UNLOCKING THE BENEFITS AND POTENTIAL OF BUILD TO RENT

Residential

A British Property Federation report commissioned from Savills, academically reviewed by LSE, and sponsored by Barclays

Foreword

Barclays is delighted to support this research to assess the further potential of the BTR market given its rapid emergence as a discrete 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, whilst also delivering broader social and economic benefits to local communities.

Decades of Buy to Let Landlord activity has driven an increasingly fragmented Private Rental Sector (PRS) with over 98% of stock currently in the hands of individual landlords and small corporate entities. Whilst 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 the quality of accommodation with the 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 but these projects require a scale of investment that is unlikely to be delivered by a fragmented market.

By delivering high quality and well managed homes and creating new, sustainable communities, BTR will enhance the overall quality of housing in the UK and become woven in to 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.

Predicted population growth of 9.7m between 2014 and 2039 indicates demand for housing in the UK will only increase and should the divergence between median wages and median house prices persist, demand for PRS over the mid-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, co-ordinated marketing, programmed maintenance and cost effective daily management. In addition to the financial benefits to 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 thought leadership and I would like to thank the British Property Federation, Savills and the LSE for compiling a valuable analysis of the sector.

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Unlocking the Benefits and Potential of Build to Rent

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Executive Summary

The British Property Federation (BPF) commissioned this report to help understand whether the build to rent (BTR) sector would benefit from any specific policy measures to help the sector establish during its infancy phase. The research was conducted by Savills Research and Economics teams, with the London School of Economics providing an independent and critical role for the collection and analysis of data. The work involves a cost benefit analysis of various policy tools and puts forward a package of measures that would help increase the supply of homes and support the burgeoning sector.

In summary, the report covers the following:

- a context for the research and the rationale for exploring the need for policy intervention arising from market and regulatory failures. It includes detail on the methodology and approach used to evaluate and assess potential policy options;
- a policy framework for the delivery of new BTR housing. It review the perceived barriers to investment and the approaches being used to deliver rented homes. It identifies the scale of delivery across England and Wales, the types of stock being delivered and the prospects for the market;
- detailed information gathered from the stakeholder engagement about the development of the sector and the key challenges for the evolution of the BTR market;
- evidence gathered from stakeholders on the additionality of BTR and the conditions necessary for BTR to generate such additionality;
- an evidence based definition of BTR which is then used in the analysis of market and regulatory failures and the potential policy options that could help to overcome these failure;
- a typology of the types of challenges faced by stakeholders in the context of existing policies and regulatory frameworks;
- identification of potential policy options and tools that could help to overcome market and regulatory failures;
- the development of an appraisal framework which uses the public sectors five case model approach as set out in the Green Book;
- an appraisal of the likely outcome from implementing these policies and an assessment of the relative effectiveness of the policy options in terms of increasing housing supply through the delivery of additional BTR homes.

The research identifies the benefits of BTR and the potential the sector holds to increase housing supply in England and Wales. 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 as set out in Chapter 2. In terms of what constitutes BTR there is a wide range of approaches being used to deliver rented housing across the UK. The completed stock to-date and the future planning pipeline show a number of different typologies, including:

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

The research involved a range of stakeholder consultation including interviews and roundtables with those engaged in the delivery of BTR from both the private and public sectors. The work described in Chapter 3 helped to identify the challenges holding back the sector and provided valuable context for understanding market and regulatory failures. 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.

Importantly, Chapter 4 sets out the evidence drawn from the consultation in terms of the impact of BTR on housing supply and demonstrates its impact on 'additionally'. The research found that BTR has the following additional benefits:

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

The additionality of BTR varies considerably across different types of site and depends on the extent to which it displaces other forms of housing supply. Additionality is most significant on larger sites where there is accelerated market absorption, which leads to faster build out rates. In the light of this conclusions, the report recommends in Chapter 9 that national and local guidance should encourage local planning authorities to recognise the significant additionality benefits of BTR when working with developers to bring forward phases of large sites so that they are built out earlier than otherwise planned, alongside the early build-for-sale phases.

In circumstances where BTR comes forward and is purely additional (e.g. where a site is made viable by BTR) displacement of affordable housing is not an issue. However, where BTR displaces traditional affordable housing on build to sell sites, it will usually be replaced by the delivery of discounted market rental (DMR) units.

With the encouragement given in the Greater London Authority (GLA)'s supplementary planning guidance (SPG) on affordable housing in 2015 and 2016 there are examples of BTR being delivered with DMR instead of traditional forms of s106 affordable housing. This allows investors to manage completed schemes in their entirety and enables the provision of affordable housing within the same block as market rented housing. Public authorities have also used covenants to ensure that the schemes and the discounted rental units remain in the rental market for a defined period and that they serve local households in need of subsidised housing.

DMR provision of this type helps rental schemes compete with the values derived from market sale. It also means investors can value the investment over its lifetime, can programme repair and maintenance of a building without having to negotiate with a third party that manages the affordable units and, importantly, can quantify the cost of repaying any preferential treatment that the scheme has received in terms of planning concessions.

The research suggested that the main forms of market and regulatory failure which policy should address include:

- Restricted access/mispriced finance;
- Inappropriate planning policy (particularly in relation to: car parking standards, unit space standards, unit mix, and affordable housing requirements);
- Professional management capabilities;
- Disadvantageous taxes/levies: Value Added Tax (VAT), Stamp Duty Land Tax (SDLT) and Community Infrastructure Levy (CIL);
- Political and regulatory uncertainty;
- Labour market rigidity as a consequence of restricted rental choice;
- External benefits for regeneration and economic benefit of BTR schemes; and
- Job creation and quality of management.

The overall conclusion set out in Chapter 10 is that the most effective policies in overcoming market failures, delivering additional new homes, and realising the positive externalities of BTR include:

- Clarifying the role of 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 the 3% SDLT surcharge;
- Zero-rate VAT on repairs and management to make BTR more competitive.

All of these policies can be implemented together. 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. 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. 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 REIT market (£60bn).

The policy measures considered in the study would increase the viability of BTR schemes relative to build for sale. This would increase the risk that some schemes would come forward as BTR and displace build for sale, more than is apparent in the current market. Any displacement would be minimised by targeting the policies at appropriate sites. Considering the very high levels of additionality that is evident on large sites and in marginal build for sale markets, our best estimate is that the additionality of BTR to overall housing supply is in no less than 80%.

The distributional costs of replacing affordable housing with DMR need to be acknowledged. To the extent that BTR is additional these distributional costs can be offset by maintaining and delivering a five year supply of housing land and ensuring affordable housing is provided on the for sale sites.

1. Introduction

1.1. Background and Context

The supply of new homes in England and Wales 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. Increasing output beyond the estimated monthly sales rate creates the potential for weaker sales values and the risk that units will remain unsold should there be an external shock as well as community resistance to further development. As a consequence, there is usually no incentive to accelerate delivery.

The buy to let (BTL) market (both mortgaged and unmortgaged/cash buyers) has played an important role in the traditional build to sell model. Evidence gathered through the stakeholder engagement for this report identified that sales to BTL investors have been making up an average of 50% to 60% of sales in London or 30% outside London. BTL sales help to de-risk development for lenders, especially where schemes are high value, speculative and cash intensive, such as apartment blocks. Typically, lenders like to see a proportion of off-plan sales to help reduce the speculative nature of the scheme and to provide evidence of demand.

In the current market environment, BTL investors are constrained by increased taxation and mortgage lending regulation, which means deliverers face the prospect of slower sales arising from investors. There is evidence in London and gathered through the stakeholder work that there is slower sales rates in London with fewer buy to let sales. This is creating a gap which could potentially be filled by other equity investors with appetite to forward fund development. This report looks at the potential of larger investors and especially those backed by 'institutional' capital to expand the residential supply through build to rent (BTR), including buying from housebuilders, developers and others involved in delivering new homes.

BTR offers an additional sales outlet from the build to sell model. It provides more certainty of an 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. Often BTR sites require substantial capital commitment (i.e. high density schemes) and without substantial third party investment they simply do not progress. In these circumstances, BTR can accelerate delivery because a developer / housebuilder can deliver stock for both open market sale and market rent concurrently. BTR also provides additional benefits, such as creating footfall and diversity of occupiers for non-residential uses on mixed-use sites, underpinning placemaking and regeneration. There is also growing evidence that there is consumer demand for BTR with a growing section of the population seeking to occupy rented housing.

BTR is especially suited for supporting housing delivery in times of economic and housing market uncertainty because BTR investors base their investment decisions on the long term prospects for housing demand. Where investors have confidence in the risk profile of a scheme, forward funding can help to de-risk large capital intensive projects, which helps developers to secure development finance. This is especially important for large regeneration projects, on which the risk issues are significant but there is also potential for build out rates to be accelerated through the delivery of BTR.

The UK needs to increase housing supply from around 200,000 net additions in 2016 to perhaps 300,000 homes per year in order to meet indentified housing need and from c.30,000 to at least 60,000 homes per year in London. Delivery of BTR can provide a significant contribution towards reaching these targets. This report seeks to clarify the potential of BTR and the policy environment that would help to unlock greater levels of supply from expanding BTR investment.

1.2. Approach

This report has been commissioned by the BPF to consider whether the build to rent sector would benefit from specific policies or changes in the policy environment to help the sector get established during its infancy phase. This research was conducted by Savills Research and Economics teams, with the London School of Economics providing an independent and critical role for the collection of data and evaluation of potential policy options.

The key questions this report aims to address include:

- How much additional BTR supply can be unlocked (and how quickly) through policy interventions?
- How much net additional housing supply that unlocks (given the potential for a proportion of new BTR supply to displace other forms of supply)?
- What are the costs and benefits of the policy options considered (recognising that there are some broader benefits beyond housing numbers that are unlocked although these may be hard to quantify)?

The approach follows central government good practice guidance on the development and appraisal of national policy. In particular, account has been taken of the Treasury Green Book, the Five Case Model, and the forthcoming DCLG Appraisal Guide (draft provided in confidence). To address these three questions the report is structured as follows:

Literature Review / Policy Rationale

There is a significant body of work identifying the barriers to expansion of the emerging BTR sector, following on from the findings of the Montague Report and the work of the PRS Taskforce, including the rationale for the various policy measures introduced by Government to encourage expansion of the sector. The common theme amongst all of this work is the aim of moving the sector to a point where BTR developers are incentivised to add to overall housing supply by either building out sites more quickly than other forms of development or widening the range of players active in the sector.

This report provides a summary of the most significant variables that determine land value and delivery for BTR, with reference to Savills experience, the relevant literature and research in to the BTR sector and how it fits in to the wider picture of housing supply. This includes examples of market failures and how BTR investors are managing to overcome them in highly competitive land markets, albeit not yet at the full scale of potential. This includes a breakdown between the London and regional markets. The report also provides a base case analysis of what has been delivered as BTR to date.

Stakeholder Consultation

The research engaged with stakeholders at two levels:

- Round tables events involving BTR operators, BTR investors, policy makers, relevant trade bodies and academics; and
- Structured one-to-one discussions with key stakeholders, including the GLA, lenders, BTR operators, BTR investors, housebuilders and developers to test our propositions on the key variables, the extent of the land value gap in the market scenarios and the efficacy of the potential policy interventions.

Review of Evidence of Market Failure

The review of literature, data and consultations brings together a list of market failures in the BTR sector. This is to inform the development of policy options that can demonstrate additionality to overall housing supply arising from an increase in BTR delivery. We considered issues falling within the Treasury Green Book definition of market failure, covering:

- Provision of public goods (i.e.) the market may have difficulty supplying some goods due to their characteristics. Affordable housing is a potential example;

- Externality benefits or costs not priced in to market decisions. Wider regeneration of town centres is a possible example;
- Imperfect information such as knowledge of the risks and returns on investment in BTR schemes as well as distorted pricing; and
- Market power both in terms of competition between providers and relative power between suppliers and purchasers, which might for example relate to the position of the BTR sector compared to the traditional housing sector.
- Importantly because this is an area of very considerable government intervention the research also identifies areas of regulatory failure which impacts on the wish and capacity to provide BTR investment.

The evidence reviewed and used to explore the market and regulatory failures facing the BTR sector included:

- Constraints on access to development finance, with reference to experience of the Build to Rent Fund (now closed) and the PRS Guarantee Scheme, which does not finance development;
- Restrictions and biases in the operation of the town planning system (e.g. Manchester pro delivery case study);
- Constraints on the types of property that can be provided;
- Knowledge limitations, for example conventional housebuilders' and financiers' understanding of the characteristics and attractions of BTR housing; and
- Volatility introduced by more general government policy and particular uncertainties such as those arising from Brexit and currency fluctuations.

Policy Options to address Market Failures

The report sets out a series of BTR public sector policy options, including a "do nothing" option and a "no BTR" option. The alternative policy options include:

- Planning in Principle (PIP) covering accelerated planning treatment for BTR schemes;
- Accepting Discounted Market Rent (DMR) as an alternative to/form of affordable housing provision and the associated point of corporate landlords allowed to manage affordable as well as market housing;
- Flexibility on space standards for BTR;
- Allocation of public land sites for BTR schemes;
- Removal of the stamp duty surcharge for additional homes on professional BTR investors;
- No/reduced VAT on repairs; and
- Concessions/incentives in Housing Zones.

Appraisal Framework – Impacts of Policy Options

The report also sets out an appraisal framework, drawing upon relevant central government good practice guidance. It is structured around the components of the Five Case Model and includes estimation of Benefit Cost Ratios (BCRs). Relevant elements of the Five Case model considered include:

- The Strategic Case: this covers the overall case for each option, including its BCR and Value for Money (VfM);
- The Economic Case: this focuses on the public value and non-market benefits of options, including for example potential for job creation, meeting distributional, social and inclusion objectives etc. It will, as appropriate, estimate additionality (deadweight, displacement, multiplier effects etc);
- The Commercial Case: this focuses on the ability of organisations to access finance and deliver options. It will consider procurement approaches and issues where appropriate (e.g relating to public sector land);
- The Financial Case: this focuses on the impact of interventions on viability and whether those interventions are fundable and affordable; and

- The Management Case: this focuses on the organisational requirements and capacity to deliver of the options, covering both the public and private sectors.

This section explores if and how each of the policy options affects market failure and whether they risk introducing new/further market distortions.

Scenario and Appraisal

The report then appraises the policy options against the appraisal framework. The appraisal includes analysis setting out an assessment of the additionality of BTR supply to overall housing supply as the result of any policy interventions, as follows:

- The known pipeline of BTR projects, using the existing work completed by BPF and the knowledge of key stakeholders;
- Engagement with BTR operators and investors to establish the delivery profile of this pipeline:
    - in prevailing market conditions; and
    - under alternative market and policy scenarios;
- Engagement with BTR operators and investors to establish the potential for additional investment in the pipeline
    - in prevailing market conditions; and
    - under other market and policy scenarios;
- Identification of the extent to which policy interventions might overcome barriers (land value gap, organisational issues, governance):
    - in prevailing market conditions; and
    - under other market and policy scenarios; and
- Interpretation of the analysis to assess the additionality of BTR supply, in particular the extent to which it might displace build for sale supply that would otherwise be developed.

These scenarios are presented within the context of the appraisal framework and overall objectives.

2. Review of Literature and Supply Data

The scope of the literature review is to explore the barriers to expansion of the emerging Build to Rent (BTR) sector, understand the rationale for the various policy measures introduced to encourage expansion to-date and to summarise the most significant variables that determine land value and delivery for BTR.

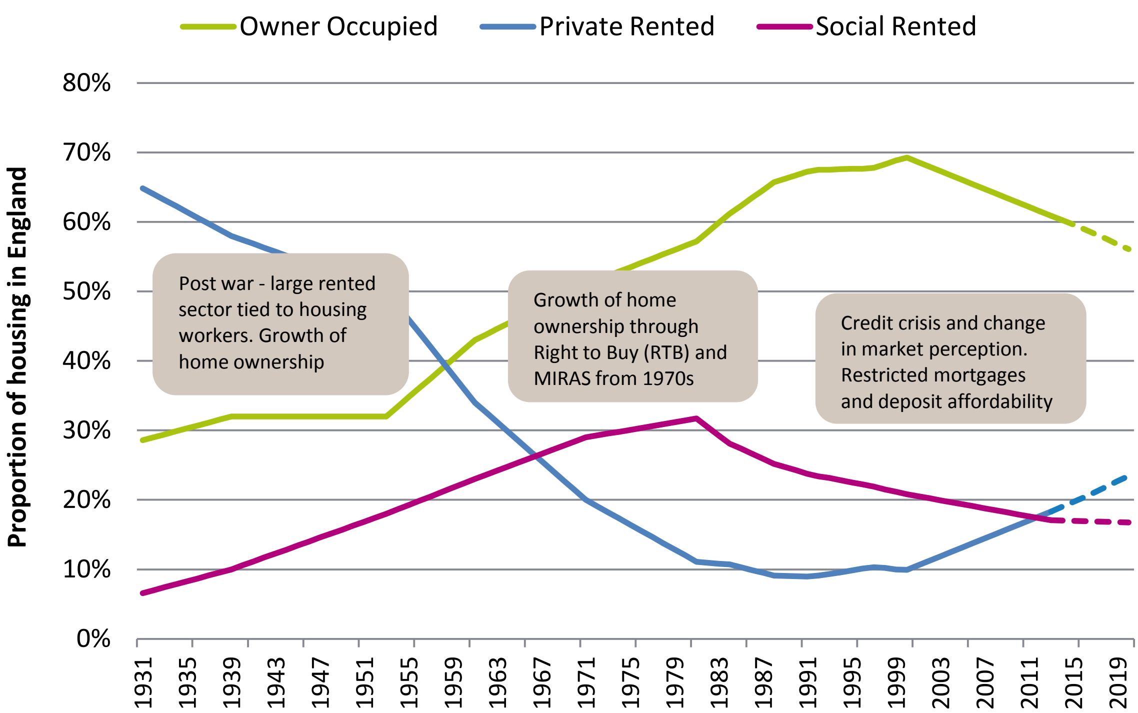
The literature identifies that 'Build to Rent' is the UK term for multi-unit blocks of purpose-built private rented housing that are in single ownership. The term originated in a government programme to foster development of such housing, but is now often used generically to refer to *all* new rented accommodation, whether built under this programme or not. Some documents from 2012 and earlier use the term 'build to let.' International markets where such accommodation is more common use different names: in the USA it is known as 'multi-family units', while in Germany and Denmark there is no specific appellation as the assumption is that most rented flats are in this format.

To help with understanding the scope of BTR and the evolving definition this section of the report also analyses BTR supply identifying the quantum and type of stock entering the market as well as the profile of deliverers, owners and investors.

2.1. Background and History

Private renting was the majority tenure in the UK until after the second world war. After 1918 large blocks of rental flats were developed in UK cities, especially London, many of which were then bought and managed by companies – in some areas with a high proportion of European tenants. In the post-war period, tightening rent regulations made such investments uncompetitive and the buildings were gradually broken up and sold off as individual units (Hamnett and Randolph, 1988) helped by legal changes in the 1960s and 1970s which gave tenants with longer leases the right to buy. Only a small number of these 20th century buildings remain entirely as rentals (e.g. Dolphin Square in London).

Figure 1 – Long Term Tenure Trends in England

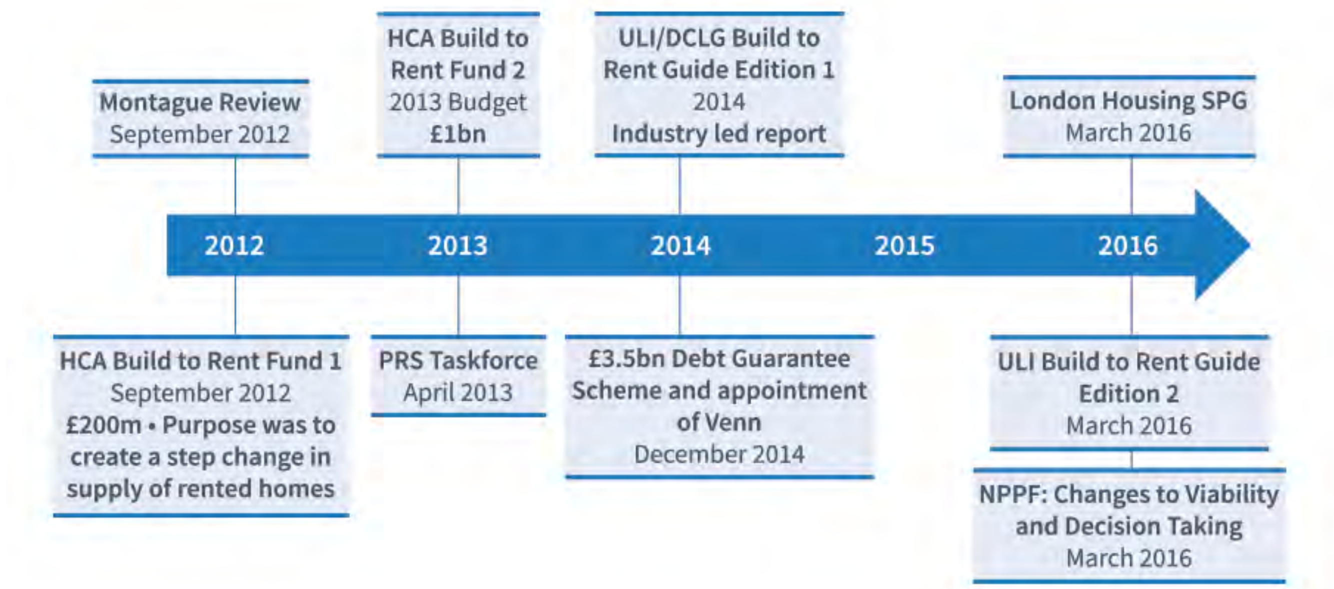


Source: DCLG, Savills

The PRS was in long-term secular decline over most of the 20th century; in fact some commentators, seeing it as an inferior good, expected that it might disappear completely by the end of the century leaving only owner-occupation and social rental tenures (Beckerman and Clark, 1982). However, late in the century there was a remarkable turnaround, spurred by two things: the deregulation of rents and tenancies under the 1988 Housing Act, and the 1996 introduction of Buy-to-Let mortgages for small investors. These provided the conditions necessary for the sector to grow: since 1991, when it accommodated only 9% of UK households, it has more than doubled in size. Some 19% of UK households now live in the PRS. This growth came from the transfer of units from owner-occupation or social rental and new housebuilder stock that was developed as 'for sale' product that entered the market through buy to let investment. There was until recently no new development of purpose built housing for rental.

Attracting institutional investment to the sector became an explicit policy priority at the end of the first decade of this century. Besides benefits for tenants in terms of quality of management and longer leases, large-scale investment in dedicated PRS units was said to enable faster development on individual sites, and to contribute to an increase in the quantum of new housing. The 2012 Montague review pointed out that investors (pension funds in particular) in turn would benefit from index-linked rents in line with their liabilities, and residential investment would offer valuable diversification (Montague 2012).

Figure 2 – Policy Timeline



Source: LSE, Savills

Crook and Kemp identified the economic conditions of 2011 as particularly beneficial to the prospect of achieving more institutional investment into the private rented sector. They looked at two separate government initiatives aiming to attract institutional funding and corporate landlords: the Business Expansion Scheme (BES) and the Housing Initiatives Trust (HIT). The Business Expansion Scheme aimed to attract institutional investment through kick starting individual investment in shares of new private renting companies and the Housing Initiatives Trust aimed to overcome taxation barriers to institutional investment in private renting through creating tax transparency. They found that these attempts to attract institutional funding into the sector were, on the whole, unsuccessful. Barriers to attracting investment still remained and could only be overcome through a substantial shift in tax arrangements surrounding the sector. (Crook and Kemp, 2011).

An institution could in principle assemble a rental portfolio of existing dwellings, and there are a few firms (notably Grainger) that operate on this model – and more that now mix existing and new units. However, in terms of management efficiency and economies of scale it is clearly preferable to have a concentration of properties of the same age and broadly similar finish, with a variety of apartment/home types which whilst not designed specifically for long term rent, do allow some management/maintenance efficiencies. One way to achieve this is by purchasing an entire block that was originally built for sale such as East Village, the former Olympic athletes' village at Stratford, or for social rent. The next step is to build the units specifically for rental purposes. The first developments on this model are now starting to come on-stream and discussed in the following chapter.

