that doesn't exist yet. The financial tools in the market are not there to deliver it."

Others were more optimistic and felt the sea change had begun:

"There are things we cannot fix – there is not a market we can measure against at the moment and won't be for a while so we need to build, lease, stabilize, and we need at least 3-5 years to develop that. The amount of capital going into the sector means it shouldn't be an issue. We have aggressive interest from foreign buyers."

"There is sufficient capital out there to build Build to Rent and PRS slowly but I don't see why we need to divulge too much into valuing against ownership. I know the deals are there for me. I think we are over-complicating things. Opportunistic capital rather than core capital is likely to be the savior here."

"The capital is poised and ready to come in and endorse this sector. Goalposts keep moving – bur it's up to all of us to come together and at least get one thing on the table that capital can value and price so there's a baseline to get the flow going."

"The two big elephants in the room are the housebuilders and the Registered Providers. Places for People and L&Q have probably done more Build to Rent / PRS than all of us put together. They are part of the same mission we are on. Ultimately we want to create an asset class so that when we trade we can put the value on it confidently and cerate a stable secondary market – all done on the yield multiple like US and Germany."

Housebuilders

There was an extensive discussion around the traditional housebuilding industry and its response to Build to Rent. Most participants agreed that having been initially dismissive of rental as something to do with their traditional product only in a downturn; that most major housebuilders were exploring Build to Rent in its own right, particularly given the extensive land banks held by many.

Concerns were raised about the ongoing competition for sites between Build to Rent developers and housebuilders and participants raised the key differential of operating cost, which presents a significant hurdle for Build to Rent deals:

"One of the major issues in London is service charge. £5000 per unit, between £5 and £8 a foot and that's without leasing and other costs on top so institutions won't come for a 1.5 -2 % yield."

The idea of closer co-operation with traditional housebuilders was welcomed and one participant noted the "revelation" that the HBF are publically supporting Build to Rent, which is really positive for the industry.

"The housebuilding industry and rental housing industry need to come together and buy land together. Density is what you want in rental and there has to be a model where they can collaborate to provide double the amount of housing that would normally be delivered on piece of land that will have both sale and rental."

"Housebuilders are primarily driven by return on capital. If we can improve that by speeding delivery on product then it could create opportunity for a conversation. I think the models can coexist."

One US participant offered some advice on achieving effective collaboration:

"You need to equalize the equation so that you're both dealing with the same sorts of constraints and opportunities. What you'll see in the States is certain sites that developers believe are better suited to a for sale rather than rental product will usually end up with a mix of the two products because ultimately it puts greater housing stock into production faster."

It was noted that Grainger have a clear live example of this collaboration with Redrow on a large 2000unit scheme where the for sale product sells at an average one a week. Under covenant, Grainger are building under covenant 1000 units of rental housing, which does not negatively impact the Redrow sales, but accelerates the development of the place. The aspiration for equality of tenures and greater collaboration was clear:

"If I could wave a magic wand it would be that the two sectors would speak with one residential voice. Housebuilders and rental."

In closing, participants reiterated the need to act now to embed Build to Rent in the UK market:

"The one thing that's always happened when we've had a strong house for sale, bear market is that rental has withered. There's never been more interest, money, research or sites going on and we've been at the end of a long bull run. The market is not going to stay that high either. This is a real moment of opportunity."

The ULI UK Residential Roundtable took place on 11 May 2016. The following organisations were represented:

Argent
Assael Architecture
be:here
Dolphin Square Ltd
Eastdil Secured
Grainger
Greystar Europe Holdings
Hermes Investment Management
LaSalle Investment Management
Lonestar
Lothbury Investment Management
Patrizia
Prosperity Capital Partners
Quintain
Residential Land
Telereal Trillium
Venn Partners

Kindly sponsored by: **Eastdil Secured**

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About ULI

The Urban Land Institute (ULI) is a non-profit research and education organisation supported by its members. Founded in Chicago in 1936, the institute now has almost 40,000 members worldwide, representing the entire spectrum of land use and real estate development disciplines, working in private enterprise and public service.

ULI has been active in Europe since the early 1990s and today has over 2,900 members across 27 countries. National Councils are ULI's country networks which organise local events and activities. ULI UK is the largest National Council in Europe with over 1,000 multi-disciplinary members.

ULI's Product Councils are forums for industry leaders to meet to exchange ideas, share best practices and foster thought leadership in a confidential and collaborative environment. The UK Residential Council's utilises ULI's extensive public and private networks to exercise leadership and share best practice for the responsible management, design, investment and development of domestic properties across the UK.

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