

DELIVERING BUILD TO RENT: Are you ready?

Part 1

Executive summary

The UK economy has never been in greater need of high-quality, efficiently managed private housing. But this is nothing new. 2012 saw the publication of the Montague Review as a result of a long-standing housing deficit in the UK. There was already a distinct awareness that the existing house-builder model simply was not building at sufficient scale to bridge the gap. Meanwhile, in the background, institutions were quietly analysing residential property performance, realising the potential wealth of opportunity in the sector.

But without stock to invest in, risk remained a significant factor. Added to that, length of tenure in the Private Rented Sector (PRS) was shifting. Issues such as affordability and mortgage availability, signalled a decline in the number of those aspiring to own their own home. Fast forward to today and the stigma around privately renting is fading as it is no longer considered a tenure of last resort. It is a tenure of choice with individuals, couples and even families establishing long-term homes in the sector. As a result, they require a greater level of consideration and protection from the industry.

Enter Build to Rent.

The UK Government launched Build to Rent (BTR), as part of a range of initiatives, to bolster the amount of properties available to rent in the private rented sector. And what began with investors perceiving demand and showing support for the

concept, was followed by developers commencing work near key London transport hubs. Today, it is entering a third phase that sees organisations begin to understand the significance of operations - including building management - from the outset, as customers start to arrive in greater numbers and the model evolves. Five years since launch, more than 15,000 BTR properties have been built while another 67,000 homes are either under construction or in the pipeline.

It is clear that BTR is gaining in force, offering an ideal model for scalable, first-class housing, tenure security and community engagement. But getting it right will require expertise, forward thinking and perhaps, even, compromise from all parties involved.

So the question is, are you ready to deliver?



This Briefing Paper accompanies the customer service briefing for residential property industry professionals, hosted by FirstPort and held at the Cavalry & Guards Club on Tuesday 5th September 2017.

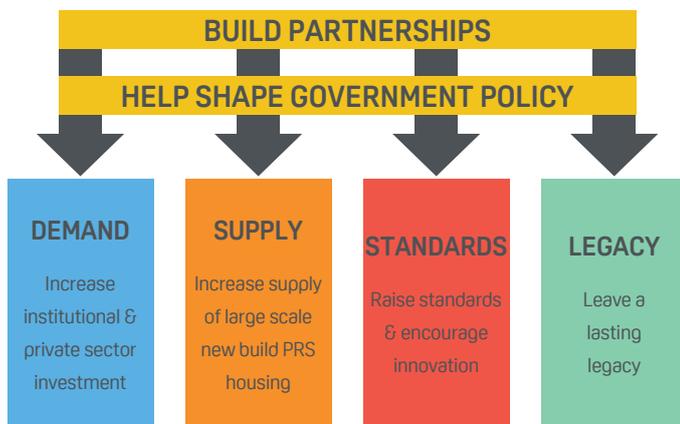
The Investment Management Perspective

Tracey Hartley, Asset Manager, Foundation Real Estate

THE PRS TASKFORCE

Sir Adrian Montague's report made a series of recommendations to "kickstart the Private Rented Sector". One of which was to set up a PRS Taskforce comprising five carefully selected, established individuals from the sector. So what were the key strategic objectives?

Key strategic objectives of the PRS Taskforce



DEMAND

Equipped with the knowledge that the institutional appetite existed, the team sought to pair investors with opportunities, demystify residential property and look at de-risking development by looking at forward funding model to encourage **demand**.

"The PRS Taskforce as something of a dating agency, matchmaking people in order to get the right entities talking."

SUPPLY

When it came to **supply**, education was key. Existing frameworks that were built to align with affordable housing requirements, in relation to housebuilding for the purpose of selling, were no longer necessarily viable in a rental model. One challenge associated with this objective was the cynicism often felt by local authorities and planners in terms of developers not having the budget to allow for more affordable housing or larger financial payments in lieu. This obstacle was met with a purposeful explanation of why the concerns were genuine and a demonstration of how overloading the rental model at the front end has a negative impact on viability in the long run.

Responses to this continue to be positive, with a range of innovative approaches to combat the issue, although the picture remains mixed nationally and there is plenty of work still to be done.