2.2. Barriers to Investment

The barriers to large-scale private investment in rented housing in the UK are well recognised, and have been described in a number of policy and academic reviews (e.g. Montague 2012; Scanlon and Whitehead 2013). The main issue is 'viability' - that is, the difficulty developers have in competing for land against owner occupation and other uses. In the UK there is no separate planning use class or zoning for private rented property, so any site suitable for residential development could be used either for homes for sale or homes for rent. Since the price of development land is a residual sum (the amount remaining after construction cost and profit), the price will be determined by the highest-value use of the land. Selling units to owner occupiers almost always produces higher values than PRS use which is generally calculated by the capitalised value of the rental income, so developers of purpose built PRS often find it difficult to compete against for-sale developers in the open market for land (Scanlon and Whitehead 2013; IPF 2015).

One way of reducing the land price and thus enabling BTR development is for public sector owners to provide land at below-market cost; in return for this implicit subsidy there is usually a covenant requiring the developer or operator to maintain the property as rental for a specified period (e.g. 10 or 20 years). A variation is for the public-sector landowner to enter into a joint venture with a BTR operator. Other barriers include:

- access to suitable stock from credible delivery partners;
- low risk-adjusted yields, plus the fact that returns are often in the form of capital growth rather than rental income;
- resulting low headroom for S106 contributions, even on fully market-rent schemes (IPF 2015);
- lack of investor experience in the sector together with the very limited performance data on which to base decisions and particularly lack of internal benchmarks within organisations;
- the need for scale - institutional investors are generally interested in transactions worth a minimum of £10m and preferably £50m. The latter figure would imply a 250 unit scheme, if each unit were worth £200,000 (although clearly fewer units in central London);
- negative investor and local government attitudes to the sector;
- poor quality and expensive management with uncertain management costs into the future;
- reputational risk;
- uncertainties around the regulatory and taxation regimes; and
- some investor mandates within financial institutions do not include residential property.

The lack of private finance for development was seen as particularly problematic a few years ago (Scanlon & Whitehead 2013), but is reportedly now less of an issue. Institutional investors may not see this as an issue as they rarely use debt. But the lack of debt capital in the market does restrict delivery via aggregators or those developers looking to replicate other comparable markets (e.g. student / hotels) where best value can be achieved by proving returns over the leasing / stabilisation period.

Investor attitudes are affected by their lack of experience and expertise in the sector and the paucity of data available to provide the necessary empirical basis for decision-making. To the extent that senior management sees important opportunities for steady income growth, there is an incentive, especially for pension funds, to overcome this inertia. International investors are seen as a potential source of funds because of their greater experience in the sector - but equally they require there to be interest from local investors. The availability of data is a chicken-and-egg problem that has yet to be effectively addressed.

Most importantly, investors in the main are looking for sensible risk adjusted return while experience is being built up. The UK Government's private rental debt guarantee scheme applies to the investment finance secured against the asset rather than a guarantee of income. So although it helps to reduce the overall risk of the investment which should favourable impact on the cost of investment finance it does not directly address the issue of the need for security of income.

An important issues for investors is the cost and risks associated with management - which determines the gap between gross and net yields. The very limited evidence available suggests that management costs are relatively high, and the professional PRS management platforms that do exist are still in their infancy. Again, there are good international examples but very limited experience in the UK.

More general risks, such as those to do with reputation and regulatory and policy change, are not directly measurable and can best be reduced by experience of stability and success.

Each of these barriers need to be addressed directly. The solutions must clearly improve expected yields and/or reduce perceived risk (although it is worth noting that declining yields in other sectors and macro investment products such as gilts, greater familiarity with the product have increased investors' preparedness to experiment in this sector). Moreover, the result needs to be a coherent package; modifying individual elements without thought to other barriers can have perverse effects. The most immediate new build issue is to ensure that land is available where developers will wish to provide rented housing, probably within mixed-tenure developments. Most of the mechanisms involve the use of public land and leases and 'covenants' to ensure long-term rental.

2.3. Specific Policies and Programmes

A number of policies have been introduced over the last decades in an effort to encourage greater institutional investment in the private rented sector. The desired involvement was not limited to Build to Rent; indeed programmes such as Housing Investment Trusts and REITs could in principle be used by firms that acquired existing rental portfolios or assembled their own from existing stock. The major programmes are listed in Table 1.

Table 1 – Major Programmes Aimed at PRS Investment

Programme	
Business Expansion Scheme (1983-1993)	Gave tax incentives to private investors who provided venture capital for unquoted companies, initially for a minimum of five years. It was not targeted specifically at housing or the property market, but in 1988 the Government chose the BES as a means of underwriting landlords' risks and encouraging the revival of private renting by extending its provisions for a limited period to companies letting residential property on assured tenancies (Hughes, 1995). The biggest success story—though not intended by the government--was purpose-built student accommodation, which accounted for about 40% of BES-sponsored units. Supported by BES and de-risked by universities and housing associations, it provided guaranteed long-term income growth for institutions. It is now a successful unsubsidised market-based product.
Housing Investment Trusts (1996)	HITs were established in 1996 to provide vehicles for financial institutions to invest in the private rented sector, but none were ever established. The trusts were not fully tax-transparent, the rules governing them did not reflect the normal operating practices of property companies, and the diffuse structure of the PRS at that time was also an obstacle (Crook and Kemp 2002).
Real Estate Investment Trusts (established 2007; rules revised 2012)	In 2012 the Government changed the rules around REITs in order to encourage the establishment of new REITs, notably residential REITs. These changes included the elimination of the requirement that REITs have full Stock Exchange listings and the abolition of the 2% conversion charge on assets. Even after these changes, though, few residential REITs were established.

The Montague Report in 2012 identified a number of barriers to the expansion of the sector. In response the Government appointed the PRS Task Force and introduced a series of measures to encourage expansion of the institutional PRS (as opposed to the small landlord sector). The idea is that support would be provided during the early, experimental years of the industry, then gradually be withdrawn as the model is shown to work profitably (as with student housing under the BES). These policy measures are set out in Table 2.

Table 2 – Recent Policy Measures

Policy measures	
Change in Stamp Duty Land Tax for bulk purchases (2011)	SDLT was until 2015 a 'slab' tax and the highest rate applied to transactions worth over £1.5 million. This meant that multi-unit transactions (of, say ten units making up an entire building) would almost inevitably incur tax at the highest rate. This rule was changed in 2011. Bulk purchasers of rental units can now pay SDLT on the average price of each unit, rather than the total sum, or elect to have the transfer of six or more dwellings in a single transaction treated as a commercial purchase subject to a flat tax rate of 5%.
PRS Task Force (2013-2015)	A two-year secondment of property professionals to DCLG, now finished. In response to Montague, who said civil service did not have required skills in institutional investment, development finance, land use planning, property management and ability to broker deals (House of Commons 2013/14). The task force was disbanded in early 2015 and replaced by a PRS 'champion' within DCLG.
Build to Rent Fund.	£200m (later increased to £1bn) of equity or debt finance for builders and developers for large demonstration projects of purpose built PRS, with the goal of 'showing the viability of the build-to-rent market and increasing investor confidence' (House of Commons 2013/14). Eligibility: schemes of 100+ units
PRS Debt Guarantee Fund	Approx £3.5 billion in Debt Guarantee for purpose built PRS; goal to reduce cost of investment finance for borrowers. Potentially covers the principal and interest for up to 30 years, on commercial terms because of EU State Aid restrictions.

Source: Savills, LSE

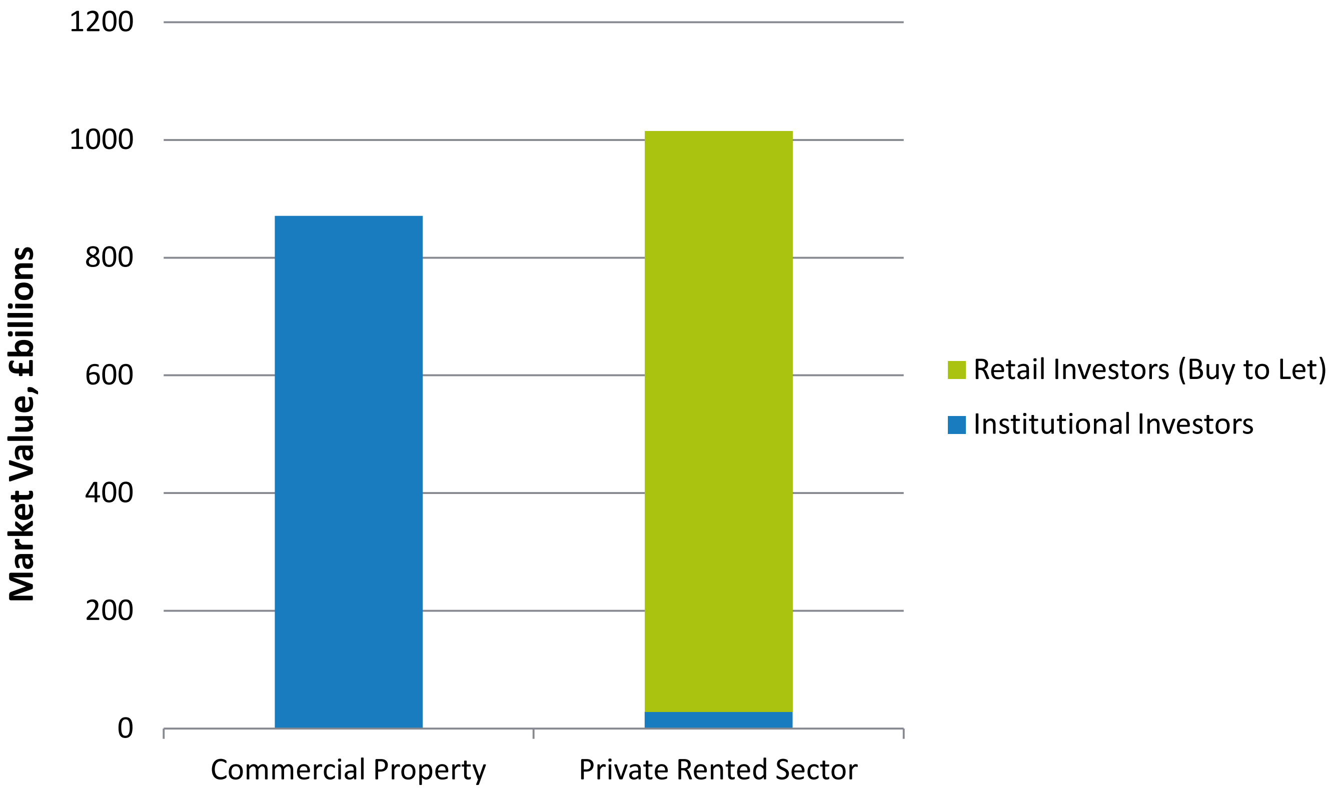
In addition to these policies to encourage expansion of the institutional PRS, the government has over the past 18 months made the tax treatment of private landlords significantly less favourable. Most of the changes apply only to individual (not corporate) owners. A new supplementary Stamp Duty Land Tax of 3% for residential purchases that are not a primary residence must be paid by all landlords. Mortgage-interest tax relief, formerly available to individual landlords at their marginal rate of tax (up to 45%), will from 2017 gradually be reduced to a maximum rate of 20% and calculated somewhat differently. Wear-and-tear allowance on furnished accommodation, formerly an automatic 10% of rental income, is now limited to actual expenditure on replacement furnishings (Scanlon et al 2016).

2.4. Market Size and Potential

The private rented sector (PRS) in the UK is mooted to be worth over a £1 trillion with the vast majority of landlords in the market (98%) owning less than 10 properties. As a result, there is a significant lack of aggregated investment stock available for institutional investors to acquire. Many new investors therefore have a strong focus on the development of new build to rent assets where they have the opportunity to influence the design, mix and specification in an effort to ultimately enhance investment returns from completed and operational stock. However, in its broadest sense the PRS incorporates all things privately rented and BTR is a subset of the wider market. Investors invest a wide range of different types of market rented housing, including:

- 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 (also referred to as Multifamily) [i.e. bespoke designed] developed directly by investors;
- Build to Rent (also referred to as Multifamily) delivered by housebuilders/investors, forward funded by investors;
- Build to Rent (also referred to as Multifamily) 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.

Figure 3 – Size of Market Rent Sector



Source: IPF (2015), The Size and Structure of the UK Property Market

Unlocking the Benefits and Potential of Build to Rent

This is a new product for the UK, particularly in the mainstream markets, and takes many of the ideas from the US multi-family market. In essence, the UK market is creating institutional grade assets in the residential sector driven by the strong underlying supply/demand fundamentals in the housing market and the desire by institutions to access returns linked to earnings.

Coupled with these drivers, is the rising demand for professionally managed, purpose-built rental housing. This is due to the increased quality of service provided by purpose-built and managed schemes, the opportunity to live in a newly constructed property, and access to amenities and concierge services. It is also due to a perception that small-scale landlords may manage their properties less professionally or maintain them to a lower standard.

According to recent research by the Investment Property Forum (IPF), institutional investors hold c.£17bn of market rented assets (excluding student). Given the rising number of investors gaining exposure to the market we expect this to grow substantially over the next 10 to 15 years as the market starts to gather momentum.

In terms of the future potential of the market, the supply data shows that there is potentially £13bn of assets in the pipeline in London and £4bn across the rest of the UK. Compare the value of this pipeline to the potential requirement to accommodate future growth in the rented sector (1.1m households across the UK over next 5 years), this produces a potential for the delivery of c. £300bn of residential assets based on the average value of flats in London and the rest of the UK. The very large gap between supply and demand is a key reason why investors are seeking to invest in residential.

2.5. Build to Rent Supply

The analysis has focused on schemes of over 50 units. In total 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.

Planning portals such as Molior (London) and Glenigan's (UK) include descriptions of the type of residential stock delivered. In terms of PRS, there were four commonly used typologies including:

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

Table 3 – Total PRS Supply by Type and Status (over 50 units)

Status	Retained for PRS	Purchased for PRS	Build to Rent	Totals
Complete	3,296	3,180	1,330	7,806
Under Construction	5,199	1,471	8,469	15,139
In Planning	5,045	2,087	25,395	32,527
Totals	13,540	6,738	35,194	55,471

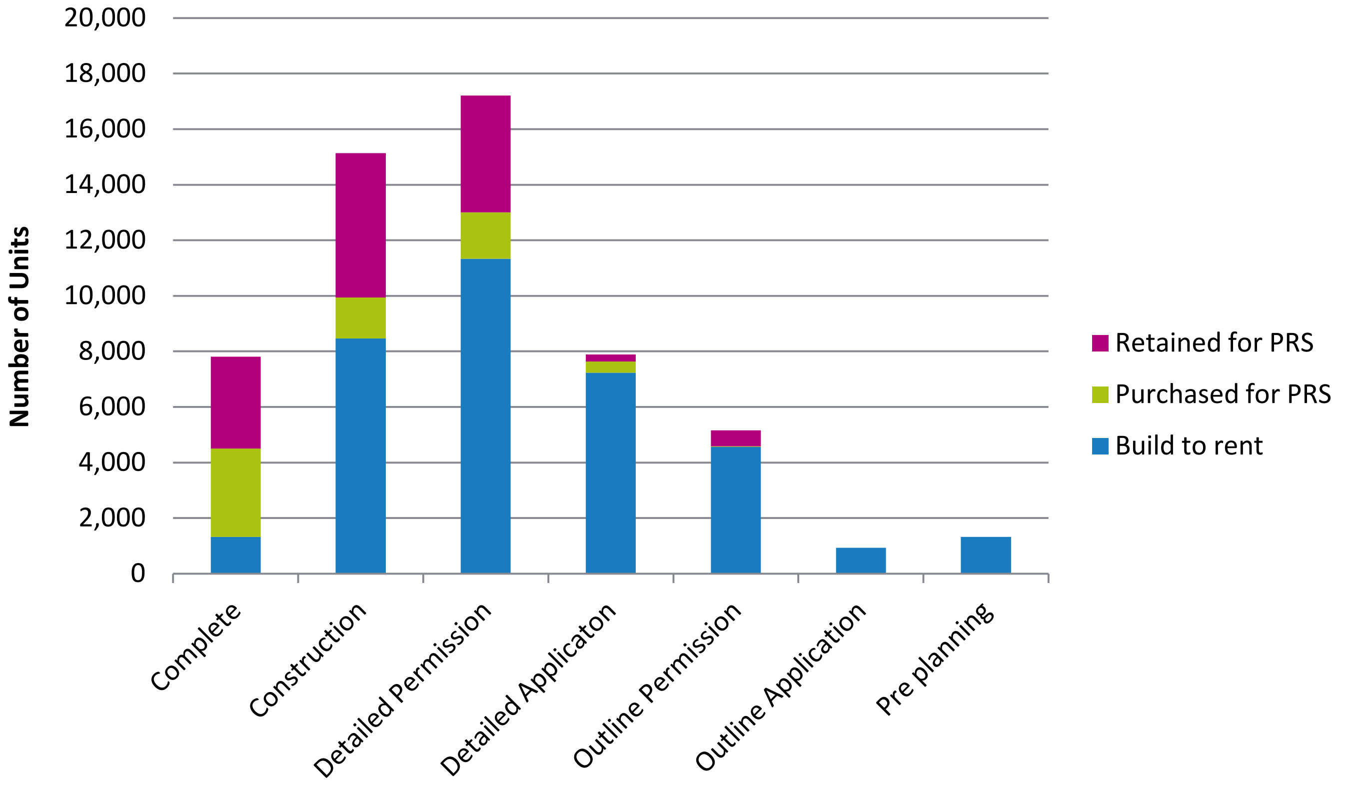
Source: Molior, Glenigan, BPF, Savills

At this point in the market, more traditional approaches to PRS are still the most prevalent forms of PRS delivery. As shown in Figure 4, in terms of completed PRS units, of the c.7,800 units completed approximately c.40% have been retained for PRS by the deliverer (not build to rent) and 40% have been purchased for PRS or forward purchased by the investor. Schemes purchased for PRS are considered build to rent 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 they are schemes that were originally intended for the build for sale market. There have been c.1,300 units (20%) delivered using a build to rent approach (i.e purpose built and intended for PRS use) including those funded by the HCA Build to Rent 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 build to rent as both purchased stock and purpose built stock, delivery is therefore in excess of c.4,500 units.

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

Figure 4 – PRS units by development status and PRS type, England and Wales



Source: Molior, Glenigan, BPF, Savills

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

As more and more purpose-built PRS stock emerges, we can also expect to see a shift in the key deliverers and funders in the market. What is clear from the analysis of the planning/supply data, is that investors are using a variety of approaches to build up scale in the rented sector. Taking the descriptions that have been used in development and planning databases such as Molior and Glenigan, Table 4 sets out the delivery approaches or typologies that have been used. The commonality or similarities across the different types of stock is that the rental supply is all new, multiple units, in single ownership and professionally managed.

Table 4 – Approaches to PRS

Private Rented Sector			
Retained for PRS	Build to Rent (HCA Funding)	Purchased for PRS (inc. Forward Purchase)	Build to Rent (inc. Forward Funding)
▪ New ▪ Multiple units ▪ No minimum size ▪ Large scale investor (RP, Institution, Private Investor, Private Company, PLC) ▪ Not necessarily purpose built ▪ Could be multiple units in different blocks/phases of development ▪ AST contracts with potential to offer longer tenancy options.	▪ "New...quality purpose built homes for the private rented sector, with strong consideration to build, management and lettings" (HCA). ▪ Large scale ▪ Long term ▪ Attractive to institutions ▪ Clear exit strategy ▪ Single or multiple sites ▪ 100 unit minimum size ▪ Private rent at market rents only ▪ AST contracts with potential to offer longer tenancy options.	▪ New ▪ Multiple units ▪ No minimum size ▪ Large scale investor (RP, Institution, Private Investor, Private Company, PLC) ▪ Not always purpose built ▪ Generally blocks/unbroken investments ▪ Single phase of development ▪ Risk sits with deliverer ▪ Little control over design and product ▪ Purchased before or during construction ▪ AST contracts with potential to offer longer tenancy options.	▪ New ▪ Multiple units ▪ No minimum size ▪ Large scale investor (RP, Institution, Private Investor, Private Company, PLC) ▪ Purpose built for PRS ▪ Blocks/groups of houses, unbroken investments ▪ Single phase of development ▪ Risk shared between deliverer and funder ▪ More control for funder over design and product ▪ AST contracts with potential to offer longer tenancy options.
	Build to Rent		

Source: Savills, Molior, Glenigan, BPF

Table 5 sets out some examples of PRS schemes that have been included in the planning and development databases against the descriptions given. Many of these schemes are considered build to rent but they have not been described as build to rent in these databases. For example, East Village which is 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. Moreover, following the acquisition it was then retrofitted for the PRS market.

Table 5 – Examples of Schemes by Typology

Private Rented Sector			
Retained for PRS	Build to Rent (HCA Funding)	Purchased for PRS (inc. Forward Purchase)	Build to Rent (inc. Forward Funding)
▪ Stratford Halo, Genesis ▪ CQ London, A2D ▪ Dolphin Square, Westbrook ▪ Saffron Square, Notting Hill	▪ Centenary Quays, A2D ▪ 3 Towers Manchester, Tribe ▪ Archway Tower, Essential Living ▪ Portfolio in Birmingham, Leeds and Manchester, Dandara ▪ Newfoundland, Canary Wharf Group	▪ 180 Stratford, Aberdeen ▪ Wick Lane Wharf ▪ East Village, Delancy, Qatari Diar & APG ▪ Royal Wharf, L&Q ▪ Rathbone Market - Phase 1 – Vermilion, Fizzy Living ▪ West Plaza, A2D ▪ Epsom, Fizzy Living ▪ Abbeville Apartments, Grainger	▪ Rehearsal Rooms, M&G ▪ Redclyffe Road, M&G ▪ Aberfeldy New Village, Be:here ▪ Clippers Quay, Grainger
	Build to Rent		

Source: Savills, Molior, Glenigan, BPF

There are a total of 12 completed purpose-built build to rent schemes across the UK, comprising c.1,300 units as shown in Table 6. In London these schemes comprise a total of 555 completed purpose-built build to rent units largely in East London in Tower Hamlets and Barking. Outside of London, delivery of PRS units as purpose-built build to rent 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 build to rent operational model.

East London 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 new 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 making 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.

Table 6 – Completed Build to Rent Schemes, England and Wales

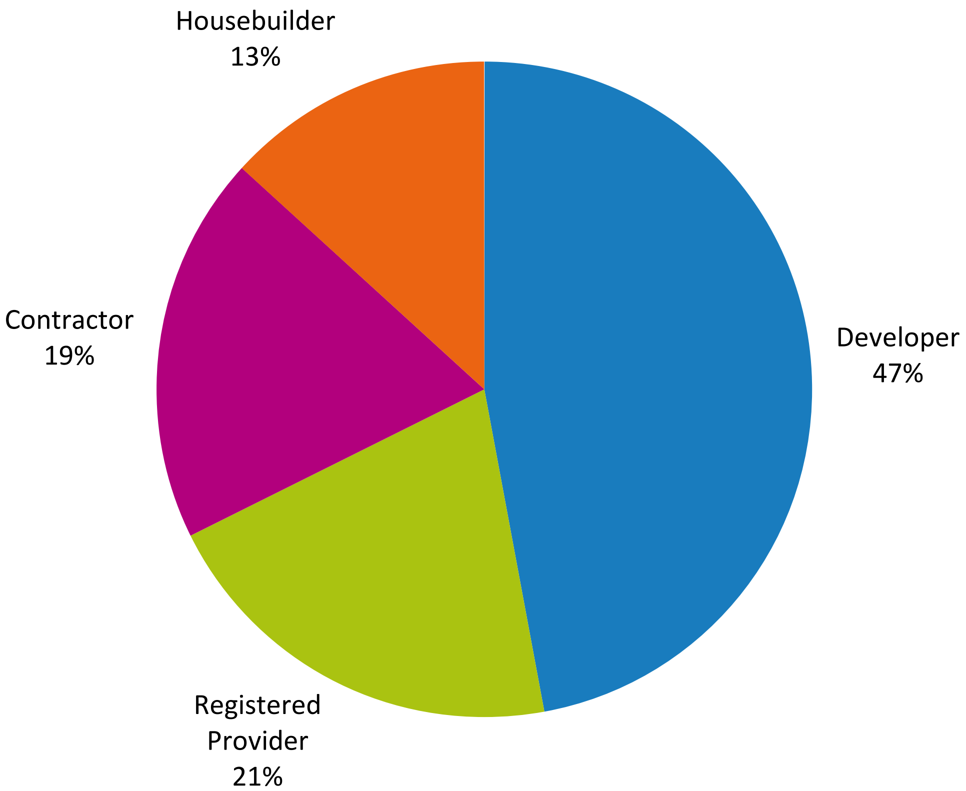
Scheme Name	Location	Primary Player	PRS Units
The Keel	Liverpool	Glenbrook Property	240
Bradstowe House	Harrow	Comer Homes	177
Aberfeldy New Village	Tower Hamlets	Be:here	138
Norris Green	Liverpool	Diffrent	132
New Broughton	Salford	Diffrent	120
Abbeville Apartments	Barking and Dagenham	Grainger	100
Bath Western Riverside	Bath	Crest Nicholson	97
Enid Wood House	Bracknell	Criterion Capital	97
Broadway Place	St Helens	Diffrent	89
St Andrews	Barking and Dagenham	Taylor Wimpey	56
Ipsus	Wandsworth	Realstar	52
Lincoln Plaza	Tower Hamlets	Galliard Homes	32

Source: Molior, Glenigan, BPF, Savills

The remainder of completed PRS schemes have been delivered for different uses and subsequently 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.

