The renting boom

Investing in Build to Rent schemes could offer pension funds a reliable, inflation-linked income, as demand for good quality rented accommodation continues to grow. David Adams investigates the growth of interest and investment in this sector

Summary
- Construction of large-scale, professionally-managed BTR schemes is increasing rapidly in the UK, particularly in London, Manchester and a few other cities.
- Investing in BTR can be a useful source of inflation-linked income and diversification for pension funds.
- Demand for good quality rental properties continues to increase as more people of all ages choose to rent rather than trying to buy property and seek safe, secure properties they can rent for the long term.

Most of us have been adversely affected by the UK's housing crisis in some way. It squeezes the disposable incomes of anyone who is trying to save for a mortgage deposit, trying to pay off a mortgage, or trying to pay high rents. It may also compel those who do own their homes outright to use their housing wealth in particular ways: to supplement retirement income, to pay for long-term care or to give financial help to family members – including those trying to get onto the housing ladder.

The crisis has convinced many people that they will not be able to buy their own home for the foreseeable future, if ever. So, as the population continues to increase, demand for rental properties is at an all-time high, while the supply of social housing has never recovered from the loss of stock that followed the introduction of the Right To Buy in the early 1980s.

Meanwhile, pension fund investors need secure, stable sources of income. Investing in Build to Rent (BTR) real estate could deliver just that, in the form of reliable, inflation-linked rental income, while also providing well-built, professionally-managed properties for rent.

BTR is a familiar model in other countries, but only started to grow quickly in the UK during the past few years. By the end of March 2019 there were at least 30,000 completed BTR properties in the UK, a 34 per cent increase on the previous year, according to estate agent Savills, with more than 110,000 further units either under construction or in planning.

Rental property at a premium

Demand for rental property is strong. The number of UK households renting privately grew from 2.8 million in 2007 to 4.5 million in 2017, according to the Office for National Statistics (ONS), while research from estate agent Knight Frank suggests that by 2021 the number of renting households will reach 5.79 million.

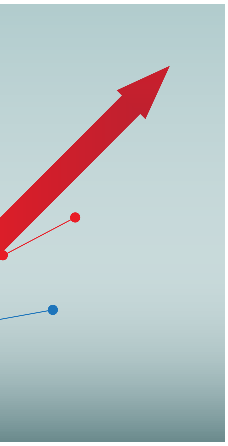
Much of this growth will need to be delivered via schemes owned by large-scale corporate landlords, as government policy drives many private buy-to-let landlords to exit the market. Some tenants will welcome that development. There are, of course, thousands of excellent private landlords. And then there are the others.

"Everybody has a horror story about renting in the UK," says Places for People (PfP) Capital BTR fund director, Alexandra Notay. "Amazingly, considering the size of the private rental sector, it's barely regulated. The standard of private rented stock isn't good: 20 per cent doesn't even meet the UK government's Decent Homes standard."

Renters also want security, says Notay, with many tenants fearing they could be evicted by landlords at any time. "The opportunity for Buy to Rent is to provide better, secure rented property at a good price."

BTR schemes usually consist of apartments, all of which a developer will continue to own and run over the longer term. Tenants usually pay for utilities, other services and access to communal facilities through an all-in rent.

Developments include Legal & General's Blackhorse Mills scheme of 479 apartments, built on brownfield land beside the River Lea near Walthamstow in east London, about 20 minutes'



from central London via tube. Residents can use an outdoor swimming pool, a gym, games room and private dining rooms; while retail and commercial space and even a microbrewery have been added to help create a complete mini-community. The development will open later this year.

Other L&G BTR schemes include the Slate Yard, a 225 apartment scheme in Salford, Manchester; and a 1,000 unit scheme under construction in Wandsworth, south London.

"Our assumption is that we are not going to sell, ever," says Legal & General Investment Management (LGIM) head of Build to Rent Dan Batterton. "We are assuming we wouldn't sell a single apartment within a block. As soon as you do, you lose the value of having control over the entire building.

"We offer five year leases – but people can leave with one month's notice, so our residents are in control. If they pay their rent and meet the terms of their lease they can stay as long as they want."

Other notable BTR schemes include a 42-storey tower of 481 apartments, with communal facilities and commercial/retail space, to be built by Apache Capital Partners and Moda Living in Birmingham. London and Manchester have the largest number of BTR units completed or in planning, but other schemes are underway or planned in a number of other UK cities. Developments need to be large-scale to pay for the training and retention of staff who run and maintain them. The BTR model also encourages construction of high-quality homes, because the corporate will be managing them over the long term, so wants to minimise maintenance costs.

Inflation-linked income

Notay is not surprised that pension fund investors are seeking to increase exposure to BTR, as commercial and office real estate markets have experienced severe difficulties in recent years. "BTR investments do not deliver the double digit returns that people used to see in commercial and office real estate, but they're much more secure in terms of cashflow and generating long-term income," she says.

A consistent, inflation-linked income stream is the most important attraction for pension funds. "Rents over the long term rise by around CPI plus 1 per cent," says Batterton. "During periods of market extremes rents don't really drop. It gives you a good diversification from your normal credit asset classes." He says BTR developments also run at very high levels of occupancy: around 97 per cent in the case of the LGIM schemes.

He says all LGIM's BTR investors are pension funds; UK local authority pension funds are looking at BTR as an opportunity to invest in an asset that can have a positive social impact; meanwhile investors from outside the UK, including pension funds in other countries, see BTR in the UK as a good opportunity.

Knight Frank partner and head of tenanted residential investments Nick Pleydell-Bouverie says the shift away from commercial real estate to the private rented sector in general, and BTR in particular, is closely linked to an increase in professionally-managed, large-scale schemes. "Where the management side has become more professional, investors can be more comfortable with the operational costs of the development," he says.

Independent Trustee Services (ITS) director Dinesh Visavadia, who serves as a trustee for a scheme that has invested in BTR, sees the attraction. "The capital values of the properties are low and the yields are looking attractive, so it's a good time to invest," he says. "This can also make a positive difference to peoples' lives, helping them to live close to their place of work and helping young people who can't afford to buy, or those who want the agility to move from city to city." He advocates using funds that also invest in BTR in other countries.

New targets

Although the marketing materials for some BTR developments appear to have been designed to attract young professionals, the target market is diverse, says Pleydell-Bouverie. "There is a demographic shift where people are choosing to rent rather than buy," he says. Findings in Knight Frank's 2019 *Multihousing Tenant Survey* suggest that more than a third of UK renters are now either couples aged between 25 and 49 who have chosen to rent in urban areas, or are families seeking to live close to workplaces, schools and transport links.

Mercer Alternatives principal for real estate Matthew Abbott says there also seems to be plenty of interest in such properties from older people, including retirees. He thinks a mix of residents is good, both for social reasons and as a way to ensure rental money is coming from a diverse range of sources.

"If you've got a scheme that ends up being for everyone from overseas students to pensioners, I'm comfortable with that," he says.

"BTR shouldn't be considered as an alternative to social housing," says Notay. "It is not going to solve the housing crisis. But it can provide safe, secure homes on longer-term tenancies and people can feel that it's their home and they're not going to be turfed out of it."

And provided demand for a secure tenancy is maintained and developers have got their sums right, BTR should also provide pension fund investors with a similar feeling of security.

"It's all about long-term income and income growth," says Abbott. "It gives you a nice income and it's a good diversifier."

Written by David Adams, a freelance journalist