STANDARDS

Arguably the most crucial of the objectives, **standards** are fundamentally linked to the concept of a greater level of both consumer and investor protection. A key concern from an investor's perspective was the threat that investing back into residential property could pose to their business reputation. Making headline news in the national newspapers for leaving an elderly customer without hot water or heating simply was not an option. Who could they turn to then to ensure that their investments would be managed to the excellent standards that they and in turn their customers expect? The answer may not have immediately been clear. The reason being that, primarily, property management had been developed to cater to the needs of the buy-to-let landlord and therefore most managers were servicing that end of the market. And with stock not yet available, this was deemed as more of a long-term problem and therefore posed, perhaps, the greatest challenge of all. Of course, the reality is that the property management sector is both highly-mature and extensive, the key lies in tapping into its full potential.

LEGACY

In 2015, the PRS Taskforce was disbanded after its agreed two-year period. But the efforts to transform the sector did not end there. In order to maintain momentum of the structural changes that had transformed the sector, it was important that a lasting **legacy** was left behind. The outcomes below triggered an acceleration of growth and development in the PRS and subsequently BTR. Consequently, the industry was no longer asking if the initiative would ever be more than pipe dream. Instead, it was asking when would this dream become a reality?

- Build to Rent Fund Round 2
- National Planning Policy Framework advice
- Venn Capital Partners Debt Guarantee scheme
- PRS Code of Practice
- IRPM Institutional PRS Management qualification

BUILDING ON SUCCESS

Undeniably, the enthusiasm for BTR is there and it is flourishing. What may have started a slow but steady process has grown into a forecast that suggests investment will see a fourfold increase in just five years. At the same time, major constraints look likely to shift from concerns over appetite for investment, to those regarding availability.

A quarterly review of the pipeline is now in place which is a real demonstration of how fast figures are moving. Meanwhile everyone eagerly anticipates what will happen next.



It is larger than the entire commercial real estate market which is valued at
£871bn



Institutional investment will grow from

£25bn this year

to
£100bn in 2022



The private rented sector has doubled over the last decade.

NOT JUST A LONDON LOOK

Evidence now suggests that the BTR sector has now reached a significant milestone, indicating that, for the first time, the sector is beginning to make its mark across the regions with supply being reasonably well matched by comparison. In the beginning, London was seen by investors as a safe haven. Now, those who saw regions as high risk, just two years ago, are taking steps to infiltrate the regional marketplace including across Manchester, Salford and Liverpool to name but a few.

Build to Rent Pipeline: London versus the Regions (Source: Glenigan, Molior & BPF)

Status	Complete	Under Construction	Planning	Total
Status	10,313	9,445	27,480	47,238
Regions	5,612	11,173	19,627	36,412
Total	15,925	20,618	47,107	83,650



“Build to Rent is not just tall, shiny buildings with hundreds of units. There is space in that sector for family homes.”

ALTERNATIVE MEETS MAINSTREAM

Whilst still technically classed as an alternative, BTR has become more accepted as mainstream, including by the government, despite levels of political uncertainty. But there is still a huge opportunity for growth that remains untapped. With evidence that investors are no longer hesitant at the prospect of venturing into the regions, there is scope to talk about what lies beyond.

THE REMAINING CHALLENGES

There are still hurdles to overcome. The following three were identified by the IPF earlier this year:

- **The valuation methodology** – The RICS is expected to go to consultation on updated advice shortly
- **A universal index** – a universal guide on best practice is key to transparency
- **Professional management capabilities** – long term operational growth to net efficiency v short term net to growth development special efficiency

“In the absence of an absolute toolkit, the knowhow of a large-scale operator is key. Having a real understanding of how people truly live, in large buildings, will help ascertain value. Not only that, we must understand our customer proposition. People over data.”

The Construction Perspective

Mark Farmer, Founding Director & CEO, Cast

As much as the success of the BTR sector depends on investment and demand for homes, there is also another piece to the jigsaw. The creation of the assets themselves. The entire industry should be taking into consideration the challenges currently faced by the UK construction market, their links to BTR and the specific role the sector can play in overcoming those tests.