The key landlords of completed schemes include the 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.

Figure 5 – Completed PRS Schemes by Type of Deliverer, England and Wales



Source: Molior, Glenigan, BPF, Savills

Developers are the leading players in the delivery of PRS having supplied almost half of all completed schemes. The majority of these schemes comprised of units originally planned for market sale which were subsequently purchased for the rented sector. More traditional approaches to PRS have allowed developers to play a key role in the sector. Going forward, there is a much higher number of units planned as BTR units and being delivered on behalf of investors.

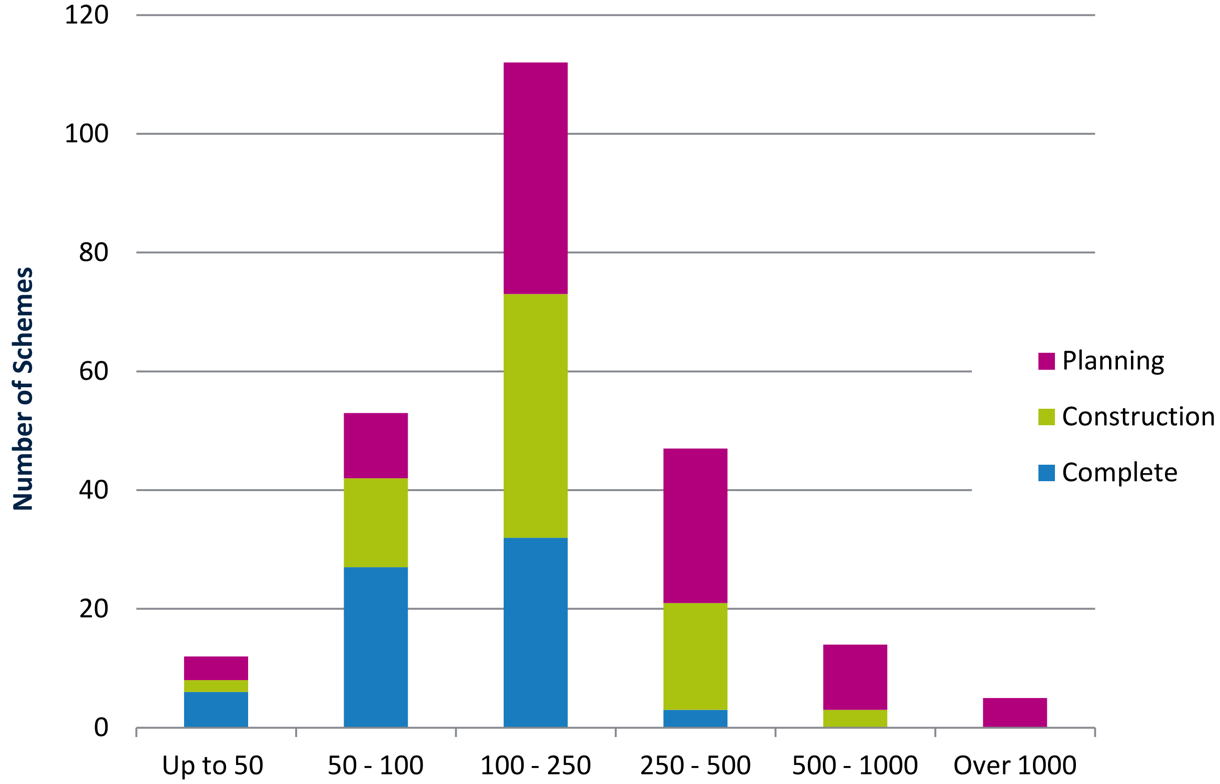
In terms of scale of delivery, few completed PRS schemes have had more than 250 units. Developments which are under construction and in the planning pipeline are beginning to get larger, with developers and regeneration specialists starting to allocate blocks and phases to PRS. All developments looking 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 build to rent schemes currently 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 build to rent 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 which are currently under construction. Developers are the predominant source of stock because they tend to analyse opportunities / risk / returns on a site by site basis, and are often funded on that basis, which often makes a de-risked, funded forward sale a good option (assuming the price is viable).

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

The largest proposed volumes build to rent units are sat within wider strategic sites like Barking Riverside, Brent Cross Cricklewood and East Village. Whilst 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. In London, this figure rises to 14%].

Figure 6 –Total number of schemes and units by scheme size, England and Wales



Source: Molior, Glenigan, BPF, Savills

There are a handful of precedents of BTR schemes being delivered with Discounted Market Rent (DMR). DMR is considered the best affordable product to sit alongside build to rent 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 of choice. The units in the development remain at DMR for a defined period and may revert to being a Private Sector Unit at full market rent.

DMR is more flexible that other options due to the ability of tenants being able to ‘staircase’ between rents. For example, this might involve a tenant’s salary being reviewed every five years and if the tenant has a lower or higher gross income than when their salary was originally assessed, and hence have moved income bands defined by a local authority, they would 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 consistent for the whole of the agreed covenant. The following example illustrates how it has worked for LB Greenwich and Essential Living at the scheme in Creekside. Essential Living proposed to the Royal Borough of Greenwich that 25% of the 249 apartments will be let at DMR, with a proportion of these units being offered at 55%, 65% and 75% of Open Market Rent as shown below.

Essential Living, Greenwich Creekside

Unit type	Rent PCM		
	55% of OMR	65% of OMR	75% of OMR
1 bed	£800	£950	£1100
2 bed	£1100	£1200	£1300
3 bed	£1200	£1400	

Source: Essential Living

2.6. Build to Rent Management

The management of build to rent is becoming more professional driven by the requirements of investors. Passive investors such as the pension and insurance companies, require sophisticated management approaches. Recent research by the Investment Property Forum (IPF) set out the types of management being used. It concluded that management is not a hurdle for growing the sector and that the demand for professional management has driven an expansion in the sector. The IPF identified that the management of BTR breaks down into a number of core functions for large scale investors as shown in Table 7 .

Table 7 – Professional Management Core Functions

Owner/Investment Manager	Asset Manager	Property Manager
Overall Portfolio Strategy Acquisitions Disposals Key Portfolio Actions Reporting Annual Budgets	Supervise Property Manager Identify/Manage Refurbishment Control Expenditure Set Letting Policy Set Health & Safety Policy	Let & Interact with Tenants Manage Income & Expenditure Manage Regular contracts Maintenance Hold Tenant Deposits Manage Arrears Implement Health & Safety Policy Financial Reconciliations

Source: IPF, 2016

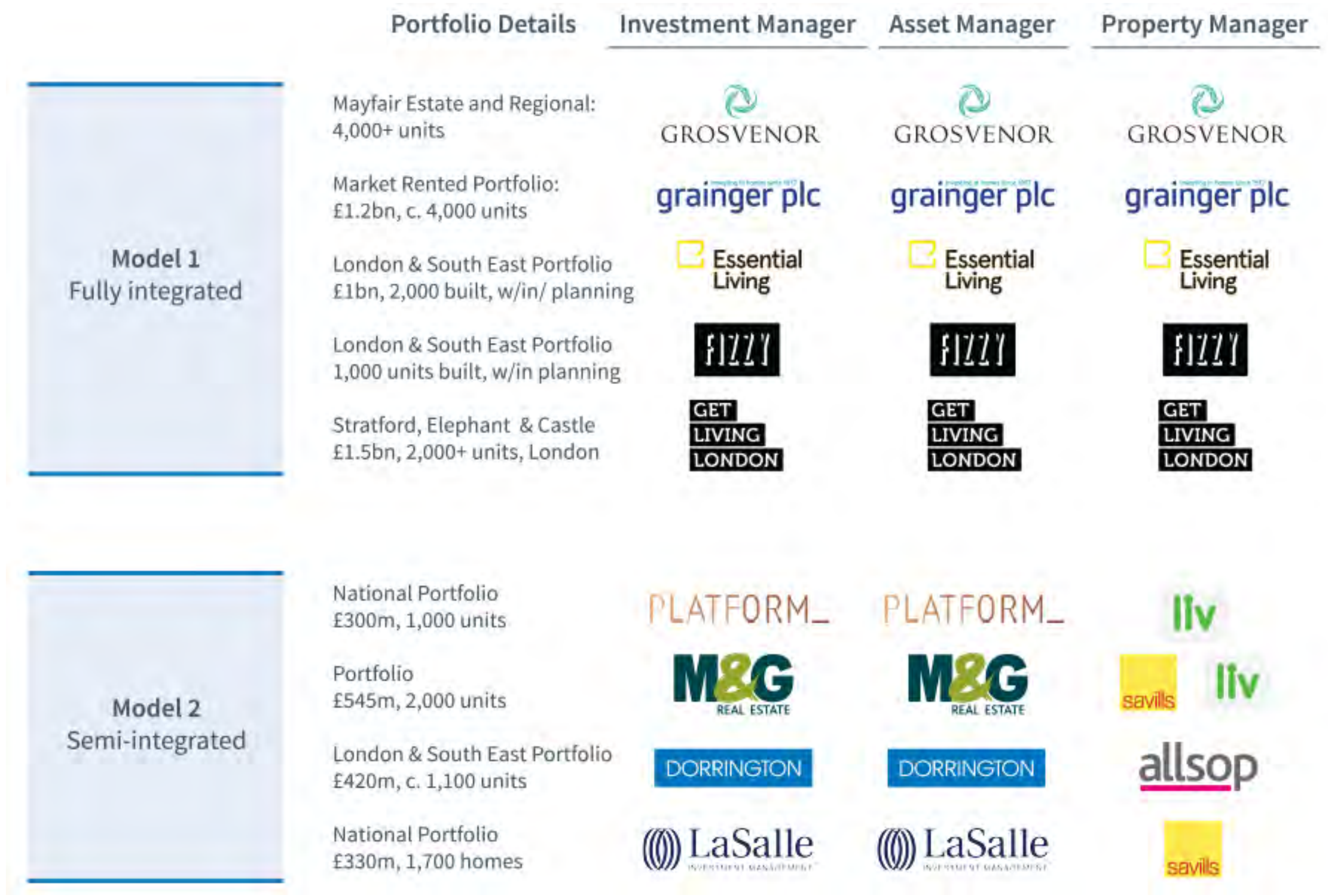
Investors vary on how they separate these responsibilities, with some doing everything in-house which the IPF termed the 'integrated model' while others divide up the responsibility and run a 'semi-integrated' model as shown in Figure 7.

Figure 7 – Emerging Management Models for Build to Rent

Source: IPF, 2016

Figure 8 illustrates how these companies are resourcing the different functions and responsibilities and provides evidence that management within the sector is becoming much more defined and professionalised. An important point to note, is that often these landlords do not charge in the same way as the broader buy to let market. Instead of charging letting fees and separate property management fees, property managers are paid based on the size of the net operating income received by the investor. This means that property managers are incentivised through the way they are remunerated to retain tenants and keep tenants happy through good service. This is an important distinction from other types of PRS and it is one of the mechanisms that is professionalising the sector and improving the service to tenants.

Figure 8 – Illustration of Management Models

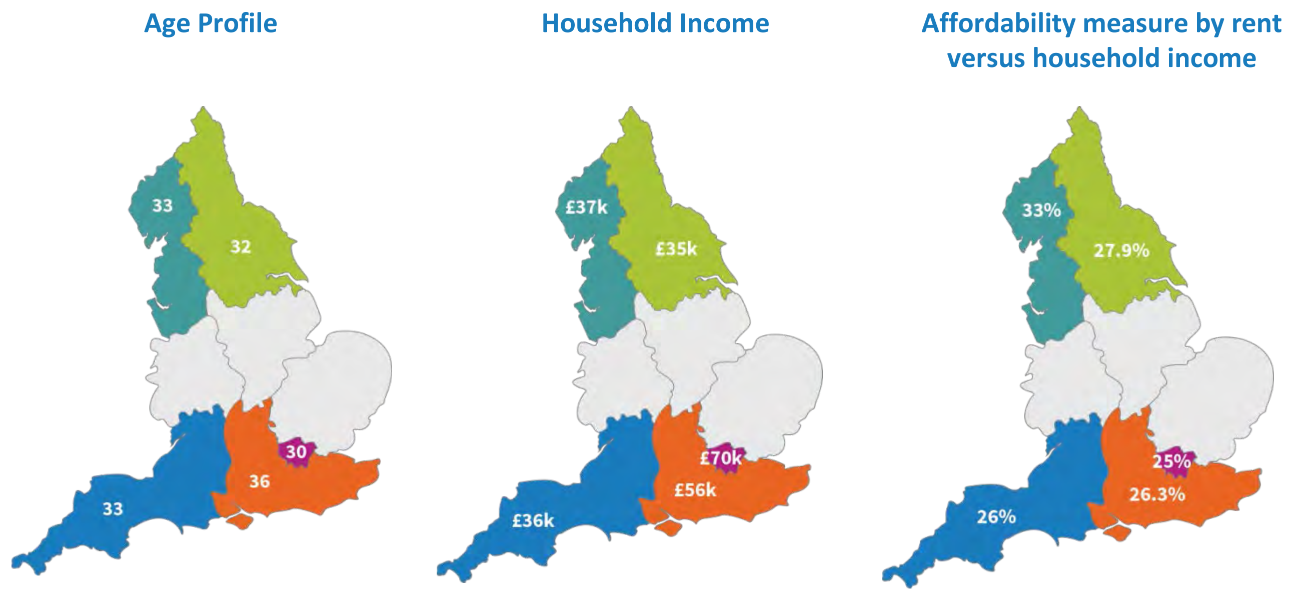


Source: IPF, 2016

Also worth noting from Figure 8 is that the vast majority of companies shown are targeting the mainstream rental market. It is important to highlight the type of consumers that use the product. A survey of members of the BPF provided information on their tenants in regards to age, household income and affordability measured by the rent as a proportion of household income.

BTR although it is generally high-quality, is predominantly not high-end. Recent evidence shows that a quarter of occupiers at Grainger's Abbeville scheme in Barking and Get Living London's East Village scheme in Stratford originate from the local market indicating that rents are accessible to local residents. As shown in Figure 9 most BTR rents fall into the 33% or less of household income bands. The main reasoning behind this is that operators want to retain their tenants because they only receive the target return if apartments are full rather than vacant and unoccupied.

Figure 9 – Tenant Profile of Large Scale Landlords



Source: BPF Residential Landlords

2.7. Market Prospects

Both the US multifamily market and the UK student housing market took 15 to 20 years to emerge as an established asset class. In the UK, it is likely that it will take at least 10 years before there is significant rental stock at scale in institutional ownership. An important comparison is with the UK student market where universities effectively helped to de-risk the sector for investors during its nascent phase through nomination agreements. A nominations agreement provides a level of certainty over gross income, and its value is variably priced against the covenant strength of the lessee, and the nuances of nominations agreements. A nominations agreement is not generally as robust as an FRI lease - it simply sets out a Universities obligations to endeavour to fill a block (or an element within) with its students at pre-agreed rates. Operational costs still remain with the operator. This structure provided investors with some certainty around levels of demand and occupancy. In the BTR market there is no such certainty around rental income and occupancy so it may take longer to get established as an asset class.

Developing new stock for private rent is a relatively new feature of the UK residential investment market – at least post WWII. It is a response to the weight of institutional capital seeking investment grade assets and the limited supply of good quality stabilised portfolios for investors to acquire. It is also a result of the recognition that delivering a customer focused service to PRS tenants requires some variation to design and construction of residential buildings from the traditional for sale product.

For larger, institutional investors, gaining exposure to the UK residential market in its broadest sense is likely to see various investment strategies and approaches being deployed. In simple terms, this can be achieved through developing bespoke buildings on an asset by asset basis. This does, however, take time and require appropriate resources and skills to identify, negotiate and transact in a market that has largely delivered housing for development sales.

Aggregators of PRS stock are also increasing in numbers with the likes of Essential Living, Westrock, Sigma, ModaLiving/Apache and others, where we may find, that once developed and stabilised, these portfolios will be sold to the institutional market through large portfolio sales or corporate transactions.

3. Stakeholder Consultation

This chapter of the report sets out the themes that emerged from the interviews and roundtables with stakeholders involved in the build to rent sector. The stakeholders fall into the following categories:

Delivery	Investment & Finance	Management	Policy	Others?
Build to rent operators	Banks	Housing associations	DCLG/HMT	Architects
Housebuilders	Pension funds	Private sector	Local authorities (Officers/Members)	Designers
Developers	Fund managers	Public sector	Public sector land owners	Planners
Contractors	Private equity		GLA	Agents
Development managers	Sovereign wealth			Legal/professional
Housing associations	Property companies			Valuers
Private land owners	Family offices			
	Charities (Dolphin Square)			
	Housing associations			
	Local authorities			
	Capital markets advisors			

3.1. Summary of Stakeholder Engagement

The stakeholder engagement identified a number of challenges that impact on the build to rent sector including:

- First and foremost, the need for a definition of what constitutes BTR. A definition would be helpful for planning, taxation and management purposes and may need to vary depending on its purpose. For example, for planning purposes, a definition would be helpful if it was used in negotiations concerning the provision of affordable housing and covenants lengths.
- Discounted market rent (DMR) is considered by the industry to be the most appropriate form of affordable housing provision for schemes delivering private rental units using a build to rent approach because it delivers a tenure blind unit that can be seamlessly managed.
- Scale is important to the definition of BTR because of the proportionate risk associated with large schemes and also in terms of the level of affordable housing provision.
- Covenant restrictions are an important tool because the clawback can be priced into an investor's / developer's cashflow. It gives certainty to local authorities that the intention is not to break-up and sell the scheme unit by unit within a specific timeframe. Where public sector land is concerned, if the land is brought to the market for sale with a potential covenant attached, it reduces the competition from the build-for-sale market.
- Taxation is generally higher for BTR than for owner occupiers. Stakeholders argue that on like for like schemes, development of owner-occupied schemes tends to outbid BTR so attributes of the sites / target consumers have to vary if BTR is to win.
- BTR is essentially a delivery approach – it refers to how the scheme is being operated and managed.
- The finance provided by the HCA and others for development is considered highly important. One of the key issues is the general market failure in the debt capital markets for the build and hold strategy (where pre-sales are obviously impossible).
- Stakeholders noted that both the debt guarantee scheme and the HCA BTR funding should be more closely aligned and used in a more targeted way.

- Acceleration is considered a route to additionality as long as it leads to more land coming forward, generates higher levels of housing output and the consented pipeline of land suitable for development is maintained. Other additionality benefits include the ability to unlock sites, intensification of sites, accelerated market absorption on large sites, placemaking and regeneration benefits, improved management and service to tenants, on-site job creation and flexibility for occupiers.
- There is a requirement for more flexibility in planning regulation with respect to car parking, design and space standards, This was considered one of the most important and effective way to get more units delivered.
- Where a discount is applied by investors to the price of stock bought in aggregate numbers the price reflects the "wholesale" price. This price is derived through a calculation set against their yield requirements, not simply because they want a discount. Retail sales to owner occupiers and individual investors will achieve higher values, but rates of delivery are directly impacted by rates of sale. BTR can achieve a quicker delivery rate but the fact that large number of units are being bought in bulk (wholesale) is reflected in a lower price.
- The discount also reflects the higher cost of management. Where an investor has large numbers of units (thousands), professional management is a necessity and this costs more than the buy to let investor will typically have to pay and more than the consumer is willing to pay. Rents can not necessarily be pushed higher to absorb the higher management cost.

3.2. Definition of Build to Rent (BTR)

A key finding from the stakeholder workshops was that policy requires a clear definition of build to rent to help provide certainty for planning negotiations and to help provide certainty for investors (used in its broadest sense) 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 s106, this would greatly improve the viability of the scheme and thus their ability to be more competitive on bidding for potential opportunities. For example, this was expressed as "we need a definition to inform policies that make a difference for the BTR sector, including concessions in planning policy and legislation."

Since the publication of the Greater London Authority's SPG there are a number of precedents of BTR being delivered with discounted market rent 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, can programme repair and maintenance of a building without having to negotiate with a third party that manages the affordable units and, importantly, they can quantify the cost of repaying any preferential treatment that the scheme has received in lieu of providing s106 as discounted market rent.

Stakeholders stated that "in planning terms, length (of covenants) doesn't matter. The period of the covenant is only relevant to the repayment of the affordable should there be a case for recovery". The mechanism that works in the United States is that "the restriction or covenant is connected to the finance, so you can buy yourself out of it if the market changes before the end of the covenant". Being able to quantify this cost adds certainty and improves viability.

Stakeholders also noted that "a definition would be beneficial for tax purposes". There is a number of tax issues that disadvantage BTR, including VAT on repairs and maintenance and higher rates of stamp duty land tax. VAT on repairs and maintenance acts as a disincentive for landlords/investors to undertake maintenance and repairs because they cannot recover the VAT unlike in commercial markets.

It was highlighted that the higher rates of stamp duty land tax (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 for 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. “Scale is fundamental within the definition because there are different levels of risks associated with different sized schemes”. “Scale comes into the definition of BTR when you start thinking about Affordable Housing”. “A scheme should have at least 50 units to qualify as BTR”.

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 (houses versus apartments). “The definition of BTR should not include a physical building type”. “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 and make BTR more competitive in circumstances where the covenant (a restriction on use) brings with it other planning concessions to enhance viability. One point that has emerged from the stakeholder work 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.

3.3. Financing Build to Rent

PRS investment and BTR development is funded in a variety of ways. Passive capital investors such as the institutional investors (for example M&G, L&G, Invesco, AIG, LaSalle) tend to be less reliant on debt markets and fund investment mainly with equity from their investors.

However, active capital investors and operators (such as Greystar, Essential Living, Fizzy or Realstar) and developers (such as Hub or Muse) are much more reliant on development debt to deliver schemes, many of which are very cash intensive and large. The stakeholders identified four key problems to do with access to finance for the build to rent sector including:

- the capacity of the debt markets to lend;
- the nascent nature of the market;
- the track record of the borrowers and the assets; and,
- the scale of the assets.

Recent changes to the legislative and regulatory environment for bank lending, such as reforms set out within Basel III and Solvency II which impacts on insurance companies, reduces the markets capacity to lend to higher risk investments. In practical terms, this means that banks must hold a minimum ratio of money on balance sheet to money lent. The more money lenders have to hold on balance sheet, the less capacity they have to provide development debt. Speculative development is seen as particularly high risk, therefore banks have less capacity to lend to developers.

Secondly, given the nascent nature of BTR and that BTR schemes are often very large, requiring very considerable loans with limited information to underwrite the deals, lenders are required to attach a higher risk weighting to these loans and thus need to hold more cash on their balance sheet. This restricts the access to development finance for BTR developers and/or makes it more expensive, which is a challenge in a market which already suffers viability issues.

There is also difficulty in bridging the gap between development finance and investment finance because of a lack of information. Investors typically assess risk by looking at market conditions and comparable transactions. However, the BTR market is still immature and has few comparable transactions and little market information such as let up rates, rent levels, and churn rates. Because of the lack of evidence to help underwrite deals, lenders treat BTR as a risky sector, raising the cost of finance.

The third problem concerns the track record of the borrowers. As the market is nascent, many developers are new companies, very often structured as special purchase vehicles (SPVs) for individual BTR schemes. This means that, from the banks perspective, there is no recourse to large balance sheets and they apply a higher risk to the borrower than, say, a larger build for sale developer or large Housing Association that has a track record and significant balance sheet.