Published in October 2016, The recent Farmer Review identified ten symptoms of failure and poor performance:

The Farmer Review: Ten symptoms of failure and poor performance



Low Productivity



A dysfunctional Training Funding & Delivery Model



Low Predictability



Workforce Size & Demographics



Structural Fragmentation



Lack of Collaboration & Improvement Culture



Leadership Fragmentation



Lack of R&D Investment in Innovation



Low Margins, Adversarial Pricing Models & Financial Fragility



Poor Industry Image

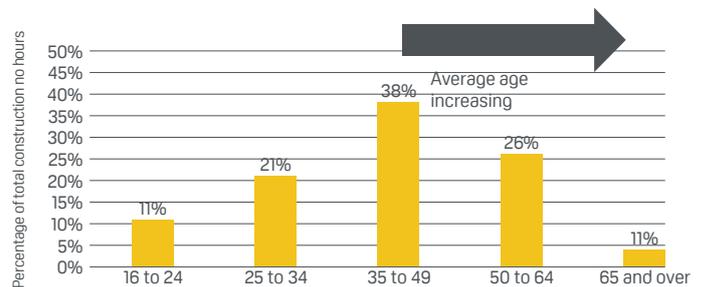
A BURNING PLATFORM

Of the ten symptoms, the issue of an increasing skills shortage and an ageing workforce has the potential to cripple the country, as part of a crisis that will be difficult to recover from if the trade does not take steps to revolutionise itself. The official prognosis? An unprecedented set of challenges that look set to affect levels of resiliency, in terms of the construction sector's ability to be malleable in reacting to an increase in demand and opportunity. In short, UK construction finds itself in a set of circumstances that it has not experienced before, requiring it to do things differently.

AN AGEING WORKFORCE: AN INTERNATIONAL ISSUE

Census data shows that, over the next decade, people in construction will be retiring at a much faster rate than that of new entrants coming into the market – a trend that will increase as time goes on. As a result, there will be a growing capacity gap.

2011 Census estimate: Residents aged 16 or over in Construction employment



BREXIT: A MIGRANT DEPENDENCY

There is also the question of Brexit and the impact that will have on a workforce. The GLA published findings, earlier this year, regarding housing in London. The data shows that 45% of all construction workers in London are not from the UK. Concurrently, 27% are from the EU, a worrying statistic for those carrying out developments in London.

Meanwhile, the age profile of these workers is younger, meaning that the industry workforce is currently being made younger, artificially, by its migrant component. This indicates that the age demographic problem is far worse than what it currently appears to be.

And this is not unique to London. These findings have also been mirrored across regions such as Manchester, Liverpool and Leeds.

SKILLS SHORTAGE: TACKLING THE PROBLEM

Improving the construction industry clearly involves significant change. The labour intensive, traditional systems used for centuries are no longer efficient. In order to facilitate that change, processes need to see a shift towards a more premanufactured environment and will require investment into:

- Clear leadership and institutional reforms that better integrate clients, industry and government
- A productivity led change agenda, letting innovation dictate future skills development which clients and supply chain can lead or respond to
- The government playing a critical role in the initiation of change across both of the above

“Why is this relevant to BTR? This marketplace is still in its infancy. While there is significant head room for growth, the bespoke assets, at scale, do not exist. And to create them, we need to build them. This means there is a construction industry dependency at the root of delivering what will hopefully be a confident, fully transactional area.”

A TWO WAY PROMISE AROUND IMPROVEMENT

So what does the future hold for BTR and the construction phase? Interesting developments are already underway in terms of policies and government responses. The Industrial Strategy Greenpaper, launched earlier this year, was an important milestone aimed at all sectors. It demonstrates the opportunity that exists for construction and real estate, in conjunction with government, to agree a deal to improve performance. Skills development and creating a world leading sector are two of the ten pillars set out in the document.

Since the publication of the Farmer Review, significant progress has been made:

- It has been acknowledged that the Construction Industry Training Board (CITB), which provides training and skills development, is not fit for purpose and needs to be reviewed. It may be that a decision is made to scrap the board entirely, leaving a vacuum as to how training is provided going forward.
- Build UK has taken steps to build relationships with developers by providing them with memberships to create stronger levels of engagement and integrated thinking with the industry.
- The Buildoffsite Property Assurance Scheme (BOPAS) is working to improve acceptance of off-site construction relating to quality assurance. This is being supported by the likes of the RICS.
- The government is now playing a role in facilitating change, injecting £2bn worth of funding aimed at modern approaches to construction.
- There is also a clear government understanding and endorsement around the role of innovative construction and modern methods, particularly in housing and the BTR sector – as seen in The Housing Whitepaper.

“We need to fundamentally change what we see on a construction site within a decade. If we don’t do that, we have some big problems ahead.”

THE EMERGING CONSTRUCTION SECTOR DEAL: PULL AND PUSH

So where is the construction sector itself heading currently?

An emerging sector deal is being put together by the Construction Leadership Council, focusing on three key themes.