The fourth problem concerns the scale of development. For investment and management efficiency purposes it is argued that “the sweet spot for build to rent is around 200 units”. “Aggregators are looking for 200 units or more and this volume of units carries a big debt requirement”. In London for example, a 200 unit scheme would require c.£60 million of debt. Funding for this number of units would be likely to come through a syndicate of lenders all charging the same rate or a cross-collateral loan fund like Blackstone. The main players are European banks and UK banks such as RBS, Lloyds, Barclays and the HCA, albeit the latter is a public organisation and not a bank. These banks will look to syndicate debt on larger BTR schemes.

The Government have sought to overcome some of these barriers following the Montague Review with the introduction of two funding schemes for PRS - the HCA Build to Rent Funds 1 and 2 and the £3.5bn Government Debt Guarantee scheme for PRS that is currently managed by Venn Partners.

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. Stakeholders stated that “the home building fund of around £3bn is not enough to meet the scale of the problem”. They also considered that in the past “private companies have an issue borrowing from a public entity like the HCA”. However, the HCA have become more commercial and more of a “vanilla lender”. Typically, the HCA have sought to bridge the gap where mezzanine debt is too expensive or for too short a period. In total the HCA have lent £500m to infrastructure and £250m development finance for housing so there is still capacity in the scheme to lend against PRS and other types of housing.

While the HCA are essentially providing development finance, the Debt Guarantee scheme for PRS is designed to provide investment finance for completed PRS stock that may or may not have used the HCA development funding. The funding scheme has drawn down one bond for £265m, of which L&Q have had a £175m chunk and the remaining £85m has been agreed with another borrower. In total, £700m of loans has been approved and there is further £1.2bn of loans in the application process. In addition, Venn Partners state that they are aware of expressions of interest for a further £1.5bn.

The Debt Guarantee scheme was originally for £3.5bn with the potential to extend the scheme by a further £3bn. The application date for the existing Debt Guarantee scheme closes on the 31st December 2017 and as the market is still in its nascent stage, stakeholders suggested that the scheme should be extended beyond next year’s deadline to show continued support of the sector, appreciating that it takes time to establish and deliver the level of stabilised stock required to access this type of investment finance. It would also give confidence to lenders providing the development finance for build to rent that there is the potential to secure investment finance/end buyer as the market scales up and matures.

At one of the roundtables it was suggested that the HCA development finance and the Debt Guarantee scheme should be talking to each other – providing more targeted finance where other lenders are struggling to fund either the development or the investment phase. At present the Debt Guarantee is being accessed by organisations with stabilised BTR assets as opposed to those that actually need access to an additional funding stream. “It would benefit the market if the PRS Debt Guarantee scheme was allowed to evolve and underwrite the construction and stabilisation phases”, therefore effectively merging the former BTR Funding and PRS Debt Guarantee product and aligning the two schemes.

In addition, the round table highlighted that the HCA and the Debt Guarantee schemes are amassing vast amounts of information/data on the new build to rent sector. There is potential to consolidate this information on the performance of the market to provide the evidence that lenders need to underwrite BTR deals. In the nascent stage of the Multi-family sector in the US, Archstone, one of the largest Multi-Family owners at that time, lead the industry to pool data on the performance of the sector which greatly enhanced transparency and lead to the development of bespoke systems for revenue and performance management.

3.4. Additionality of Build to Rent

The stakeholders identified that the additionality benefits of build to rent include 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, creates on-site jobs and provides a flexible tenure for tenants.

Many of the stakeholders consulted pointed out that BTR can accelerate housing delivery, either through letting rates being higher than sales rates or through additional potential routes to market. Higher absorption rates were described as “we are able to deliver rental units five times faster than units delivered for market sale”. Others described the optionality of additional sales routes as “we can develop a site as quickly as possible and then make a decision on tenure. It’s easier to build units for rent and then sell them than to build units for sale and then let them”.

For housebuilders engaged in the research, delivering BTR allowed an increase in delivery rate over and above their annual target for open market sale. “BTR helps people crack on and build by having an additional tenure alongside everything else being built…pace of delivery is accelerated”. “BTR is an accelerator on site. The additionality of supply is enormous”. “Quicker delivery can be gained from housebuilders by allocating land to PRS, which can be brought forward at a faster rate”. “Additionality comes through speed, density, and the nature of the site”.

A key feature of BTR is its ability to de-risk development by providing certainty of an end user for the scheme that uses a different source of funding. This was described as “PRS is vital, especially on larger sites to de-risk and speed up delivery. Money and equity go a lot further. We can deliver several phases of one scheme at the same time because BTR does not compete with the for sale stock”. “When building PRS you can secure funding up front and therefore double delivery speed, whereas with market sale you usually adjust build rate to match sales rate”. “BTR speeds up delivery because it uses different buckets of cash. It builds homes that wouldn’t otherwise get built”.

Stakeholders also identified a number of examples where sites would not have been developed if not for BTR. For example, one stakeholder stated that had they not been engaged in aggregating build to rent stock then the site would have been sold to a housebuilder or developer for the delivery of open market sale. “We would not have developed...if we couldn’t do it as BTR, we would have sold the site…in that sense, it is additional”. Similarly, BTR developers considered that some sites were not suitable for open market sale. “Our sites are too small for major housebuilders”. “Some sites aren’t suitable for market sale but are suitable for private rent, therefore you don’t need to compete with major housebuilders for the land. An example of such a site was a site in Birmingham where there is a mortgage issue on apartments”. “Many schemes in urban areas would not have delivered for residential use at all, which in turn would have had a negative impact on the financial success of the town centres (in terms of retain, F&B, leisure spend from economically active and progressive tenants)”.

Several stakeholders claimed that BTR sites delivered through Permitted Development Rights (PDR) were additional, as they may not have been developed as housing if BTR were not an option. “Permitted development is the key to proving additionality”. “Office to residential conversion brings forward more units. You don’t need to deal with planning officers or provide affordable housing”. “Permitted development is a real opportunity for PRS. It has introduced new players. There are no planning issues, and you are able to deliver 15-20% more units because you don’t have to conform to space standards. The additional units can improve the viability of the scheme and makes it more competitive with open market sale”.

Some stakeholders stated that as well as providing a greater volume of housing more quickly, BTR also improves the quality of developments through better stock, enhanced placemaking and better management. “Additionality is speed of delivery and improved management. BTR has the potential to raise standards across the whole private rented sector”. “BTR is a different product from for-sale. It has bigger circulation spaces…higher quality materials. There’s also shared facilities, such as gyms and pools”. “The benefits include the speed of development, the functionality of the housing, good management and rapid occupation”. “On regeneration sites BTR might attract households who wouldn’t have considered buying in an area to try it out as tenants. For example, Barking Town Centre”. “We want to improve the rental offer to support working households living in the city centre”. “The ground floor of these buildings doesn’t necessarily have to be a Tesco. When you convert units to PRS there can be some opportunity for place-making on the ground floor”. The BTR owner tends to invest more in their external areas of the schemes to enhance placemaking and potential revenues.

3.5. Planning and Affordable Housing

Many stakeholders expressed dissatisfaction with how the planning system treats BTR. “Experience, guidance, and knowledge across local authorities is patchy, particularly in relation to what the BTR sector is and the different economics that apply to it versus build for sale. Poor knowledge of the sector is a constraint”.

Overall stakeholders concluded that there is some guidance for the BTR sector set out in the National Planning Policy Framework (NPPF) and the National Planning Policy Guidance (NPPG) but there are no clear policies. Current planning policy framework favours the delivery of owner occupation and affordable housing, which is a different model from BTR. As a result, stakeholders argued that BTR needs a different approach from a planning perspective. One issue stressed by stakeholder was viability assessment given the apparent gap in land values. “The planning sector doesn't understand how viability relates to BTR”. In particular, stakeholders identified problems with traditional forms of s106 affordable housing. There was a general consensus that where there is a requirement for affordable housing Discounted Market Rent (DMR) works well for BTR and investors are keen to provide it alongside the market rent units where it is viable.

In these circumstances, there is the potential for the DMR units to be tenure blind within schemes, pepper potted amongst the open market rental units. “BTR schemes shouldn’t include traditional affordable housing, they should include a pepper potted mix of DMR”. In some cases, where DMR has been supplied instead of other forms of affordable units, a higher number of DMR units have been provided than was originally sought by the local authority.

There was also a preference for DMR that is not linked to local authority providing nominations. The concern from the investors perspective is that a nomination requirements linked the Local Authority could result in potential void risk should the nominated parties not be considered appropriate by the landlord (i.e. a dispute between Landlord and LA), and also to ensure that DMR remains a true intermediate tenure, not social rent (which would further negatively affect viability). “We’re happy to develop DMR, but not on a nominations basis”. A key reason why DMR works is that the building can be managed in its entirety. There is no need to agree a service charge with a Registered Provider and no discussions over maintenance and repair schedules. It gives the investor full control over budgets. In this regard, all affordable units in BTR schemes should be DMR to suit the ‘single ownership/professional management’ definition. “The BTR model can and should provide a range of homes that are affordable, and possibly DMR and London Living Rent in the mix”.

Where the schemes are securing planning concessions to improve viability versus build-for-sale, stakeholders recognised the need for covenants to ensure homes remain in the PRS for a minimum amount of time. From a local authority's perspective, "all sites are covenanted for a minimum of ten years. Without that it would be a trickier sell to local politicians, who would be afraid people would game the system". "International investors and private equity investors are comfortable with covenants. We saw a 40 year covenant on a scheme in Westminster".

However, one stakeholder expressed concern regarding covenants in perpetuity. "Requirement in perpetuity makes it almost impossible to justify maintaining buildings".

Rehearsal Rooms, North Acton

Victoria Square is a 152 unit scheme located within a regeneration area where a substantial supply of units are proposed. The scheme is being developed by Hub Residential and is being forward funded by M&G. Prior to Hub acquiring the site, permission was granted for the development of an build to sell scheme, with the affordable offering comprising ten affordable rent units and seven shared ownership units. Given the substantial supply of units in the area Hub wanted to reduce their sales risk and provide a BTR development. Hub amended the consented scheme, renegotiating the affordable housing to provide 20 DMR units (with a marketing agreement but no nomination rights retained by the local authority). The car parking provision was also reduced from c20 spaces to c10 spaces within the consent, which removed the need to build a large basement and further improved viability. This allowed an incoming investor to retain control of the entire building, meaning Hub was able to secure funding for the scheme from M&G and bring the development forward. This case study shows how a more flexible approach to affordable housing provision for BTR can facilitate the delivery of additional units by ensuring the viability of schemes.

3.6. Planning and Regulations

Stakeholders claimed that a lack of flexibility in planning regulations make development of BTR housing both more difficult and less appropriate. In particular, car parking standards, design and space standards, and unit mix were identified.

In terms of unit mix, BTR operators consider that demand for PRS units differs from the demand for units to be delivered for open market sale. In particular BTR operators consider that policy requirements to deliver three and four bedroom units are not always appropriate for BTR schemes. One stakeholder commented that “The planning system doesn’t reflect the PRS market. For instance, there will be a requirement for 3 and 4 beds in areas where there is only demand for 2 beds, or requirements for private outdoor space in a dense, urban environment”.

BTR stakeholders claim that local authorities also require the same car parking provision as build to sell schemes. The stakeholders considered that this was leading to excessive car parking provision that is inappropriate to the characteristics of BTR occupiers. In urban and town centre locations in particular, renters would need to rent these car parking spaces and there is little demand from tenants to rent car parking spaces in addition to their rental unit. One stakeholder notes that “parking requirements and space standards are all problems linked to the current planning system”.

By comparison, in the US, “they have broad building controls which means a developer can build what the market demand dictates”. This means that the investor has a long term alignment of interest in getting an optimal mix for micro market demand. Stakeholders also noted that local opposition to BTR planning applications often centres around lack of parking provision, highlighting how there may be a lack of knowledge in the general public of how the characteristics of BTR occupiers differ from traditional build for sale purchasers. It was considered that this local opposition had led to onerous and unnecessarily high parking requirements being placed on BTR schemes.

Some of the stakeholders encountered problems engaging with local residents, particularly with regards to parking and traffic. BTR schemes tend to be situated near public transport and in fact require less car parking as the majority of tenants in urban markets typically do not require or want to rent parking spaces. This space could be put to more effective use, proving additional rental income wither through more residential units or amenity space for tenants to use. “We buy property near public transport hubs and target young professionals. However, locals will still complain that there will be too many cars because of the scheme”.

“Building regulations and planning controls reduce the number of units on a site. In particular, London space standards, sprinkler systems and rules on north facing units mean we [BTR developers] can’t use space effectively”. “We can innovate in design, but London design guidelines constrain innovation. More innovation in terms of space and number of units could be helpful”. In essence, “the ability to have up to 100% single aspect apartments allows more units off cores (subject to satisfying fire regulations) which makes a huge difference to viability of the scheme”.

Although stakeholders from planning authorities and other public sector bodies suggest that there is the ability to be flexible, lack of clarity adds uncertainty, which in turn lengthens the development and delivery process. Local authority stakeholders also argue that there are other costs associated with BTR and that their role is to meet community requirements more broadly.

3.7. Pricing and Valuation

A common comment from BTR players is 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 as values tend to exceed institutional investment pricing, which is based on a multiple of the rental income. This was described as “BTR is very much a yield-based pricing model”.

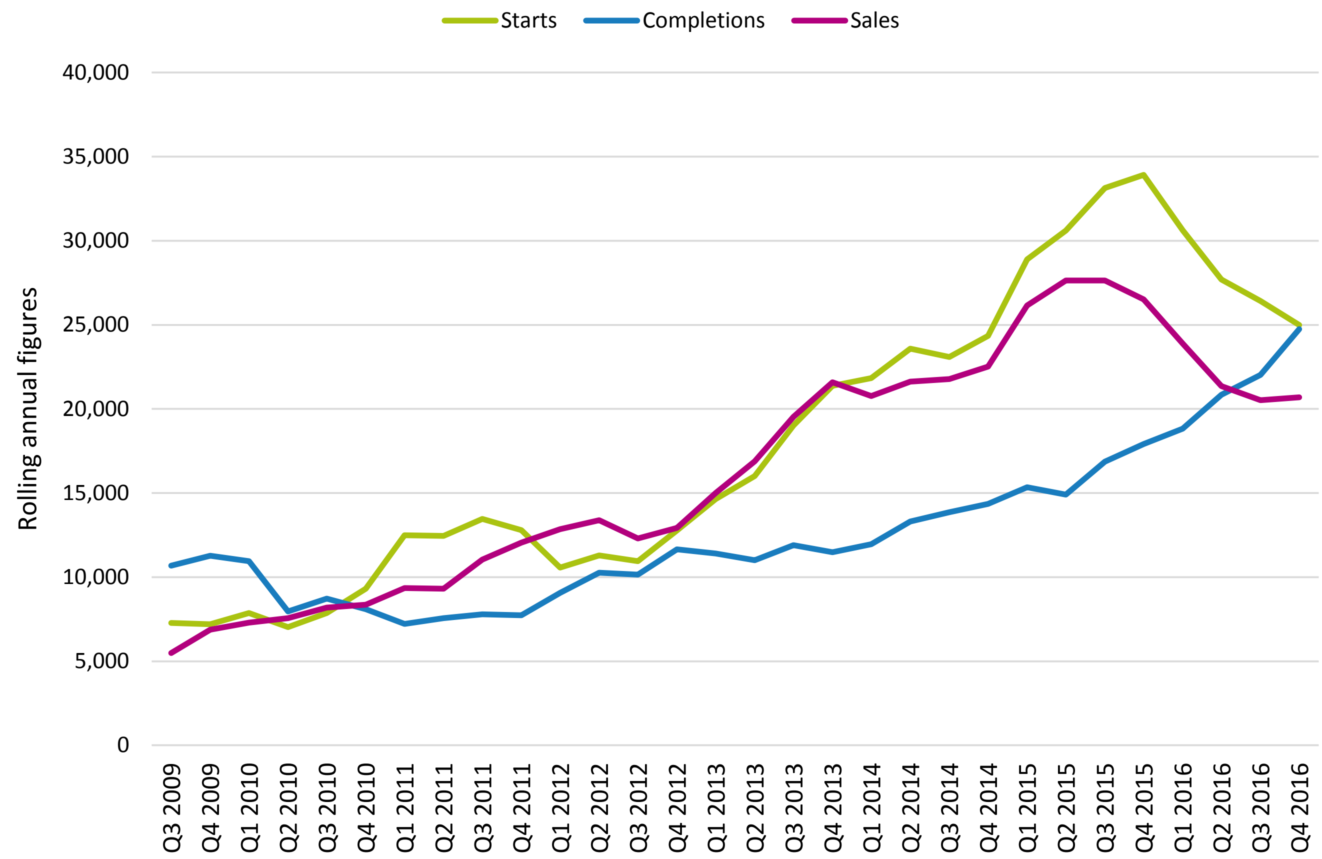
Similarly, house builders driven by maximising profit on cost have tended to prefer selling to retail investors because it has maximised profit and ultimately shareholder value. In the current market environment there is little or no motivation for housebuilders to sell to investors at a discount. One housebuilder stakeholder described it as “we are not doing any PRS as we can sell faster than we can build. That's not to say we would not do PRS in the future but it depends on market conditions”. It is also important to note that most BTR investors entering developments want to fix the purchase price "today", whereas many developers and housebuilders have benefited from significant house price inflation during the construction and marketing phases. This creates a potential additional GDV arbitrage unless rental growth is directly correlated to house prices. Whereas in reality, rental growth tends to lag house price inflation.

As shown in Figure 10, both new build starts and sales rates have weakened. The increased tax burden on domestic buy to let investors was cited as one reason for slower sales rates and new build starts. This is clear evidence that house builders will only deliver what they can sell and when sales rates slow, new build starts also slow. Stakeholders pointed out that sales rates have weaken and there is more overseas investors active in the market as a result of currency advantages. Clearly, a slow down in sales rates impacts the whole market including the delivery of traditional forms of affordable housing.

When sales markets show signs of slowing and sales prices come under pressure, opportunities for PRS investors, particularly among risk averse developers, rise. This can be observed in the current market in London, with developers such as Barratt are packaging up sites for PRS investors. Feedback from BTR players is that they are able to find tenants of new development more quickly than rates of purchases of for sale development. This will tend to bring forward revenues, which while maybe offering lower returns, are more certain and quicker, particularly when the wider economy has slowed down.

Market conditions were frequently observed by stakeholders as a factor affecting BTR development, especially the difference between London and the regional markets across England and Wales. Stakeholders noted that regional markets hold substantial capacity for growth in the BTR sector. Many local authorities do not require affordable housing which helps delivery. Demand for rented homes is also strong in the regions. “It’s easy to rent units outside of London. In the regions, we have five applicants for each property we build”. “There are opportunities for BTR wherever employment or the economy is strong; not necessarily just in major cities”. “BTR works in places with decent employment in locations where there is a disparity between end values”.

Figure 10 – New Build Starts and Sales in London



Source Molior

"Build to rent is all about yield". Investors engaged in the research stated that the price they are bidding reflects the target yield they require. Typically, there might be as much as a 20% discount from the values that could be achieved from sales to retail investors. However, housebuilders stated that investors are looking for a 20% discount which is too high. "In the current market it doesn't make any sense, but in a weaker market we can potentially support a discount of 7% and 10% from market value. Given that housebuilders often offer incentives to buyers, wiping off this level from the retail sales prices brings the two in line. Lenders also agreed that typically retail profits are "about 10% higher than when selling an entire PRS block". Investors on the other hand stated that they may require a discount to meet their yield returns rather than target a discount level.

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 say 12% to 15% whilst BTR is usually backed by a bank and requires professional management. Leakage is much higher at around 20% to 25%. 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.

4. Evidence of Additionality

This chapter of the report sets out the evidence that was gathered through the stakeholder engagement in terms of housing supply and its impact on additionality. Drawing on evidence and case studies of BTR, it helps to illustrate how these benefits exhibit themselves in the sector.

4.1. Summary of Additionality

The additionality benefits of build to rent include 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.

It is however 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 step change in completions which is then sustained. Moreover, even identifying acceleration can be difficult – while BTR schemes can undoubtedly be built more quickly, the relevant period over which acceleration must be observed is from identification of a site through to occupancy, not just the construction process alone.

Table 7 sets out, with examples, the most likely ways in which acceleration may lead to additionality. Separately or together these mechanisms can be expected to mean that BTR schemes increase residential development overall, but this has yet to be empirically verified.

Table 8 – Additionality Derived from Accelerated Supply

Potential for Additionality	Examples
1. Units are occupied more quickly 2. Provided to meet different types of demand 3. Potential to reduce costs 4. Potential for reduced risks 5. Potential to expand land supply	1. Direct benefit of acceleration 2. Enables higher levels of output because offers a new form of investment and/or offers a somewhat different and more desirable type/quality of unit. 3. By speeding up development BTR may reduce costs especially in terms of finance (although other costs might increase). 4. Pre-sales of BTR properties may reduce risk for developers and financiers, 5. May make some available sites viable; accelerated output may encourage local authorities to make more land available under the five-year land supply rules. 6. BTR investors are seeking to maximise net operating income from sites, not just consider the property types that can deliver the best profit on cost through a sales programme

4.2. Accelerated Delivery through Permitted Development Rights (PDR)

Most stakeholders involved in the research considered that residential supply delivered through Permitted Development Rights as “wholly additional”. This suggests no offsetting reductions elsewhere in the development chain which is probably a bit overoptimistic. Again this cannot be empirically verified as yet. What is certain is that it increases opportunities.

PDR was introduced in May 2013 and has delivered c.63,000 net additional residential units since its introduction. The most recent data (2015-16) shows that there were over 30,000 net additional residential units which is a 50% rise in residential conversions on the previous year.

Savills analysis of the build to rent supply pipeline shows that 12% (8,000) units is linked to PDR. Clearly, there is also additional rental supply entering the rented sector through buy to let sales on PDR schemes that have sold into the open market. Therefore, PDR is an important contributor to rental supply.

The stakeholders considered that the speed of delivery of PDR units is mainly attributed 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 schemes do not go through lengthy negotiations and viability assessments for affordable housing with schemes delivered more quickly as a result.

Two significant build to rent operators using PDR as a route to developing scale in the investment market have already emerged: Westrock’s ‘PLATFORM_’ and Criterion Capital’s ‘Miflats’.

Westrock have planned investment of £300m in 1,000 build to rent units under its branded operator PLATFORM_. Currently, they have c.600 Build-to-Rent 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 they do not have to engage in lengthy Section 106 negotiations”. The company considers that all the homes they are developing are additional as they are not delivering market sale product, they are aggregating residential units for long term investment. It was noted through the stakeholder engagement that although the delivery of PDR tends to be much faster than traditional forms of residential, costs can be higher.

11 The Boulevard, Crawley

11 The Boulevard is a 185 unit scheme which was developed by Westrock and is managed by their management brand Platform_. The scheme is an office to residential conversion and gained planning approval through permitted rights meaning unlike a new build development the proposals were not assessed against the planning policy framework. Only approximately 13% of the units are compliant with the Nationally Described Minimum Space Standards which are adopted in Policy CH5 on the Crawley Borough Council Local Plan (2015). If the scheme had been required to meet the minimum space standards it would have provided approximately 27 less studio units or 20 less one bedroom units. This 10 – 15% reduction in the number of units provided would have had considerable implications on the viability of the development. This case study shows how a more flexible approach to space standards could provide substantial additional unit density on sites and improve BTR scheme viability.

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. The majority of Miflats schemes are formerly offices being converted to rental units under PDR with the exception of New Maldon. This allows the design of units suitable for the rental market without constraint from design guides, planning restrictions, or space standards.

4.3. Accelerated Delivery on Housebuilders' Sites

Sigma*,* the private rented sector specialist, developed a partnership with Gatehouse Bank plc for the delivery of large scale PRS portfolios. Since construction commenced in December 2014 Sigma have completed their 1,000th unit and gross development cost of the new homes completed by Sigma's PRS platform has grown to £120m.

By November 2016, 2 years on from agreeing the Gatehouse Partnership, Sigma have delivered or are in the process of delivering in excess of 2,500 new rented homes – 1,000 completed units and 1,500 under construction. Their approach to delivery has allowed them to build up significant numbers of assets at a faster pace than we have seen previously. Because they are not reliant on sales rates, they can deliver much faster as the absorption of rental units is higher.

In terms of the actual delivery of homes, Sigma is delivering rental homes on sites being developed out by Countryside. In practical terms, Countryside is building homes for market sale and affordable use, while also acting on a D&B basis for Sigma on these sites. This means that Sigma is accelerating the delivery of homes by Countryside and, because they do not compete for sales with Countryside, there is a much faster rate of delivery. They are also de-risking an element of delivery for Countryside by being an end user.

Sigma have just completed their 1,000th rented unit across 18 sites. On these sites, Countryside have delivered 543 market sale units, which means that total delivery has been 3 times faster as a result of build to rent. An additional point is that Sigma have used an alternative source of funding from Countryside through their partnership with Gatehouse, which has permitted the higher rates of delivery.

Another example of accelerated delivery on large regeneration sites under housebuilder control is the Barking Riverside redevelopment in the London Borough of Barking and Dagenham. The scheme as a whole is a mixed use, multi tenure, multi sized new community expected to deliver c.10,800 new homes.

L&Q bought out Bellway's stake on the regeneration scheme, taking over their 51% stake in the scheme, and intend to deliver it with existing joint venture partner the Greater London Authority. Bellway Homes has retained an option in the joint venture to build a "significant" number of the planned new homes on the site.

L&Q's total investment in the scheme is estimated to be £1.5bn[1], including a £70m contribution into the £263m project to extend the London Overground line to a new station at Barking Riverside, to be completed by 2021.

The scheme's current build out rate is 500 units a year and before L&Qs involvement it had a 20 year development period. Due to the mix tenure approach of L&Q they expect to increase delivery to c1,000 a year which will shorten the development period to 10 years.

[1] Financial Times, 11th March 2016

L&Q attribute the faster build out rate to the inclusion of PRS. L&Q state that they are not doing BTR but rather retaining units as PRS. It is considered an accelerator of delivery because PRS development secures funding up-front while the build out rate of market sale housing is adjusted to match sales rates. L&Q secure funding up front for PRS because they pre-sell a chunk to their PRS subsidiary. In this way output can be increased and does not displace the delivery of other tenures on site.

Last year, L&Q issued two bonds (£250m and £300m) and raised additional bank debt facilities to support its growth plans. They are therefore able initially to fund the Barking Riverside scheme from their own balance sheet. However, recently, the L&Q PRS subsidiary raised £175m through the Government's Debt Guarantee scheme which effectively means that longer term the PRS subsidiary becomes self-funded.

As a registered provider, L&Q's housing delivery strategy is to deliver homes that households can afford. Their overarching strategy is to deliver 25% PRS, 25% open market sale, 25% shared ownership and 25% sub market rent. In London, homes for market sale and shared ownership have become increasingly unaffordable especially in, higher value areas. PRS therefore makes more sense in many parts of the capital. Outside London, shared ownership works better as it's more affordable to households.

From an asset management perspective L&Q views blocks of PRS as better investments because they provide more potential exit routes, such as selling whole blocks to investors or indeed breaking them up and selling the units individually should the profile of rental demand change. That said, L&Q envisage holding these investments indefinitely as they produce income that can be used to cross subsidise other activities and because they tend to appreciate in value.

4.4. Impact of Accelerated Market Absorption

Market absorption of rented homes is significantly faster than for open market sale. Typically, housebuilders 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 means that units can be delivered faster.

Quintain, for example, manages the redevelopment of Wembley Park in north London. Quintain's strategy is to develop sites more quickly because it has the option to either hold or sell units on completion. They have also started to design units for the rental market, adopting design features such as evenly sized bedrooms, less internal circulation space and fire sprinkler systems. Quintain have the option upon completion to hold the units as a long-term investment or sell the units into the open market depending on prevailing market conditions.

Quintain's strategy is to speed up development and delivery on their sites and make the decision on tenure upon completion. Emerald Gardens was the first of many residential phases, comprising 473 homes of which 141 were built for private rent. Future phases, Alto and NW07/08, are programmed to deliver 370 and 361 homes of which 120 and 295 will be built for rent, respectively.

At Emerald Gardens, for example, Quintain sold 332 within a 2 year period, but leased 141 in 6 months, so roughly twice as fast. Therefore, in terms of the future phases, Quintain's experience suggests that they will lease 415 units in 18 months and sell the same number within 3 years. Their view is that rental demand is much more constant than buy to let investor demand, and much less affected by market conditions (e.g. overseas markets, domestic market, availability of mortgage finance, stamp duty, Brexit). Quintain is backed by one large institutional investor and it therefore considers building for the rental market less risky than delivering into the sales market.

Another example of high levels of market absorption through the delivery of rented homes is at East Village in Stratford. It is the largest built to rent 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 report that East Village is fully let and that on average during the let up phase (1 year and 10 months) they saw c.15 units absorbed each week. In contrast, to deliver the same number of homes as open market sale, based on a sales rate of say 15 units per month, the scheme would have taken 8 years to deliver the same number of households.

Table 7 – Example of Accelerated Market Absorption at East Village

	BTR	Build for sale
Number of units	1,439	1,439
Let up rate	15 per week	15 per month
Delivery period	95 weeks	95 months
	1yr 10 months	8 years

4.5. Evidence of PRS Unlocking Development

Stakeholder engagement also identified that the provision of large volumes of rented homes can help to unlock sites that have previously remained undeveloped. An example that arose from the consultation is the former GlaxoSmithKline and Sunblest Bakery site in Greenford, which was acquired earlier this year by Greystar.

Greystar is the largest US multifamily operator with over 410,000 homes under management across more than 140 cities in the US and globally. In recent years, the company has invested over £2.8bn in the UK Student Accommodation market and is currently building up a pipeline of development sites to deliver purpose-designed rental communities using their multi-family operational model.

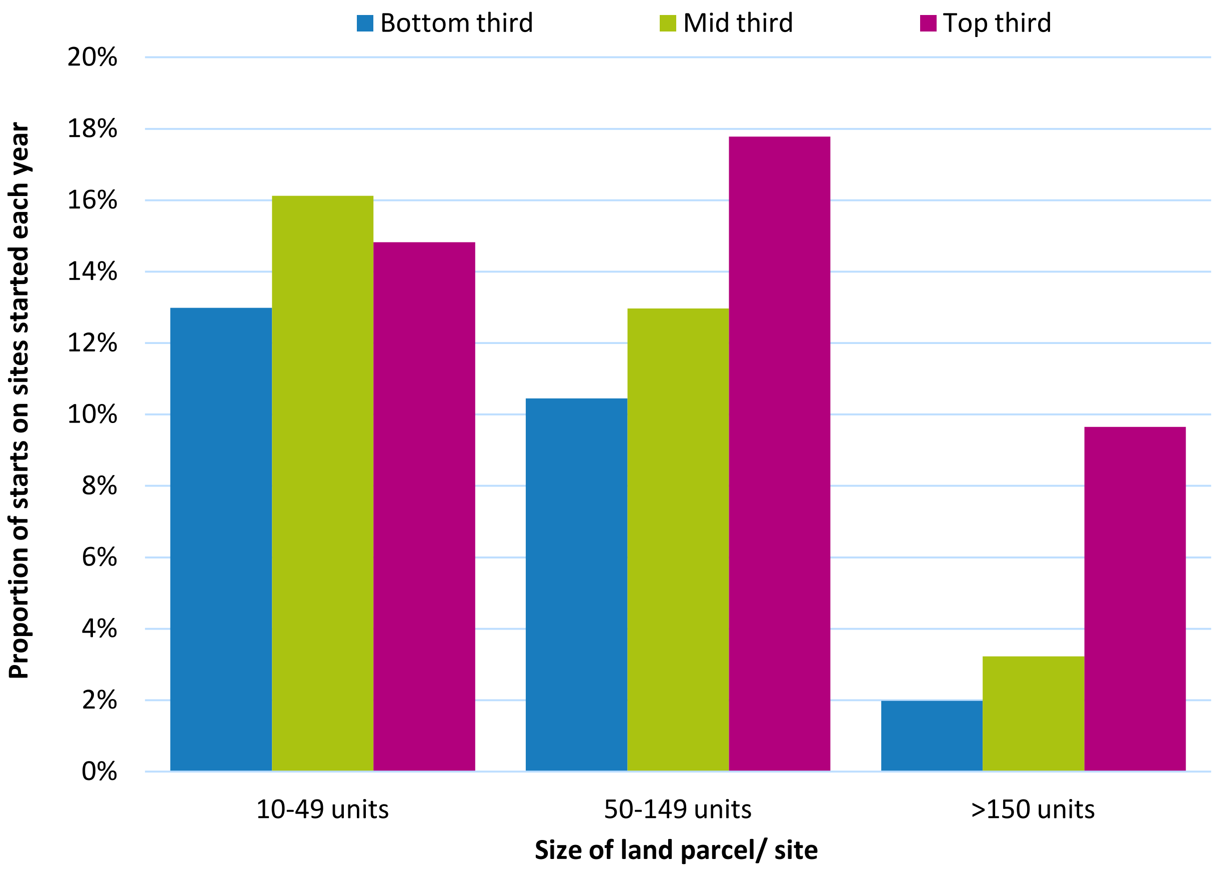
The site in Greenford was acquired by Greystar with an outline planning consent for 593 homes. By delivering a mixed-use scheme that largely comprises rented homes, rather than open market sale, Greystar have made an updated planning submission for a much larger scheme of 1,965 units which is evidence of BTR increasing density and therefore land value gain. A delivery strategy that is focused on rental housing has directly led to a planning application for an additional 1,372 homes that would not otherwise 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.

4.6. Evidence of Acceleration and Potential Additionality from Build to Rent

An example of accelerated delivery from the stakeholder engagement involved Ferry Lane in Walthamstow, which has just secured planning consent for a built to rent scheme. The scheme, which is a former industrial estate, was acquired by Legal and General in February 2015. The 2013 outline consent was for 311 units which L&G have increased to 440 units following consultation with the local authority. This also demonstrates higher density being achieved. Plans for the development include new cafes, a food store, communal working spaces, open landscaped areas and communal leisure spaces for residents. It is expected to create up to 100 long-term local jobs as well as 3,000 temporary roles over the life time of the development. Within the scheme there is a proportion of affordable units which will be let on a discounted market rent basis.

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

Figure 11 – Proportion of Starts on Sites Opened Up in Any One Year, by Site Size and Strength of Housing Market



Source: Savills and Hometrack, using NHBC data

Analysis by Savills and Hometrack, using NHBC data, shows that around 15% of NHBC starts on sites opened up in any one year are on sites of more than 150 units. Within this total, 10% of starts are on larger sites in stronger markets.

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 and, in these markets, more large sites are brought forward. The sites in the NHBC data include land parcels on large multi-phased sites, on which multiple sales outlets on separate land parcels will be operating at the same time.

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.

5. Working Definition of Build to Rent (BTR)

It is clear from the stakeholder consultation, the literature review and the data analysis that Build to Rent (BTR) does not have a widely accepted definition. In the US for example, BTR is commonly known as Multifamily Units for the rental market with some operators in the UK describing their portfolios of stock as Multifamily. A clear definition of BTR is needed to assess whether the sector is constrained by market failures in the following chapters. In addition a clear definition is required to assess what the impact of various policy options might be on the sector and the consequent recommendations on potential initiatives.

The most widely recognised definition of BTR is that used in the HCA's Build to Rent funding programme. This referred to multi-unit blocks of purpose-built private rented housing that are in single ownership as set out in the literature review. This however does not reflect the reality of the growing market. The definition of BTR that has been used for the purpose of identifying market and regulatory failures is:

'New residential supply for market rent in clusters with a single owner using professional management'

The view of what constitutes BTR varies by player involved. The table below summarises relevant factors that differ for: investors/developers; planning policy organisations and the HCA; and HM Treasury/tax purposes.

Table 9 – BTR Definition

Terms	Definitions	Investors and developers	Planning policy organisations and the HCA	HM Treasury
New	Newly developed housing. This may include units converted from other uses, such as office to residential conversions undertaken through permitted development rights (PDR).	As per overarching definition	As per overarching definition	As per overarching definition
Cluster	Each scheme can be on one or more sites but each site should have at least 50 BTR units in the same block or located close together.	Main driver of cluster definition but may be willing to look at sites/blocks of less than 50 units	As per overarching definition	As per overarching definition
Residential supply for market rent	Property that will remain available for rent to tenants for a defined period. Each lease will be for an agreed fixed term (while some definitions insist on longer term leases this is not necessarily appropriate for all types of BTR tenants).	Could include DMR as well as market rent	Seek to secure long commitment via e.g. covenants	No distinction made between BTR and BTL

Single owner	One legal entity owning the relevant development/cluster of sites.	Single owner is usual model for BTR but variations could be possible	As per overarching definition	As per overarching definition
Professional management	Management of the units using an integrated or semi integrated approach which delivers a high standard of management and service including a comprehensive maintenance programme.	Key characteristic required to ensure quality	Likely to be seen as desirable	n/a

From the stakeholder engagement there was general consensus that any definition should not include the physical characteristics of buildings. Rather, the defining characteristics of BTR schemes are 'professional management' and 'single ownership'. Other considerations raised during this consultation process included whether the scheme was held under a covenant that required the units to stay in the PRS for a set period or whether the scheme provided affordable housing through discounted market rent. Reflecting these earlier definitions and input from the stakeholder consultation,

The definition of BTR differs from that used for the HCA Build to Rent fund in that it makes no specific reference to the scheme comprising 'multi-unit blocks'. Rather the definition recognises that the built product on BTR schemes may be large, individual blocks or streets of terraced or semi-detached houses (such as the stock owned by Sigma or Hearthstone (formerly Mill Group). It also differs from the HCA definition in that it specifies the scheme must be professionally managed.

6. Market and Regulatory Failures

This section sets the findings on market and regulatory failures relating to the BTR sector. The work draws upon the definition of market failure given in the Treasury Green Book:

- Provision of public goods (i.e.) the market may have difficulty supplying some goods due to their characteristics.
- Externalities - benefits or costs not priced in to market decisions. Wider regeneration of town centres is a possible example. Investment products are particularly prone to intergenerational externalities.
- Imperfect information, such as knowledge of the risks and returns on investment in BTR schemes.
- Market power, including both imperfect competition and asymmetric information which might for example relate to the position of the BTR sector compared to the traditional housing sector and to the relative position of stakeholders in assessing risk .

While some elements of the above typology are relevant, the report also considers that an important dimension of the situation is various instances of regulatory failure in that the regulatory framework inappropriately disadvantages the BTR sector and/or exacerbates market failures.

The work focuses on types of market and regulatory failure that are specific to the BTR sector and its role in the housing market. In general it does not cover types of market failure that are of wider applicability across the housing sector unless they have specific and/or disproportionate relevance to the BTR sector. The main types of market and regulatory failure relevant to the BTR sector and consequent supply of housing are summarised in Table 10.

Table 10 – Market and Regulatory Failures Affecting the Build to Rent Sector and Supply of Housing

Market/Regulatory Failure	Main Type of Failure
Restricted access/mispriced finance	Imperfect information/immature market
Inappropriate planning policy (particularly in relation to: car parking standards; unit space standards; unit mix; and affordable housing requirements)	Regulatory failure
Professional management capabilities	Imperfect information/immature market
Disadvantageous taxes/levies: Value Added Tax (VAT), Stamp Duty Land Tax (SDLT) and Community Infrastructure Levy (CIL)	Regulatory failure
Political and regulatory uncertainty	Regulatory failure
Labour market rigidity as a consequence of restricted rental choice	Externality
External benefits for regeneration and economic benefit of BTR schemes	Externality
Job creation and quality of management	Externality

Source: Savills and LSE, 2016

Importantly, and notably with respect to the delivery of subsidised housing, there will be equality impacts of BTR provision compared to other forms of housing offer. This is a relevant consideration in addition to market failure in Treasury Green Book and other guidance.

Also potentially relevant is whether BTR could be considered a 'merit good'. These are goods and services that the government feels that people will under-consume, and which ought to be subsidised so that consumption does not depend primarily on the ability to pay for the good or service. Affordable housing is regarded as a merit good in that lower income households who cannot afford market housing still need appropriate quality housing. The remainder of this section gives more details on the specifics of these failures and also the equality context.

6.1. Restricted Access to Finance

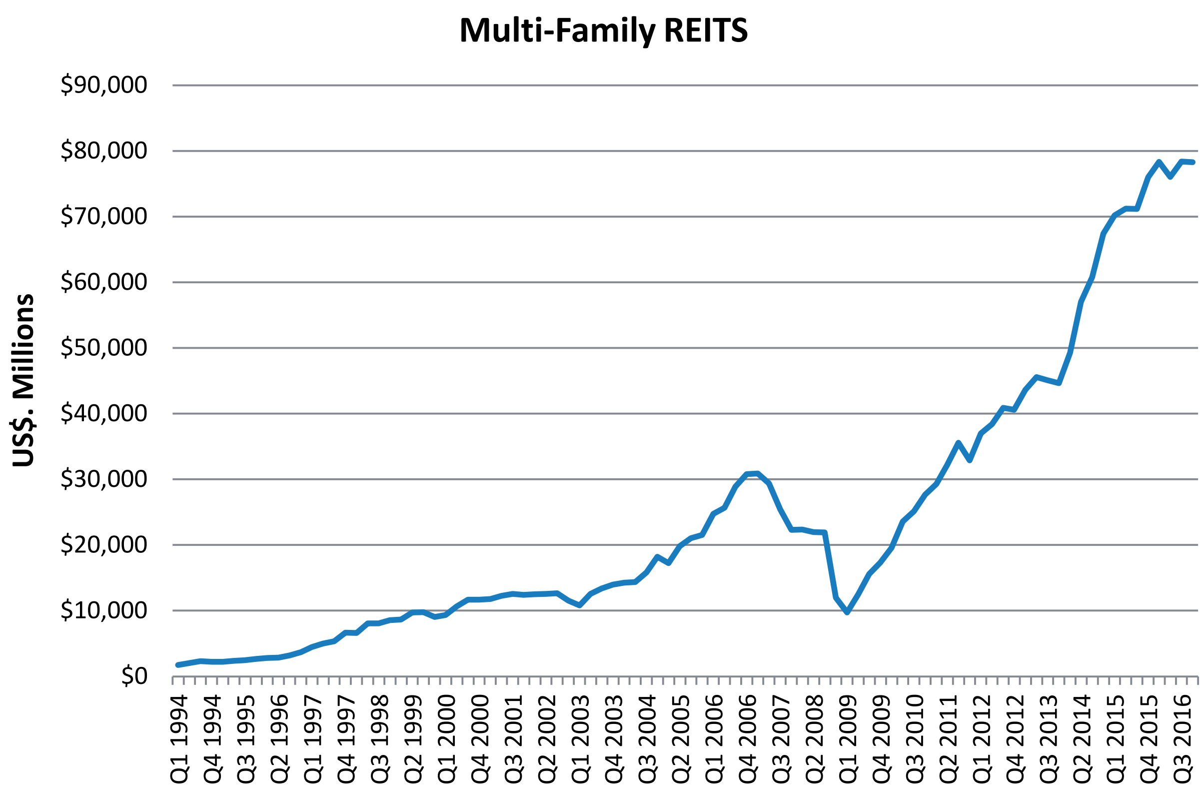
Given that BTR is an emerging sector in the UK there is relatively limited experience and data on its financial characteristics and performance of the sector. This will tend to mean that lenders and investors will factor in additional risk premia with respect to future revenue and cost streams which increase the cost of borrowing and/or limit access to funding. This represents an imperfect information market failure.

For many investors BTR transactions are their first foray into the residential investment space. They need large amounts of information to satisfy investment committee decisions that demonstrate everything from day one rents and rental growth to operating expenditure and exit yields. This is particularly challenging given that BTR is a nascent market and expected to set new precedents in all of the above. The evidence gathering is thus negatively impacting timescales taken to transact as well as overall levels of investment.

Equally, debt providers, particularly the UK clearing banks, have been slow on the uptake with respect to PRS development financing, largely owing to the relative unchartered waters, but also due to the lack of performance evidence for the asset.

To illustrate how financing for the BTR sector could mature it's worth considering the US experience. In the US, investment in multi-family for rent housing (the American term for BTR) has grown strongly over the past 20 years. This growth has been the result of a combination of factors, but investors today have the security of evidence relating to demand, historic growth and rental data for the asset type, facilitating decision making. The US multi-family market has grown by 9 million people in the 10 years between 2005 and mid-2015. This is the largest growth within any 10 year period and represents a total rental population of 37% of households, the highest level since 1965 (PNC Real Estate, 2016).

Figure 12 – Market Cap of US Multi-Family REITS



Source: NAREITS

This shows that the long established US multi-family market can withstand global recessions, regulatory changes and demand/supply changes. The US still have their issues in terms of affordability, with viability of developments dependant on providing middle to high end rental products, as opposed to units designed for renters on low income. Although with continued rental growth, in the context of low vacancy rates, and increasing capital values, new capital from investors and private lenders are expected in this market.

Like the US market which took over 20 years to mature, the UK market has a long way to go before we have enough stock to measure performance transparently. However, during the US multi-family's nascent phase, Archstone instigated the pooling of their data with other owners and this was instrumental in creating the market transparency that the sector enjoys today. An independent consultant set up the analysis of the rental multifamily data which has lead to the revenue management systems that are widely used today.

6.2. Inappropriate Planning Policy

Issues with how the planning system deals with BTR were continually voiced as a concern by both the public sector and private BTR stakeholders. As set out in the stakeholder section, the evidence relates to four aspects of planning policy as applied to BTR schemes:

- Lack of definition of BTR for planning purposes;
- Excessive car parking requirements;
- Inflexible space standards;
- Inappropriate unit mix requirements; and
- Inappropriate and inconsistent approaches to affordable housing requirements.

The specifics of each type of policy are considered below. In addition, it is possible that the collective application of inappropriate planning policies may reduce the potential for BTR schemes to contribute towards regeneration of areas, particularly in a town centre/inner urban context, with consequent reductions in wider benefits and positive externalities.

6.2.1. Lack of definition of BTR for planning purposes

It is clear from the stakeholder consultation, the literature review and the data analysis that BTR does not have a widely accepted definition for planning purposes. This leads to a lack of consistency in planning negotiations and inhibits the implementation of planning policy with specific reference to BTR.

6.2.2. Excessive Car Parking Requirements

Research has shown that tenure has an impact on private car ownership levels (see DCLG, 2007 and Transport for London, 2012). Households that occupy rented accommodation can have up to 0.5 fewer cars than owner-occupied households in dwellings of similar size and type (DCLG, 2007). Figure 13 shows how across all household sizes, owner occupied properties have higher numbers of cars per household than non-owner occupied households.

This suggests that car parking demand for PRS developments may well be lower than traditional BTS schemes. Additionally, most BTR schemes are situated in urban/town centre locations, meaning they often have good public transport connections and it is likely that occupiers are less likely to require a private car than those living in the wider PRS.