- Digital
- Manufacturing
- Performance

Cutting across those themes are three additional factors which are beginning to see a strategic change

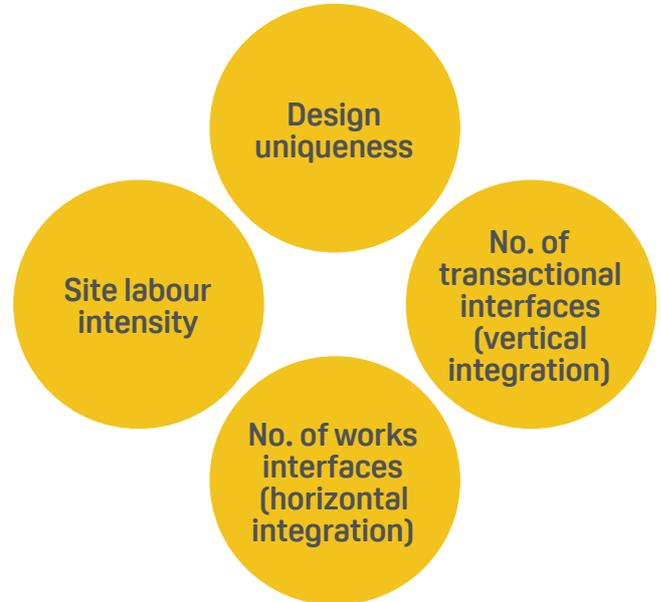
- Procuring for better value
- Industry-led innovation
- Skills for the future

Historically, however, the industry has struggled with change. Can the burning platform provide the right stimulus to change? If it can't, perhaps the exponential levels of discontent with construction performance can be the driving factor such as negative media exposure alongside evidence of poor quality workmanship and recent high profile design failures.

THE ROOT CAUSE OF FAILURE

Where is the industry failing? There are four fundamental issues. Designing everything from scratch, site labour intensiveness, fragmentation and working in trade silos. All of this needs to be integrated.

The four root causes of design, procurement and construction delivery failure



And the solutions? Building Information Modelling (BIM) and collaboration have both been signalled as key enablers but they will not work in isolation. Going forward, the central plank of any construction strategy must be to move up the pre-manufactured value spectrum by using a more integrated delivery model.

What's the learning?

The success of BTR will depend as much on the quality of its management and the method of construction as on its rental yields and location. Management excellence will directly impact on returns and, in turn, the value of the investment. Get it right and the sector could provide the type of rental space that people have been waiting years for.

But the brave new world of BTR calls for a new way of thinking and a new set of skills, not least in the development phase. It is vital to start constructing assets in a more innovative way - now.

Finally, the successful maturity of BTR will rely on a new type of collaboration being built between investors, developers, operators and construction professionals.

Ultimately, relationships will be king.

Meet the speakers



Tracey Hartley,

Asset Manager, Foundation Real Estate

Tracey is a market leader in UK residential investment management and has more than 15 years' experience of the PRS sector.

Tracey previously worked at Grainger Plc, where she was Fund Manager of the GRIP Fund before becoming Director of Residential Operations.

Possessing an extremely credible, granular understanding of the PRS sector's drivers, Tracey served on the government's PRS Taskforce. She also chairs the RICS Property Management Working Group and sits on the RICS Residential Professional Group Board.



Mark Farmer,

Founding Director & CEO, Cast

With nearly 30 years of experience in the construction and real estate sectors, Mark is a recognised commentator and thought leader on a variety of issues and has been at the forefront of the emerging Build to Rent market.

Mark is a member of the RICS, Vice Chairman of the ULI UK Residential Council, a member of the BPF Build to Rent sub-committee and co-chairman of Constructing Excellence.

Mark authored the October 2016 UK Government Review of the Construction Labour Market Model entitled 'Modernise or Die'.

Like to explore more?

FirstPort is the UK's premier property management group, spanning 184,000 homes across more than 3,800 developments in the residential, retirement and luxury markets. With a 30-year track record, we offer home builders and institutional investors a uniquely scalable combination of residential property planning and asset management backed by our national reach.

Our Build to Rent proposition delivers an integrated solution that spans skilled consultancy, property and asset management, residential services, tenancy and lettings management.

If you would like to learn how FirstPort can help support your Build to Rent investment today and well into the future, while providing an exceptional experience for customers, then come and talk to us.



01582 393 756



buildtorent@firstport.co.uk



firstport.co.uk/buildtorent