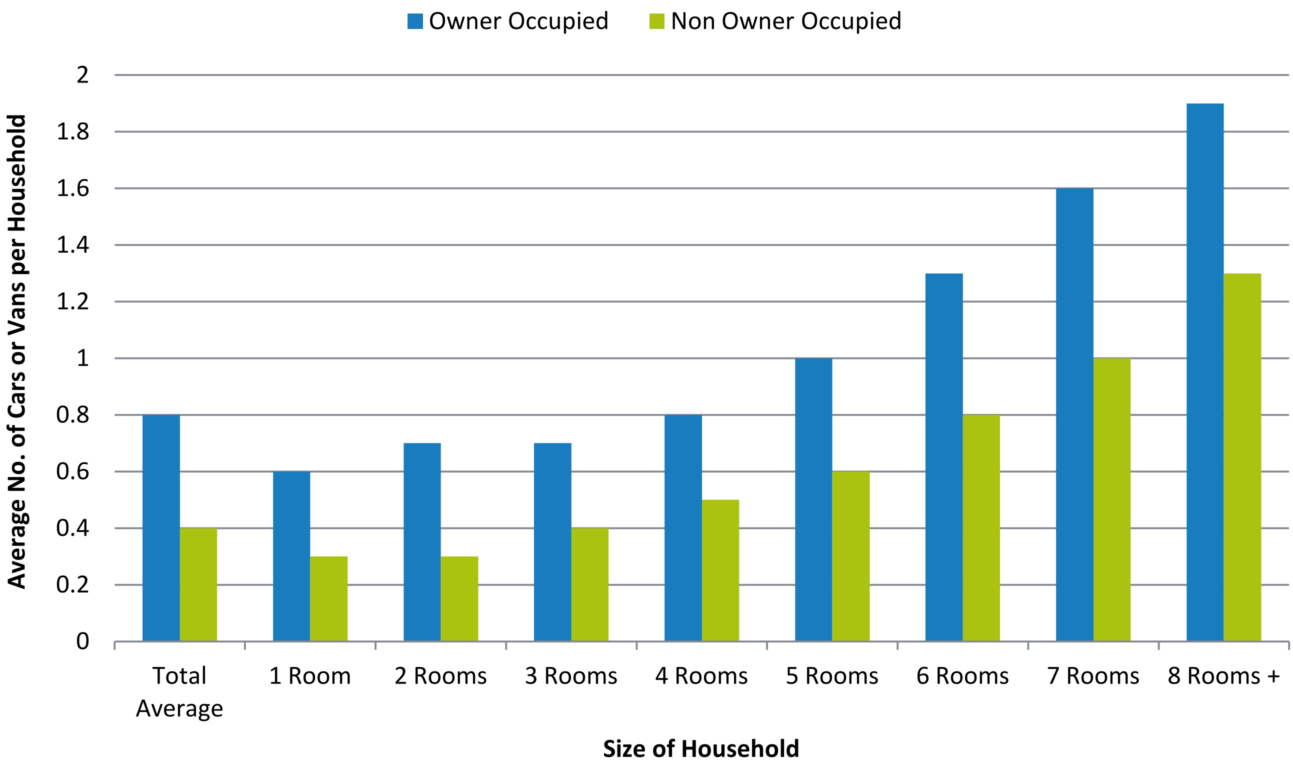
In Inner London, it has been shown that households that rent or part-own/part-rent their properties are significantly less likely to own a car than those who own their home outright or with a mortgage, with around 4 in 10 renters compared to more than two thirds of owner occupiers having access to a car (Transport for London, 2012).

The potential consequences of applying onerous car parking requirements include:

- Unnecessary space being set aside for car parking that could be used for housing and/or more attractive amenities for tenants;
- Unwanted car parking spaces that tenants do not rent and result in loss of income from valuable development space;
- Development densities in terms of units per hectare are lower and consequently reduce the potential of the BTR sector to increase the supply of housing; and
- BTR schemes have additional costs and reduced potential revenues which reduced scheme viability and likelihood of delivery.

Not all current car parking standards are necessarily inappropriate to all BTR schemes. Some local authorities allow low/no car parking provision on town centre and inner urban/good public transport accessibility locations and some BTR schemes are located in more suburban/rural sites where existing car parking standards are more in line with market expectations. However, a more consistent and tailored approach would help ensure such good practice is applied across the country.

Figure 13 – Private Car Ownership by Tenure and Household Size



Source: Census 2011

6.2.3. Inflexible Space Standards

A large number of local authorities (alongside the GLA) implement policies imposing minimum space standards for units within new developments. Such standards need to be in line with the Nationally Described Space Standard (DCLG, 2015). These policies are implemented in order to improve the quality of the residential units delivered and reduce the chance of overcrowding and its associated negative impacts, including harmful implications on mental and physical health (see Carmona, Gallent, and Sarkar, 2010 and Evans, Wells and Moch, 2003 for further details).

However, as with other areas of regulatory failure in the planning system, these policies are applied tenure blind and BTR operators consider that a distinct, more flexible approach should be taken for BTR developments due to fundamental differences between BTR and other forms of residential development.

A key difference between BTR developments and open market sale is often BTR contain additional common areas and services that would not usually be provided in a BTS or buy to let scheme. Examples of facilities provided at recently developed schemes include roof top gardens, resident gyms, resident lounges, laundry rooms, delivery rooms, concierge, cinemas and conference rooms.

In practice, shared amenity space works for BTR because it allows for common areas (for example, roof top gardens with BBQ areas) to provide functional space which would have otherwise been provided less efficiently within private units (for example through the provision of balconies). By removing the need for such spaces to be provided within private units, shared amenity space can improve block efficiencies and enable greater unit density. This reduces build/maintenance cost due to more efficient amenity provision where the cost is spread across all the units. Shared amenity spaces can also help facilitate relationships between tenants, fostering a sense of community within blocks. This helps minimize tenant turnover and therefore reduce void and re-letting cost.

These additional spaces mean that some of the tenants daily activities may take part in communal areas, which may justify a more flexible approach to space standards. Also, the inclusion of such facilities reduces the gross to net efficiencies of BTR schemes compared to BTS developments. By enforcing the same space standards on BTR developments, local authorities will therefore reduce the overall number of units that could be provided on these sites and the overall viability of the development compared to a BTS scheme is lower.

There is also an important point regarding management and maintenance. An investor will look to design a building that is efficient for management purposes so single aspect versus dual aspects and numbers of units off cores/corridors becomes relevant. For example, if a cleaner is required to pick up waste from storage cupboards on each floors (or outside apartment doors) on a daily basis, they can waste a lot of time navigating multiple cores in the same building.

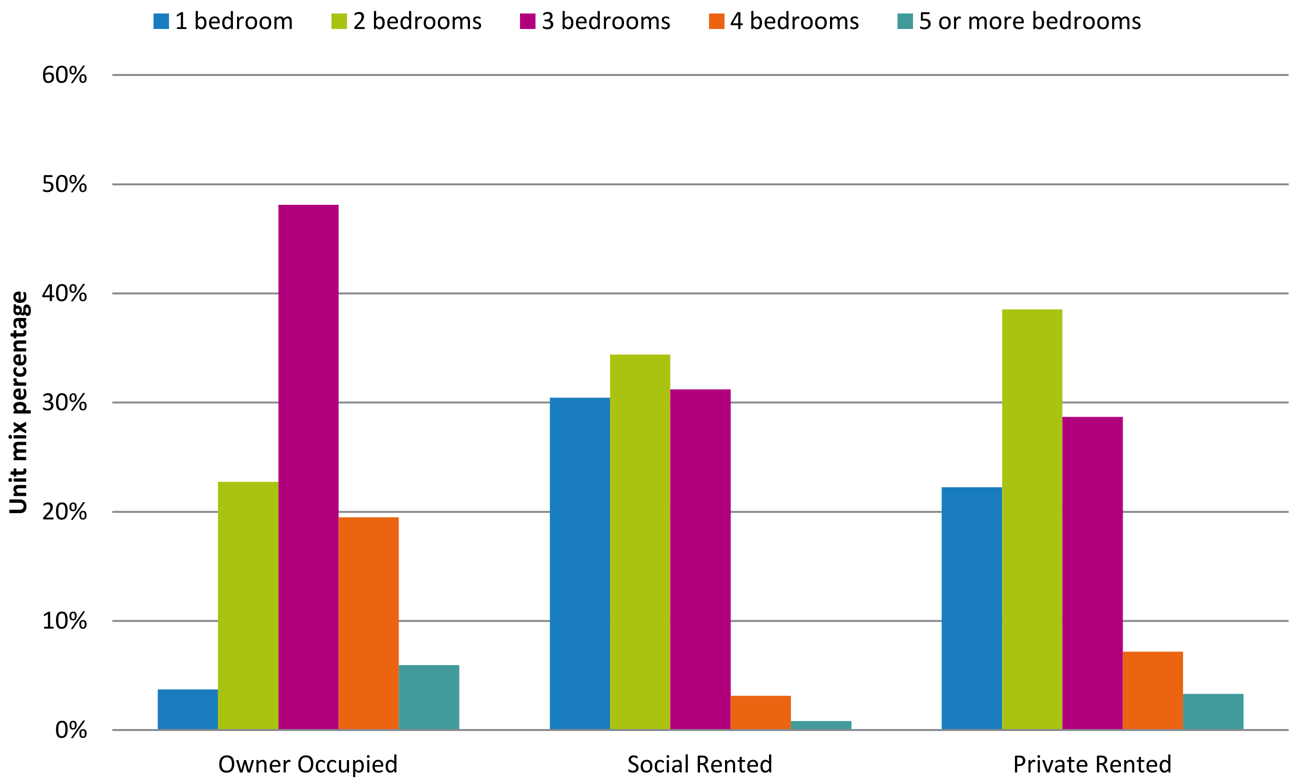
6.2.4. Inappropriate Unit Mix Requirements

National planning policy states that local authorities should plan for a mix of housing based on demographic and market trends. As a result, local authorities often implement policies which prescribe the unit mix (number of bedrooms per unit) of new developments on a proportional basis. These policies are intended to ensure that the needs of the borough's current and future population are met and are most commonly generated from the local authorities Strategic Housing Market Assessment. Frequently, the policies will include requirements for larger three and four bedroom units, intended as family accommodation but do not define the tenure that requires these units.

Therefore, the unit mix requirements are most commonly tenure blind and apply the same standards to both open market sales and PRS schemes. As stated in the stakeholder section, BTR operators consider that demand for PRS units differs from the demand for units to be delivered for open market sale. In particular BTR operators consider that policy requirements to deliver three and four bedroom units are not always appropriate for BTR schemes.

As shown in Figure 14, PRS units in England and Wales have a considerably higher proportion of one and two bedroom units compared to owner occupied units, which have larger number of three and four bedroom units. This is because the occupier profile of PRS differs from the buyer profile of schemes delivered for open market sale as PRS generally includes more young people and couples who do not require larger units.

Figure 14 – Unit Mix of Different Tenures in England and Wales



Source: Nomis, Census 2011

Unit mix polices are also often applied geographically blindly across a administrative area and therefore fail to reflect the nuances of market geography, delivering the wrong unit mix for demand in certain localised contexts. BTR schemes are often in town centre/inner urban contexts, which will typically further skew the occupier profile away from larger households and families, meaning policies requiring three and four bedroom units are often not appropriate. Overtime, the trend towards smaller households will be exacerbated as renters concentrate in more urban areas and in newer schemes.
The GLA Housing SPG (March, 2016) and the Draft Affordable Housing and Viability SPG (November, 2016) state that a flexible approach should be applied to unit mix policies for BTR schemes situated in edge of town centre locations or close to transport nodes to reflect demand and the distinct viability challenges faced by BTR. The SPGs recognise that investment yields and risk perceptions can be affected by an increase in the number of large units within a scheme and that BTR schemes can be particularly suited to higher density development.

However, although the London Mayor, the SPG and the PRS taskforce have been promoting the need for and benefits of BTR to local authorities, according to stakeholder evidence, a large proportion of local authorities are not to understand the model. The guidance is being implemented in differing degrees across the London boroughs, with recent research identified that only 8 of the 33 boroughs in London are proactive in terms of BTR development and supply.

The consequence of applying inappropriate unit mix requirements to BTR operators is that they feel that they are not able to offer their preferred products to the market. The requirements may in effect increase overall unit cost and/or reduce the development density of BTR schemes with consequent impacts on overall scheme viability and likelihood of delivery.

6.2.5. Inappropriate and Inconsistent Approaches to Affordable Housing Requirements

There are certain structural factors that mean that BTR schemes tend to achieve a lower value than open market sale. BTR stakeholders have stated that these lead to complications when negotiating Section 106 affordable housing contributions given the lower residual value of a BTR development compared to the BTS scheme which impacts upon viability margins. These differences maybe related to market failures.

BTR stakeholders have reported that more positive local authorities who are proactively promoting BTR have applied a more flexible approach to affordable housing negotiations by allowing developers to provide lower levels of affordable housing where necessary. They are able to do this by ensuring that the development remains in single ownership, PRS use for a fixed period of time by applying a covenant to the units, with 'clawback' mechanisms included within the section 106. Such mechanisms make provisions to ensure local authorities are compensated if units do end up being openly marketed.

Some local authorities have also recognised that social rent or shared ownership tenure affordable housing may not always be appropriate for BTR developments. Allowing developers to provide discounted market rent (intermediate tenure) where there is an affordable housing requirement allows BTR operators to retain control over planned maintenance and management of the whole of a scheme and ensures blocks remain unbroken. DMR can be used as an option to improve overall viability (versus alternative uses) and any relating covenant is there to manage concessions in planning.

Viability constraints mean that a scheme may be able to provide more DMR units than other tenures of affordable housing. Additionally, the provision of DMR means that the affordable element of a scheme can be pepper potted throughout the scheme, rather than within a separate core, which would be required for other affordable tenures that would need to be retained outside of the ownership of the BTR operator. The pepper potting of affordable units is both desirable from a planning point of view and can lead to design efficiencies in the scheme which may increase the unit density viable on the site.

The GLA's Housing SPG (March 2016) provides guidance on affordable housing viability negotiations for BTR schemes, stating the importance of local authorities recognising the distinct economics of the sector relative to mainstream market housing when undertaking viability assessments. This includes recognising that lower levels of affordable housing may be acceptable for BTR schemes where necessary if covenants and clawbacks are applied.

Despite this guidance, BTR scheme viability testing is still being treating inconsistently across the London boroughs, and even more so nationally. BTR stakeholders have reported that some local authorities are viability testing BTR schemes as if they are BTS developments, failing to recognise the positive benefits of rental supply in markets that need this type of supply nor the fundamental differences in the economics of BTR developments. It has also been reported that some local authorities will not accept discounted market rent in BTR developments and are requiring nomination agreements for all affordable units, meaning operators are unable to retain control over the whole scheme or pepper pot affordable and private units throughout blocks. Some local authorities are also making unreasonable requests for covenants to be made into perpetuity, which has VAT implications (as discussed in more detail below).

The inconsistencies in approach to viability testing are compounded by a lack of consensus around valuation methodologies. When in negotiations different local authorities and their counterparts in private consultancies will use different techniques to test viability, with some using discount to aggregate break up values and others using an initial yield basis. Further complications are generated by the various structures used to deliver BTR projects whereby risk assumptions change from scheme to scheme.

6.2.6. Context: GLA Draft Affordable Housing and Viability Supplementary Planning Guidance

The GLA has recently brought out a new draft Affordable Housing and Viability (SPG) (November, 2016). This document includes substantial guidance on BTR and recognises that BTR schemes have distinct viability challenges.

The SPG states that unit mix policies should be applied flexibly to BTR schemes in town centre of edge of centre locations and that local authorities should have consideration to the viability challenges that can arise by increasing the number of larger units within a scheme. It also states that whilst the space standards set out in the London Plan apply to all tenures, the Plan also provides flexibility to consider innovative designs where they meet identified need and are of an exceptional design and standard. The document states that London Plan space standards are not prescriptive regarding the layout of dwellings and that local authorities should take account of the value of on-site management and purpose built design features of BTR, which may warrant some flexibility on design standards compared to a BTS scheme. It states that local authorities should consider that the length of covenant applied to BTR units may influence the level of flexibility that is acceptable.

The SPG also recognises the benefits of ensuring unified ownership and management of BTR developments and that affordable housing requirements should not compromise this, meaning an affordable offer of entirely discounted market rent units is appropriate on BTR schemes. The Mayor states a preference for these units to be discounted at London Living Rent levels rather than DMR. The document also provides some additional limited guidance as to how viability assessments should be undertaken for BTS schemes.

This document has only very recently been issued so its impact is unknown. Although this draft SPG goes further than the Housing SPG which was adopted in March 2016 in terms providing more detailed guidance it is still only guidance in status and does not form part of the London Plan. As has been evidenced by the Housing SPG, there are considerable inconsistencies the way local authorities interpret such guidance. In order to ensure this guidance is applied more consistently across the London boroughs and has application nationally, amendments to the NPPF and NPPG should be implemented.

6.3. Professional Management Capabilities

The BTR sector has introduced new approaches to management and have brought higher levels of professionalism to the sector as set out in the literature review in section 2. However, given the BTR markets immaturity, stakeholders have reported that the availability of skills and the education of professionals to manage BTR properties are not adequate. This suggests an imperfect information/immature market failure.

6.4. Disproportionate Taxes/Levies on BTR

As set out in the stakeholder section, there are three types of tax/levy on development that are seen to be disproportionately applied to the BTR sector and potentially represent regulatory failures for the BTR sector including:

- Stamp Duty Land Tax (SDLT) surcharge;
- Value Added Tax (VAT); and
- Community Infrastructure Levy (CIL).

6.4.1. SDLT Surcharge

Earlier this year the Government introduced a SDLT surcharge on purchases of additional residential properties. The higher rates are 3% above the current SDLT rates which took effect from 1 April 2016. The higher rates apply to purchases of residential property by individual buyers and companies.

Feedback from BTR operators suggests that in most cases the land value differential between developments for the owner occupation market and the BTR sector means that the SDLT surcharge is in effect disproportionally higher for BTR. Compounded with the relative immaturity of the BTR sector may hold back higher levels of BTR development.

6.4.2. VAT on Construction Costs

It is normally possible to reclaim VAT on the construction of new residential units, as the first grant of a major interest (the initial grant of a freehold or leasehold interest of over 21 years) in a residential property is classified as a zero rated supply. However, if a BTR scheme is developed and held by a single developer/investor, there is no qualifying major interest granted, as the units are retained by the developer and Assured Shorthold Tenancies granted to occupiers, which fall below the 21 year leasehold minimum required to be classed as a major interest. This means that the supply of the units is exempt from VAT rather than zero rated, and therefore it is not possible to reclaim VAT on the construction costs. This adds a considerable disproportionate cost to the construction of BTR for developer/investors compared to the construction of other forms of housing, including units that are sold to BTL investors. This impacts on the viability of BTR sites and means BTR schemes may be unable to compete for sites with other forms of development.

6.4.3. VAT on Maintenance and Repairs

As discussed above, the first grant of a major interest in a residential property is a zero rated supply. This only applies to the initial grant of a freehold or leasehold interest of over 21 years. As well as being problematic for BTR developer/investors in regards to construction costs, this also means BTR operators are unable to reclaim VAT on maintenance and repairs expenditure. This is because rent charged to occupiers of the BTR units is an exempt supply rather than being zero rated, as the Assured Shorthold Tenancies granted to occupiers fail to meet the 21 year minimum term and the units are continually re-let over the period of the investment (meaning after the first tenancy is granted, letting of the units is no longer classed as the 'first grant' of the interest). This means there is nothing to off-set the maintenance and repair costs against and the VAT on these costs are unable to be reclaimed.

For commercial properties, generally a landlord is able to reclaim VAT on maintenance and repairs as they can opt to tax (or waive the rental exemption), meaning they can charge VAT on the rent of a commercial tenant. This additional VAT on rent is normally then reclaimable for commercial tenants, as generally they will be VAT registered businesses, producing VAT chargeable supplies. As residential occupiers do not produce any VAT chargeable supplies, they are unable to reclaim VAT charged on rent. It is therefore not possible to opt to tax a residential property. This puts an additional 20% on the cost of holding a BTR investment compared to a commercial property, which has a substantial impact on viability.

6.4.4. Community Infrastructure Levy

Community Infrastructure Levy (CIL) is a planning obligation levied on the development of new floorspace, payable on commencement of construction. It is set by each local authority at a rate that should not affect viability for most schemes. However, the way CIL charges are typically set and applied may disadvantage BTR development. CIL charges for residential development are typically estimated by preparing a series of generic development schemes and assessing viability and residual land values against typical local costs, values and assumptions on affordable housing and Section 106 requirements. These appraisals do not usually separately consider BTR schemes separately and consequently viability is calculated with reference to the values achieve by BTS schemes. Where there is a differential between BTR and build for sale scheme values per square metre this could disadvantage BTR schemes.

6.5. Political Uncertainty and Regulation

Unlike traditional open market sale developers, BTR operators will typically be committing to holding their assets for at least 10 years. This means that the risk of future political and regulatory changes is of much more importance to BTR investors. In the 1960s and 1970s, rent controls and security of tenure policies substantially reduced institutional investment in the sector. The more prevalent a political consensus is on the BTR sector means that there will be much lower risk of regulatory changes which in turn will increase the volume of investment into the sector.

Whilst there appears to be near ubiquitous support for growing the PRS, it is to some extent at odds with successive government ideology to promote and sustain homeownership. Key government initiatives such as changes to stamp duty indicate a less than wholly positive political arena for PRS investment and for some investors continue to sustain their reticence. We are anticipating that the new government administration post-Brexit will show more support for the development of mixed tenure in a bid to increase supply across the board, as indicated in recent speeches by the Housing Minister.

At a local level there also appears to be some reticence/lack of understanding/lack of support for BTR housing that expresses itself in inappropriate and/or inflexible policies and initiatives such as approaches to development of public sector land and/or joint ventures.

Overall these factors will tend to add to the uncertainty around the parameters and returns for BTR schemes and will tend to reduce the amount of development compared to a situation with more certainty and support. This can be characterised as an imperfect information market failure and a regulatory failure.

6.6. Inflexible Labour Markets

Labour market mobility is of wider benefit to the economy as it allows a better match between vacancies and skills, with consequent higher productivity, economic growth and household income. It has been shown to increase both the employment rate and the rate of participation in the labour force (Di Tella and MacCulloch, 2002; Nickell, 1997).

Research has found that private renting tenants in the UK continually have higher levels of mobility than both owner occupiers and local authority tenants, and migration rates for private tenants had increased over time (e.g. see studies by Hughes and McCormick, 1981, 1985, 1987, 1990 and 2000) although this trend has been less clear as the sector has expanded (Cho and Whitehead, 2013). This trend is not isolated to the UK, with OECD analysis also showing that on average an owner without a mortgage is estimated to be 13% less likely to move every year than a private renter (OECD, 2011). Some authors have argued that housing tenure is one explanation for why the UK has lower mobility of people in lower paid occupations (mainly manual) compared to US where the PRS is proportionally much larger (Champion et al., 1998; DTZ Consulting & Research, 2006).

Interpretation of these trends is, however, difficult because causation cannot be easily established and because it is particularly important to distinguish local and longer distance moves (a very small minority) and choice versus constrained moves given short term tenancies. Households' preferences for mobility will also influence their choice of tenure, leading to self-selection bias (Caldera Sánchez and Andrews, 2011; OECD, 2011). Nonetheless most authors agree that tenure does have at least a partial causal impact on mobility (e.g. DTZ Consulting & Research, 2006).

This impact is in part underpinned by the considerably higher transactions costs of moving home as an owner occupier compared to a private renter (see Coulson and Fisher, 2009). It is also likely a result of regional house price disparities which affect owner occupiers more than those in the PRS. Owner occupiers from comparatively low priced regions find it difficult to move to higher priced regions and homeowners in regions with high house prices may also be reluctant to move out because they may be unable to afford to move back unless they can rent out their property. If house prices do start to fall household may also be reluctant to move into areas with falling prices because investment in property seems unwise and owners within areas with falling prices may find it hard to sell (Champion et al, 1998; DTZ Consulting & Research, 2006). Such investment considerations are not as prevalent a concern for PRS tenants.

To the extent that BTR helps increase the size of the PRS and provides a somewhat different product in the UK, it can help improve labour market flexibility and subsequently generate wider economic benefits. The BTR sector tends to be well suited to young professionals on medium range incomes who might otherwise consider owner occupation which could inhibit flexibility. The branded nature of BTR schemes also means that tenants may benefit from a quality assurance when moving between developments under the same management or managed to similar standards, which will likely influence relocation decisions and therefore improve labour mobility.

The wider benefits of increased labour market flexibility are an externality and may not be reflected in the relative price of PRS compared to owner occupation and/or are not reflected in the choices of tenure made by occupiers due to insufficient supply (which inter-relates with other types of market failure in the BTR sector). Like some of the benefits in the improvement of managerial quality BTR could bring to the PRS, labour market flexibility is unlikely to be recognised in the narrower commercial incentives relating to BTR schemes and alternative competing potential uses of possible BTR development sites. If this is recognised as a benefit of the BTR sector, this into the longer term could justify use of public sector policy intervention to enhance the scale and nature of BTR development. However, it should be noted that the scale of the impact over the next few years can only be small.

6.7. Contribution to Regeneration and Economic Development

There are potentially a number of reasons why BTR schemes, particularly in town centre contexts, bring wider regeneration and economic benefits. For example BTR schemes in town centre locations tend to offer greater opportunities for higher density development, increased local household incomes and propensity to spend in the local area. Relevant ways this could operate include:

- Residents of BTR schemes may bring greater economic benefits. This, for example, is in terms of greater local spending, leading to creation of more local jobs in services including retail and leisure. If schemes also include / support co-working and/or business start-up type space, it could also facilitate creation of digital and media type jobs.

- BTR schemes may deliver more housing units and take more appropriate advantage of the higher public transport accessibility of town centre location than other types of development. An element of this case could be that residents of BTR flats are less likely to own cars and want car parking spaces, consequently freeing up more of the sites for homes and/or employment uses.

- The higher absorption rates of BTR compared to BTS developments can mean that delivering a portion of BTR on larger multi-phase regeneration sites can have placemaking benefits by accelerating the occupation of the site, helping foster a sense of community whilst the wider development may still be on-going.

The lack of market signals/mechanisms to recognise the benefits of BTR for regeneration and economic development represent an externality market failure. Such benefits are not recognised in the narrower commercial factors relating to BTR schemes and alternative competing potential uses of possible BTR development sites. If this is recognised as a benefit of the BTR sector this could justify use of public sector subsidies to enhance the scale and nature of BTR development.

6.8. Job Creation and Quality of Management

As well as directly providing a higher level of professionalism to management in the sector, it is likely that a larger BTR sector will indirectly improve the quality of management across the PRS. As tenants are provided with more choice within the market, other rental providers will have to increase the quality of their management as well in order to compete with BTR schemes. to the extent that this overall increase in the quality of management and professionalism in BTR developments provides a benefit, this is unlikely to be recognised in the narrower commercial incentives relating to BTR schemes and alternative competing potential uses of possible BTR development sites. This is a market failure in that it is a positive externality which could justify the use of public sector policy intervention to enhance the scale and nature of the BTR sector.

Another positive externality associated with the management of BTR schemes is the number of additional jobs generated. It is estimated that for every 500 BTR units approximately 15 jobs are created (including concierge, estate management, building management, cleaners, maintenance and gardeners). These jobs will generate wider economic benefits for the economy which are again not priced into the narrower commercial incentives relating to BTR schemes and alternative competing potential uses of possible BTR development sites. Again this is market failure in that it is a positive externality not priced by the market which could justify the use of public sector policy intervention.

6.9. Equity/Distributional Impacts

'Distributional impacts' is a term used to describe the distribution of the costs or benefits of interventions across different groups in society. Proposals might have differential impacts on individuals, amongst other aspects, according to their income, gender, ethnicity, age, geographical location, and disability2. The analysis gives consideration to potential distributional impacts of each of the policy options through a qualitative assessment.

[2] See 'The Green Book', Annex 5, HM Treasury, 2003.

7. Policy Options and Appraisal Framework

This chapter sets out a set of policy options designed to address the market and regulatory failures outlined in the previous chapter. These options draw upon published studies, internal sources, and the stakeholder consultation.

The report focuses on policy options that address the specific market and regulatory failure as they relate to the BTR sector and its role in the housing market. It does not cover policy and regulatory options that could address more general types of market failure that are of wider applicability across the housing sector unless they have specific and/or disproportionate relevance to the BTR sector.

The primary focus of each intervention is to increase the growth in the number of BTR units above the current rate provided that this does not inappropriately lead to a reduction in the delivery of other types of housing. To achieve the objective a range of policy options have been identified that are targeted at addressing market failures, regulatory inequalities and promote market maturity. Policy options are divided up in to the main types of market failure/intervention and then different approaches that could be taken within each market failure heading.

The policy options are mostly independent of each other and could be applied individually or collectively.

The report does not present policy options to address the externalities of labour market flexibility, regeneration benefits, job creation and improved quality of management as these have been taken as potential benefits that are a consequence of other policies rather than specific policy triggers. However, if these benefits are recognised they could have implications for the scale and nature of the policy mix.

The following policy objectives apply to the objectives of this study:

- To increase the number of new homes coming forward for development by appropriately promoting the BTR sector.
- To optimise the wider social and economic benefits of promoting the BTR sector.

These are the overarching tests and outcomes on which to assess the policy options (See following chapter for further details on the appraisal framework).

7.1. Do Nothing/Reference Case

7.1.1. Continue with Current Policies

The Treasury Green Book and Five Case guidance requires that the appraisal includes a do nothing/reference case option. This has been taken to be a continuation of the current rate of delivery and relevant policies without additional public policy intervention.

7.2. Policies to Improve Access to Finance

Three policy options aiming to address the imperfect information/immature market failure of the BTR sectors restricted access to the finance have been presented:

7.2.1. A1. Market Transparency

Policy/Guidance: Improve knowledge of the characteristics of the BTR sector by disseminating available information on the financial performance of the BTR sector to lenders and investors.

Suggested Implementation Mechanism: Draw upon international experience through the UKAA (an affiliation of the US National Apartment Association (NAA), promote MSCI Performance Measurement for BTR, explore information held by the HCA could be aggregated to provide data on financial performance and characteristics, and, explore how the GLA Portal for advertising BTR stock could be extended nationally.

7.2.2. A2. Extension of public sector loans programme

Policy/Guidance: Continue to provide development loans for BTR schemes from the Home Builders Fund for targeted delivery of BTR where there is a clear additionality benefit.

Suggested Implementation Mechanism: Ring fence a proportion of funding from the Homes Builders Fund to support the delivery of Build to Rent schemes.

7.2.3. A3. Extension of PRS Debt Guarantee scheme

Policy/Guidance: Continue to provide public sector debt guarantees for investment finance of BTR schemes.

Suggested Implementation Mechanism: Extend the existing PRS Debt Guarantee Fund using some or all of £3bn that was held in reserve when the programme was introduced. The scheme has completed two bond raises (January 2017) and the deadline for application for the funding is December 2017. The Guarantee should also be extended to allow for capital raised through the programme for lending during a construction / stabilisation period (priced on a risk adjusted basis). The guarantee might also be used to underwrite MMC. For example, MMC struggles to get off the ground given funder risks of backing new companies pioneering construction methods, and often very difficult to value works completed versus in progress.

7.3. Changes to the Planning System

Six policy options aiming to address regulatory failure of inappropriate planning policy have been presented:

7.3.1. B1. BTR Planning Definition

Policy/Guidance: Provide a statutory definition of BTR within national planning policy, along with guidance regarding appropriate covenant lengths where concessions are made in the provision of Affordable Housing or other planning obligations which give the BTR scheme a financial advantage over a typical build-for-sale planning application. Provide guidance on the wording of covenants to ensure that the construction of BTR units can be VAT zero-rated.

Suggested Implementation Mechanism: The inclusion of BTR within Annex 2 (Glossary) of the National Planning Policy Framework and the introduction of new National Planning Policy Guidance (NPPG).

7.3.2. B2. Car Parking

Policy/Guidance: Strengthen policy requirements for local authorities to provide an adequate evidence basis for minimum car parking standards imposed on residential developments, which explicitly assesses need based on the unit mix and tenure of schemes, alongside the site's accessibility to public transport infrastructure and local amenities. Provide further guidance on how this should be applied to BTR schemes.

Suggested Implementation Mechanism: Amend the wording of paragraph 39 and 40 of the NPPF (2012) and provide additional supporting guidance on how this applies to BTR developments specifically within the NPPG.

7.3.3. B3. Unit Size

Policy/Guidance: Strengthen planning policy requiring local authorities to identify appropriate internal space standards taking in to account different types of housing product before adopting them and to ensure that the impact of adopting standards on the viability of both BTS and BTR schemes are considered. Amend policy to allow for smaller units to be included in BTR developments where extensive communal amenities are provided on-site.

Suggested Implementation Mechanism: Amend the Nationally Described Space Standards (2015) and the supporting NPPG 'Housing- Optional Technical Standards' (paragraphs 018 – 023). Amend paragraph 020 of the NPPG and consider bringing it into the NPPF.

7.3.4. B4. Unit Mix

Policy/Guidance: Strengthen policy requirements for local authorities to take explicit account of tenure, alongside accessibility to public transport infrastructure and local amenities when setting unit mix requirements. Generally higher density, smaller units should be encouraged close to public transport links, particularly, where there is evidence of under-occupied larger units in the rest of a local authority area. When the evidence base suggests it is required this may include setting different standards for BTR developments and/or for development situated in town centre or edge of town centre locations.

Suggested Implementation Mechanism: Amend paragraph 50 of the NPPF.

7.3.5. B5. Affordable Housing Requirements

Policy/Guidance: Provide guidance on how affordable housing viability assessments should be undertaken for BTR proposals. This should allow for the possibility of lower levels of affordable housing on BTR schemes if suitable covenants and/or Section 106 clawback provisions are agreed. Guidance on the wording of Section 106 agreements and covenants to ensure that the construction of BTR units will always be VAT zero-rated should be provided.

It should also recognise that discounted market rent (DMR) is often a more appropriate form of affordable housing for BTR developments than traditional affordable/social rent or discounted market sale tenures. Justification for this approach would include: BTR in viability terms is less able to support other types of tenure; DMR is a form of affordable housing easier to integrate with BTR than other forms; and overall BTR together with DMR offer the opportunity to increase the overall supply of housing (see subsequent chapters for appraisal). Guidance on appropriate covenant and clawback lengths should be provided, including guidance on how covenants and clawback mechanisms should be worded to ensure the construction of BTR units can always be zero-rated. Valuation methodology best practice guidance should also be provided.

Suggested Implementation Mechanism: Introduce new NPPG guidance and support the RICS in producing an updated version of their 'Financial Viability in Planning' (2012) Guidance Note with specific reference to BTR schemes, or support/promote a similar alternative professional guide.

7.3.6. Planning Preference for BTR on Large Sites

Local authorities currently allocate development land for various uses within their local plans, in line with local need and requirements set out in the NPPF. To differing degrees these allocations establish the principle of development on a site. For larger sites local authorities will often produce policies outlining the volume, type and broad layout of development they would like to come forward. This de-risks sites for developers, increasing investor confidence by speeding up the planning process.

Additionally, the Housing and Planning Act (2016) brought a new route to gain planning approval for housing-led development known as Planning in Principle (PiP). Intended to speed up the planning system and provide more certainty to developers, the aim of PiP is for local authorities to grant approval for the fundamentals of the development of a site (land use, location and quality of development). PiP is awarded either via an application made to the local authority by a developer/land owner or through 'qualifying documents' produced by the local authority, including the development plan documents, neighbourhood plan documents or brownfield registers. Once a site has been granted PiP an applicant will then need to submit only streamlined application with the details of the development, as opposed to having to establish the principles of the scheme. Details of PiP have yet to be set out in regulations. However, it is anticipated that the mechanism will be primarily focused on smaller sites, where detailed site allocation policies are currently unlikely to exist.

It is anticipated that it is unlikely that local authorities will be able directly to allocate sites for BTR, as use classes do not allow for tenure to be defined and typically allocations are on a land use rather than tenure basis. This means such allocations or PiP qualifying documentation will need to encourage BTR, or state a local authority's preference for BTR on a site, rather than enforcing a requirement for BTR. For example, a local authority could state that their vision for a site includes certain blocks within a master plan coming forward as BTR.

Encouraging local authorities to consider BTR when producing site allocation documents or granting planning approval via PiP could be justified by the positive externalities the sector can generate in terms of labour market flexibility, regeneration benefit, job creation and improved quality of management. Local authorities could also use BTR to encourage sites to come forward quicker, as the faster absorption rates of BTR allow for quicker build-out. It could also work to address the regulatory failure of political and regulatory uncertainty currently within the sector, de-risking sites for BTR developers.

Policy Suggestion: Encourage local authorities to state where BTR may be appropriate within site allocations within the Local Plan or when granting PiP for development sites.

Suggested Implementation Mechanism: Amend the NPPF (Chapter 6) to include specific reference to BTR, ensuring local authorities consider BTR when assessing 5 year land supply. Ensure local authorities are fully aware of the benefits of BTR by better promoting existing best practice guidance (for example the DCLG guidance: "Accelerating housing supply and increasing tenant choice in the private rented sector: a Build to Rent guide for local authorities" (2015)). Provide further guidance setting out how local authorities could encourage BTR via site allocations of PiP.

7.4. Improve BTR Property Management

Two policy options aiming to address the imperfect information/immature market failure of poor professional management capabilities have been presented:

7.4.1. C1. Residential Management Apprenticeships

Provide funding for residential management apprenticeships, likely building on existing work by Aspire Group and the National Housing Federation (with the Department for Business, Innovation and Skills and the Skills Funding Agency).

7.4.2. C2. Sponsor/Promote Residential Management Good Practice

In co-ordination with improved training, examples of best practice and exemplar schemes could be recognised by appropriate Government departments (assumed to mainly concern DCLG and Department for Education) and their practices promoted across the industry.

7.5. Changes to Levies/Tax Tools

Three policy options aiming to address the regulatory failure of disproportionate taxes/levies on the BTR sector have been presented:

7.5.1. D1. Amend SDLT Surcharge

Exempt large scale landlords from the 3% SDLT surcharge. The stakeholder consultation raised questions regarding the compatibility with state aid rules. However, there appears to be precedents set by the Scottish Government's decision to exempt institutional transactions when the surcharge was introduced and this should be investigated further.

7.5.2. D2. Revise CIL Regulations

CIL legislation is currently being reviewed, presenting an opportunity for BTR to be explicitly considered in regard to the current and any new proposed system. Consideration to the implications for BTR should be made as part of any proposed amendments to the existing regime to ensure CIL does not compromise the viability of BTR.

Policy/Guidance: Encourage CIL charging authorities to carry out separate appraisals for BTR development and set distinct charges for BTR development at appropriately different rates to for sale housing.

Suggested Implementation Mechanism: Amend paragraphs 021 – 022 of the NPPG or possibly make amendments to the CIL statutory instruments.

7.5.3. D3. Zero Rate VAT on Repairs and Maintenance

The current wording of VAT legislation means that whilst it is generally possible to reclaim VAT on the construction of other forms of residential properties, it is not always possible for the construction of BTR units. The legislation also means that unlike landlords who own property let to commercial tenants, BTR landlords are also unable to reclaim VAT on management costs.

Policy/Guidance: Extend the criteria for the zero rated supply of residential units to include the grant of any (not just the first grant) freehold interest or leasehold interest of over 1 year (allowing the grant of Assured Shorthold Tenancies to be applicable).

Suggested Implementation Mechanism: Amend the VAT legislation. It is understood that this may not be possible to implement until the UK leaves the EU, as the EU currently has substantial powers over the VAT regimes of Member States.

7.6. Reducing Overall Political and Policy Uncertainty

One policy options aiming to address the regulatory failure of political and regulatory uncertainty has been presented:

Policy/Guidance: Establish cross-party support for BTR in order to minimize the risk of political and regulatory uncertainty and enhance investor confidence.

Suggested Implementation Mechanism: Set up a cross-party commission for BTR, or include explicit consideration of BTR within the scope of a wider cross-party Housing Commission.

7.7. Summary of Policy Options

The policy options taken forward for analysis are summarised in the following table.

Table 11 – Policy Options

Policy	Type of market/regulatory failure it aims to address
A. Improved access to finance	
A1. Market Transparency	Imperfect information/immature market
A2. Extension of public sector loans programme	Imperfect information/immature market and externalities
A3. Extension of PRS Debt Guarantee scheme	Imperfect information/immature market and externalities
B. Improved planning policies	
B1. BTR planning definition	Regulatory failure
B2. Car parking	Regulatory failure
B3. Unit mix	Regulatory failure
B4. Unit size	Regulatory failure
B5. Affordable housing	Regulatory failure
B7. Planning Preference for BTR on Large Sites	Regulatory failure/immature market
C. Enhanced quality of management	
C1. Residential management apprenticeships	Imperfect information/immature market
C2. Promote residential management good practice	Imperfect information/immature market
D. Changes to tax tools	
D1. Remove SDLT surcharge on BTR	Regulatory failure
D2. Revise CIL Regulations	Regulatory failure
D3. Zero-Rate VAT on repairs and maintenance	Regulatory failure
E. Reduce overall political and policy uncertainty	
E1. Establish cross-party support	Regulatory failure

Source: Savills and LSE, 2016

The options are not necessarily alternatives and could be used in combinations. However, different options may be more or less cost-effective.

8. Appraisal Framework

This section sets out the process used to appraise each of the policy options. It sets this in context by first considering overall objectives, outcomes and outputs and fit with the Treasury Five Case model. It then sets out the general and specific approach to appraisal of the policy options.

8.1. Objectives, Outcomes and Outputs

The objectives used to define the effectiveness of the policy options include:

- To increase the number of new homes coming forward for development by appropriately promoting the BTR sector.
- To optimise the wider social and economic benefits of promoting the BTR sector.

The outcomes are:

- Additional BTR housing units and additional housing units overall;
- Better quality PRS;
- Improvement in housing management (specifics to be developed);
- Additional jobs and economic output; and
- Neutral equality/distributional impact.

The intermediate outputs include:

- Scale and nature of improved lending terms to the BTR sector;
- Scale of public sector subsidy to the BTR sector;
- Number and nature of revised planning policies more favourable to BTR;
- Number and nature of management training courses completed;
- Number and nature of revised/new CIL charging schedules with specific and favourable allowance for BTR development;
- The number of additional BTR units;
- Changes to the number of other types of housing units; and
- Equality/distributional impact monitoring.

8.2. Five Case Model Tests

The approach set out below takes account of the Five Case model, covering the strategic case, economic case, commercial case, financial case and management case[3]:

- The **strategic case** should demonstrate 'that the spending proposal provides business synergy and strategic fit and is predicated upon a robust and evidence based case for change'. This is largely covered by the overall objectives and review of the role of the BTR sector and quantification of the change in the supply of housing.

- The **economic case** 'is to demonstrate that the spending proposal optimises public value (to the UK as a whole)'. This is covered via the analysis of economic benefits of the options in terms of jobs created and GVA added.

[3] E.g. see 'Public Sector Business Cases Using The Five Case Model Green Book Supplementary Guidance on Delivering Public Value from Spending Proposals', HM Treasury, 2013

- The **commercial case** should demonstrate 'that the preferred option will result in a viable procurement and well structured deal'. This is addressed this by considering how easy it will be for the public sector to procure relevant services to meet each of the policy options.

- The **financial case '**demonstrates that the preferred option will result in a fundable and affordable deal'. this is considered by the potential public sector capital and revenue requirements to delivering each policy option.

- The **management case** 'demonstrates that the preferred option is capable of being delivered successfully, in accordance with recognised best practice'. This is addressed by considering the practicality of delivering each policy option, primarily in terms of organisational resources and skills.

8.3. Overall Approach to Appraisal

The overall approach follows Treasury Green Book appraisal good practice. In particular, the approach compares the estimate of the outcomes of each policy option with the reference case/do nothing scenario to assess the net additional change of each option.

The timeframe focuses on the periods to 2020 and 2030 with the intention of allowing enough time for the policies to take effect and influence the scale of development while not extending too far in to an uncertain future.

There is limited relevant information and a large number of unknown current and future variables that makes it difficult to estimate the quantitative impact of policy options. The general principles of the approach set out below are to assess the strategic and economic cases through qualitative analysis of the policy options and consider the nature and scale of impacts. The approach then uses an order of magnitude and precedents to give indications of the quantitative impacts.

8.4. Specific Option Appraisals

Below we set out the specific approach to assessing strategic and economic impacts for each group of policy options.

8.4.1. A. Improved Access to Finance

The approach to appraisal of policy options A1 and A2 is:

- Review and assess the different types of financing used on existing BTR schemes; and
- Consider to what degree the guidance will help change the terms on which the different types of finance are offered; and

8.4.2. B. Improved Planning Policy

The approach to policy options B1 to B3 (encouraging planning policies more favourable to BTR schemes) is to:

- Categorise BTR typologies in terms of relevance of policies (e.g. urban versus suburban);
- Clarify examples of where developers are saying standards are inappropriate; and
- Draw conclusions on the effectiveness of policies.

8.4.3. C. Enhance Quality of Professional Management

The approach to policy options C1 and C2 (housing management training and good practice guidance) is to:

- Review evidence on the nature of deficiencies in housing management practice and skills relevant to BTR; and
- Review and estimate likely effectiveness of housing management training and good practice guidance in improving housing management practice.

8.4.4. D. Changes to Tax Tools

The approach to appraisal of policy options D1 changes to SDLT surcharge and D2 CIL and D3 VAT is to:

- Estimate the extent to which changes to the costs will improve the profitability and competitiveness of BTR schemes. This might use generic development scenarios and assumptions on costs and returns; and
- Estimate net additional BTR schemes coming forward over the appraisal period as a consequence of the policies.

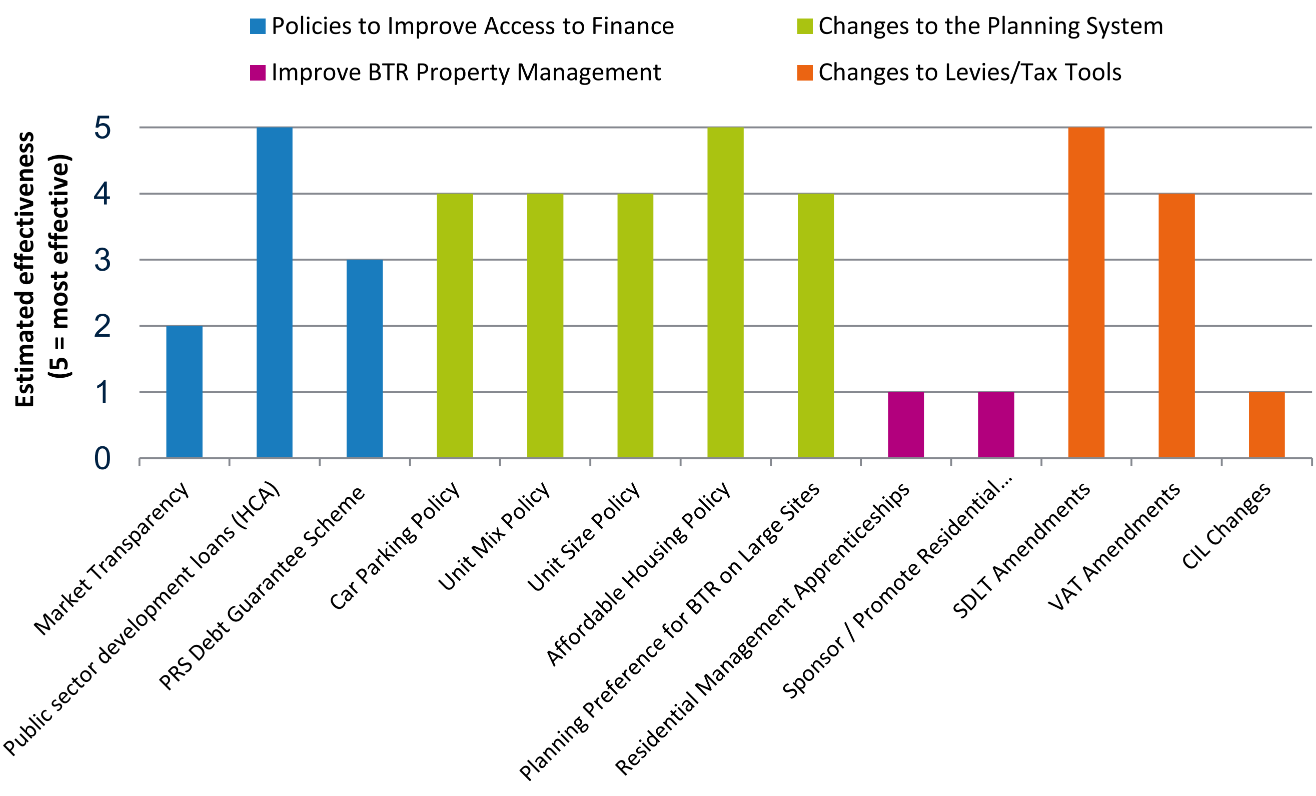
9. Policy Options Appraisal

This chapter sets out the analysis of the policy options to address BTR market failures. It looks at the cost benefit of the different policies as well as the number of BTR units that could be delivered. The policies have been considered in terms of their potential effectiveness over time. The assessment focuses on a comparative and qualitative appraisal. The analysis suggests a number of factors that will differentiate the effectiveness of different policies. Each policy is given a score between 0 (very low) and 5 (high) to indicate their potential effectiveness at increasing BTR and overall housing supply.

9.1. Summary

In summary, our assessments is that the most effective policies in terms of increasing the supply of BTR homes are policies to improve access to development finance, changes to planning policy and amendments to taxation. The policies to improve access to finance primarily relate to the continuation and extension of existing schemes by time and scope whilst the changes to planning policy represent further evolution of existing policies. The planning changes are likely to generate the greatest increase in the delivery of BTR homes while the tax changes will have the biggest impact on investor returns and thus viability.

Figure 15 - Summary of the Comparative Effectiveness of the Policy Options



Source: Savills, 2017

The success of these policies will depend on the extent to which BTR is truly additional to other forms of housing development. The most important positive impacts will be in two situations: risky markets and large sites but Planning policy changes can also have site specific benefits through increasing viability.

Risky Markets

BTR has positive impact on delivery on sites where other forms of housing are not viable but the policy leads to a BTR scheme being viable. This is most likely on sites situated in locations where there is substantial sales risk, either because the site is in a lower value regeneration area or where there is a substantial pipeline of residential stock planned to come forward for sale. In these locations, a development for sale is less likely to be viable, but a BTR scheme (or a portion of the scheme being brought forward as BTR) may mitigate sales risk and therefore unlock the development of new homes where there otherwise would have been none.

Where perceived sales risk is lower, these policies may lead to BTR displacing other forms of housing development on some sites. On such sites the policies will be less effective in terms of increasing the overall supply of new homes. Build to sell schemes generally support the delivery of affordable housing so where BTR comes forward instead of a build for sell scheme then there is potential displacement shift in the balance of affordable housing provided towards DMR.

Large sites

The majority of the policies are considered to be most effective at increasing supply on larger urban sites. Given that BTR developments are often situated in town centre or edge of centre urban locations usually with good infrastructure links, it is positive that the policies are most effective for this development typology. In general, this development typology has the biggest viability challenges and therefore policy intervention is needed for these sites.

9.2. Policies to Improve Access to Finance

9.2.1. A1. Market Transparency

Market transparency would be improved by promoting the distribution of information about the financial characteristics and performance of the BTR sector. How effective this policy could be depends on factors including:

- How much information is available that players do not have access to?
- How does the sector work and how do players use information to make decisions? Consequently, how long it is likely to take for the effects of improved market information to take effect?
- Once the policy does take effect how much impact could it have on the scale of supply? What examples and parallels in other sectors may give an indication of potential growth?

The HCA and Venn Partners, through issuing debt and equity funding to the emerging BTR market, hold a large amount of financial and market information on the sector. Our suggested immediate focus for this policy is to collate this information on stock that is going through the stabilisation phase to draw out the key financial characteristics in aggregate form that the wider lending markets require. There are a number of organisations that report on real estate performance, including PRS and multifamily. For example, MSCI report on the performance of all real estate sectors on behalf of institutional investors globally and they have the reporting systems in place to be able to collate and disseminate data and financial information.

The relative cost of initiatives to promote market transparency is likely to be modest compared to the potential scale of investment and growth in the sector. Improved information will benefit the vast majority of BTR developments in all locations and of all sizes. This policy will have the biggest impact on large urban sites, as these are typically more complex with greater up-front capital expenditure and therefore a higher risk profile.

The information is already held by the HCA and Venn Partners which means there should be minimal cost in ensuring this data is collated and made available to the BTR sector. Collecting and publicising the data as the sector emerges will require some expenditure, although a substantial proportion of this is likely to be funded by the private sector (through existing and future new subscription databases such as MSCI or Molior). Getting to full market transparency can take many years so this policy has the potential to speed up this process.

It is critically important that as the BTR market emerges that the information and data required by the industry, both public and private sector, is collated and disseminated. Much of this should be done by the private sector but there is the opportunity for the government to speed up this process.

This policy will benefit the whole BTR sector. It has the potential to speed up delivery by helping lenders and funders make quicker investment decisions, give confidence in the performance of the sector and lower the cost of finance through greater market transparency. It is also considered cost effective with much of the cost being met by the private sector. It has however been given a score of 2 (Medium Low Impact) in terms of its effectiveness at directly impacting on the delivering of new BTR homes in the short to medium term. It is assessed as being likely to take a while to set up and for the relevant decision makers to adjust their perspectives in the light of the information. Part of the context is that decision makers would ideally like to have a longer timeframe of performance information.

9.2.2. A2 and A3. Extension of Public Sector Development Loans and PRS Loan Guarantees Programmes

The HCA BTR Fund 1 and 2 has provided development funding for new BTR schemes since its introduction in 2012. The aim of the financial support is to bridge the funding gap and effectively provide funding where a scheme cannot secure funding in the market at a viable cost. These loans are on commercial terms and repaid on completion or sale of the scheme. Further targeted funding in the BTR sector should be beneficial given current funding constraints. It would provide a positive signal to the market that the Government continues to see benefit in supporting delivery of new rented housing.

This policy initiative is likely to play a vital role in unlocking BTR schemes that cannot secure viable funding from the mainstream lenders. In practice, a proportion of the Home Builders Fund could be used to support BTR delivery focusing on locations and sites where the BTR will not displace build for sale. This programme already exists and is deemed highly cost effective to extend and therefore has been given a score of 5 (High Impact).

In addition, the Government's PRS Debt Guarantee Scheme could be extended beyond next year and its scope could be widened to allow for construction/leasing periods. There is a large pipeline of stock applying for the funding. Having potential investment finance available to support completed schemes gives the market a positive signal of continued support of BTR delivery. The programme is already up and running so there would be limited costs in extending the programmes. The risk of default is considered low given the pricing of this debt.

Extension of the PRS Debt Guarantee scheme is seen as cost effective because the scheme is already operational and the risk of default is considered low evidenced by the price of these bonds. There is strong appetite from investors to supply investment finance so extending this finance is less effective than the HCA loans which target development and delivery. This policy has therefore been given a score of 3 (Medium Impact).

9.3. Changes to the Planning System

9.3.1. B1. BTR Planning Definition

A statutory definition of BTR used for planning purposes is very desirable to help ensure implementation of our recommended changes to planning policies and ensuring a consistent interpretation across local authorities. A statutory definition could accelerate and maximise delivery of homes indirectly. For example, a definition that includes covenants ensuring development remains as BTR for an agreed term (as for example used by the GLA) helps the other planning policy recommendations to be considered acceptable in planning terms, and ensures that the distinct economies of BTR developments are recognised consistently by local authorities. It will also improve the knowledge and understanding of the sector among planning professionals. This policy is complementary to the others considered rather than a standalone initiative and has therefore not been scored.

9.3.2. B2, B3 and B4. Car Parking, Unit Mix or Unit Size

The impact of changes to car parking, unit mix or unit size policy is affected by the following:

- The potential displacement of build for sale activity (see section 9.7).
- The local authority’s approach to unit mix, unit size standards and car parking for BTR schemes and the degree to which this is resulting in inappropriate requirements on sites.
- Local need/demand for different unit sizes and/or car parking in the PRS, and the discrepancy between demand and the local authority’s requirements. This discrepancy is likely to be highest in inner urban areas, town centres or edge of town centre locations with good public transport accessibility. In more suburban or rural locations existing requirements are more likely to be appropriate.
- The cost associated with providing lager units or car parking provision. This is likely to be highest on restricted or complex sites, again most likely in an urban setting.
- The extent to which increased density could be unlocked with reduced requirements for large units and/or car parking. Changes could increase plot ratios/site coverage on some sites. For unit mix or unit size policies this would be determined by the detailed design of the scheme and the degree to which smaller units will be feasible within the proposed block/core/site layout arrangement.
- While we know residential purchasers (including buy to let investors) on build to sell schemes will purchase car parking spaces, there is less evidence that renters are willing to rent car parking spaces on BTR schemes in central urban markets.

Changes to car parking policies will have the biggest impact on urban sites, where car parking demand is likely to be lowest. Similarly, unit mix and size policies will also have the biggest impact on central urban sites, as demand for smaller units is likely to be higher in these locations. In rural locations demand for car parking and larger units is typically higher and therefore existing policies are more likely to be appropriate.

The cost associated with implementing changes to planning policy would be relatively low. Given the National Planning Policy Framework is already in the process of being reviewed, there is an opportunity to incorporate the suggested changes at a low administrative cost.

These proposed changes will take several years to reach their maximum impact on delivery. The speed with which new applications pass through the planning system, and existing consents are amended, will determine how quickly these policies deliver. It will also depend on the time it takes for local authorities to update their local plans where relevant and for local officers/committee members to fully understand and interpret the policies.

The setting of planning precedents and a widening evidence base will lower the level of perceived risk associated with BTR schemes. This in turn will be reflected in falling levels of risk applied to investors' hurdle rates of return making more sites viable.

Stronger policies and guidance around car parking, unit mix and unit size are likely to have a substantial impact on the viability of sites situated in areas with existing onerous planning policies that do not reflect local demand. Changes to the policies should be cost effective and have a positive impact on increasing supply in locations where policies are not already appropriate. They have therefore been scored 4 (Medium High Impact). This score also reflects the fact that it is unlikely the policies will be implemented fully across all local authorities.

9.3.3. B5. Affordable Housing Requirements

Lack of clarity and consistency in affordable housing requirements and the role of DMR in BTR is currently a key barrier to the delivery of BTR schemes. All new residential developments are either viability tested for affordable housing requirements or affordable housing requirements are applied at the full proportion set in Local Plans.

Policies which set out clearer guidelines for how BTR schemes should be assessed will benefit all sites. Even sites situated in local authorities that are already taking a more proactive approach to affordable housing requirements for BTR schemes are likely to benefit from more consistent and clear polices. Such policies will speed up the planning and design process and will give confidence to developers that the approach taken will be consistent across all administrative areas.

The impact that affordable housing policy changes will have on individual sites will depend both on how ambitious the existing requirements applied by the local authorities are, and to what extent clarity on requirements would speed up Section 106 negotiations and the planning process overall. Policies clarifying affordable housing requirements will impact all schemes which fall above the 10 unit threshold that triggers the requirement for affordable housing provision.

Permitting DMR as the affordable housing provision on BTR sites is considered the most important policy to increase the supply of BTR units. DMR is an appropriate affordable housing option for BTR because institutional investors can manage the scheme in its entirety and therefore maintain control over day to day management repairs and maintenance programmes. Providing DMR may involve a lower subsidy than providing other types of affordable housing. However, there have been a number of BTR precedents that have supplied higher numbers of DMR units than requested by the local authority and at bigger discounts than the target 80% of market rent. DMR combined with BTR is a good solution for local authorities where it increases overall supply, meeting the need of different income groups.

Allowing lower levels of affordable housing provision by applying covenants and clawback provisions where necessary is likely to have a large beneficial impact on scale of development for sites in local authorities that have yet fully to appreciate the need for such mechanisms. Best practice guidance on the details of these mechanisms and appropriate valuation methods will help provide clarity and reduce delays in the planning system.

The provision of DMR as the affordable requirement means that the affordable element of a scheme may be pepper potted throughout. This removes the need for separate cores and helps with building management. The pepper potting of affordable units is desirable from both planning and design perspectives because it can lead to design efficiencies and increase unit density on site. It may also have benefits in terms of social cohesion. There have been BTR precedents of local authorities retaining the right to nominate tenants to the DMR units, but the norm appears to be that local authorities have not sought nomination rights but preferred the operator to advertise locally.

Permitting DMR as the affordable offering within a scheme may also mean that the development is able to provide higher numbers of affordable units than would be viable for a BTR scheme providing alternative forms of affordable housing. However, where BTR displaces other forms of housing development, traditional affordable housing tenures will usually be replaced by DMR units which may disadvantage lower income households (negative distributional impact).

The proposed changes will take several years to realise their potential impact on delivery. The speed with which proposed schemes pass through the planning system will dictate how quickly the impact comes through. It will also depend on the time it takes for local authorities to update their Local Plans and for local officers/committee members fully to understand and interpret the policies. Changes to affordable housing policy should be cost effective if undertaken during the ongoing review of the NPFF.

Specific policies and guidance that address the lack of clarity and consistency in current affordable housing requirements is likely to have a high impact on the delivery of BTR although there are potentially displacement and distributional impacts. Providing a different form of affordable housing can also generate significant efficiency improvements. Therefore, this policy has been given a score of 5 (High Impact) in terms of effectiveness at increasing the supply of BTR homes.

9.3.4. B6. Planning Preference for BTR on Large Sites

In the light of our research we conclude that there is greater potential for additionality on larger sites which could be encouraged through national and local guidance. Local planning authorities should recognise these significant additionality benefits when working with developers to bring forward phases of large sites via BTR so that they are built out earlier than otherwise planned, alongside the early build for sale phases. The provision of DMR as the affordable housing within the accelerated BTR phase would, in the near term, be additional to the affordable housing provided within the build-for-sale phases reflecting the fact that land is being diverted to BTR but it is being completed earlier. There is also potential for affordable provision on the remaining build for sale phases to be adjusted to a faster delivery rate as part of the agreement on planning obligations.

Specific policy guidance on this issue will improve the ability of BTR schemes to compete with other forms of housing development, improving viability provided that it is applied appropriately. The policy has been scored 4 (Medium High Impact) in terms of effectiveness at increasing the supply of BTR housing.

9.4. Improve BTR Property Management

9.4.1. C1 and C2. Residential Management Apprenticeships and Sponsor/Promote Residential Management Good Practice

The quality of management in BTR schemes will be improved by funding residential management apprenticeships and sponsoring/promoting a management good practice guide. As good management is a key driver for tenant retention this will help minimise voids and re-letting costs and therefore contribute to improving the viability of schemes indirectly. Better quality management will also reduce investors' perception of the management/reputational risk associated with management of BTR properties, further reducing internal rates of return (IRR) hurdles/compressing yields and making more development viable.

Fostering the professionalised management of the BTR sector have the potential to help deliver the positive externalities of quality and job creation. Better management practices could enhance the positive externalities of town centre and placemaking that can be provided by well managed BTR schemes.

Residential management training and promoting good practice will benefit schemes of all sizes and types.

Although providing funding for apprenticeships is likely to have a significant impact in addressing a lack of skills in the management sector, it carries some financial cost. The cost effectiveness of funding residential management apprenticeships is therefore considered to be relatively low. The cost of promoting a residential management good practice guide would be low and is therefore relatively cost effective.

The impact of funding for apprenticeships will take some time to have full effect. Courses will take several years to form and finesse and the first students will then take some years to complete them. This delay is unlikely to be problematic until the BTR pipeline starts delivering at scale and pace.

A good practice guide will be quicker to deliver and will therefore have a more immediate effect. It will still however, take some time for the best practice principles to disseminate, and for managerial risks perceptions to fall.

The primary impact of the Government providing funding for residential management apprenticeships will be more skilled professionals available in the market which will contribute to improving viability. However, it is a costly initiative that is unlikely to help accelerate BTR delivery directly. It has therefore been scored a 2 (Medium Low Impact).

Sponsoring and/or promoting a residential management good practice guide is likely to improve knowledge and skills within the sector, although to a lesser extent than funding professional training, and has therefore been scored 1 (Low Impact).

9.5. Changes to Levies/Tax Tools

9.5.1. D1. Exemption from SDLT Surcharge

Amendments to the SDLT rules to exempt large scale landlords from the 3% surcharge would benefit all BTR schemes in all locations. The effect would be greater in lower value locations, where the flat 3% surcharge has a higher proportional impact on the total SDLT payable (as a result of the SDLT banding and multiple dwelling relief). Due to multiple dwelling relief, it is unlikely that the policy will affect varied sizes of scheme differently.

As shown in the analysis of BTR supply, a higher proportion of BTR delivery has used a forward purchase approach. This approach would incur the surcharge. On build to rent schemes that use a forward funding delivery approach, the surcharge does not apply on the first transfer of the interest but applies to any future disposal of the investment. It therefore indirectly affects the value of the investment and the price an investor is willing to pay.

The lost future SDLT revenue from the exemption will be costly but amending SDLT will have an immediate positive impact increasing housing supply.

Amending the SDLT rules would have a considerable impact on the viability of BTR sites. It has been scored 4 (Medium High Impact). This score takes into consideration that the mechanisms for amending SDLT are likely to be highly effective at delivering the policy objective, and considerably more effective than amendments to the planning system.

9.5.2. D2. Revise CIL Regulations

BTR schemes usually generate lower land values than build for sale schemes. Yet few, if any, local authorities have given consideration to BTR developments when setting CIL rates. Revised CIL regulations requiring recommendations/analysis on differences could therefore benefit all schemes located within local authorities with an adopted CIL charging schedule.

The impact that revised rates would have on viability will depend on the size of the scheme, the length of the construction period, the rates currently levied, the difference between BTR and other forms of housing development land values on a site, and, the degree to which payments can be phased under the existing regime.

CIL amendments will have a bigger impact on larger schemes where excessive upfront CIL payments have a greater impact on viability. It is unlikely to have a differing impact urban and rural sites. That said, CIL rates tend to be low or at nil rates on large sites where there is the greatest additionality to supply from BTR.

There may be some future CIL revenue lost. It will take several years for amendments to the regulations to take full effect because local authorities will need to adopt new or updated charging schedules. Also there may be a level of inconsistency in how local authorities assess the impact of CIL on the viability of sites and therefore some limitation in the degree to which amending the legislation will deliver the maximum possible effect on the sector.

Changes to this policy will only have an impact in areas where CIL is already adopted and existing rates generate viability issues. This policy will therefore only be moderately effective in terms of increasing the supply of BTR homes and has therefore been scored 1 (Low Impact).

9.5.3. D3. Zero-Rate VAT on Repairs, Maintenance and Management

Landlords/operators are generally unable to reclaim VAT on repairs, maintenance and management of residential buildings where the manager is an external service provider. This acts as a disincentive because it increases these costs by 20%. It is likely to be of substantial benefit to all BTR schemes to zero-rate VAT because it will reduce costs by 20% which improves operating margins and overall viability. There are EU constraints which make changes to the VAT regime difficult.

Amending VAT legislation will benefit schemes of all sizes and types. Although the cost of implementing changes to VAT legislation will be relatively low, the lost future VAT revenue will have a larger associated cost. Tax advisors have stated that changes to VAT will only be possible post-Brexit.

Policy that seeks to amend VAT legislation could generate a positive impact because it increases investor returns which would improve the viability of a large number of BTR sites. This policy has therefore been scored 4 (Medium High Impact). However, we understand from Tax Advisors consulted as part of this research that changes cannot not be made easily until the UK Brexit has been agreed and formalised.

9.6. Reduce Overall Political and Policy Uncertainty

9.6.1. E1. Establish Cross-Party Support

The degree to which cross-party support for the sector is effective at increasing the supply of BTR homes is dependent on several factors including:

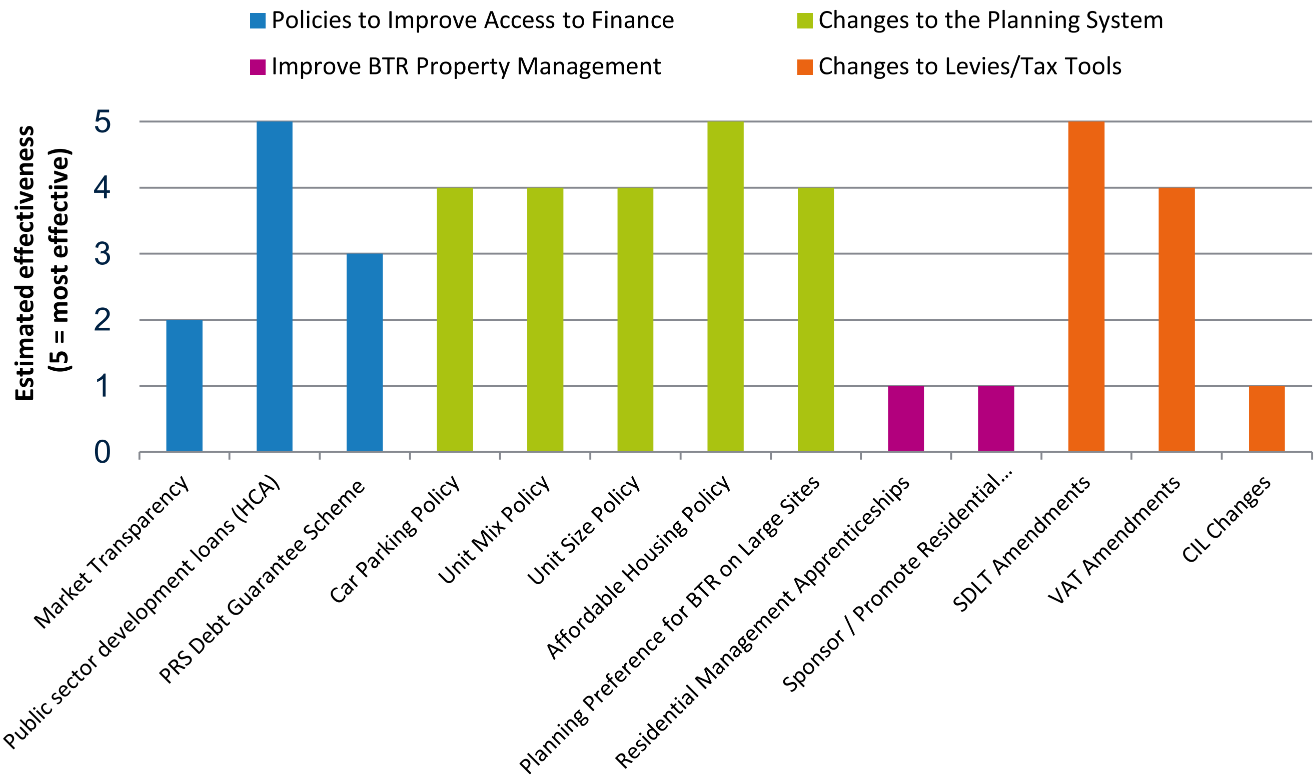
- How long it is possible to retain cross-party support;
- Does cross-party support reduce the perceived risk of regulatory change; and
- How far does cross-party support facilitate the implementation of the other policy suggestions through fostering a more positive political environment to growth in the sector.

Although establishing cross-party support for the sector would in itself improve investor sentiment, the primary value of the policy will be in facilitating the implementation of the other policy suggestions. Therefore, as this policy is mainly a tool for implementing the other policies, rather than a standalone mechanism to increase the supply of BTR units it has not been scored.

9.7. Comparative Effectiveness

Our assessment is that the most effective policies in terms of increasing the supply of BTR homes are the policies to improve access to development finance, changes to planning policy and amendments to taxation. The policies to improve access to finance primarily relate to the continuation and extension of existing schemes by time and scope whilst the changes to planning policy represent a further evolution of existing policies. The planning changes have the greatest potential for generating increases in the delivery of BTR homes. Of these policies, changes to affordable housing to permit single ownership and management with DMR on BTR (where concessions are given in terms of affordable housing provision) are seen as most effective at increasing supply but there is the potential for displacement of other forms of affordable housing and distributional costs.

Figure 16 - Summary of the Comparative Effectiveness of the Policy Options



Source: Savills, 2017

Changes to taxes/levies will have a variable impact on the supply of BTR homes, with changes to SDLT having the greatest impact while changes to CIL being less effective. As well as directly improving the financial viability of developments, it is anticipated that policy amendments to SDLT and VAT will also improve investor confidence by showing the Government's commitment to supporting the sector, reducing the perceived risk of future detrimental regulatory change.

The majority of the policies are considered to be most effective at increasing supply on larger urban sites. Given that the majority of BTR developments are situated in town centre or edge of centre urban locations usually with good infrastructure links, it is positive that the majority of the policies are most effective for this development typology. This development typology also tends to have the biggest viability challenges and therefore policy intervention is needed to bring these sites forward.

A number of the policies will take several years to reach maximum effectiveness. Improving market transparency is relatively short term while changes to planning policy are likely to be effective over a longer period. Conversely, changes to SDLT and VAT would have a more immediate positive impact.

9.8. Additional Benefits

As discussed in Chapter 6, as well as increasing and accelerating the delivery of new homes, there are several additional benefits of expanding the BTR market. These include:

- **Regeneration Benefits:** BTR schemes in large regeneration areas. This includes economic benefits of residents generating greater local spending power and the placemaking benefits high absorption rates can facilitate, especially on large multi-phase regeneration schemes.

- **Job Creation:** It is estimated that for every 500 BTR units approximately 15 longer term jobs are created (including concierge, estate management, building management, cleaners, maintenance and gardeners) in addition to the jobs created by the schemes construction. These jobs will generate wider economic benefits for the economy which are again not priced into the narrower commercial incentives relating to BTR schemes and alternative competing potential uses of possible BTR development sites.

9.9. Cumulative Impacts of Policies on Additionality

The overall conclusion is that the most effective policies in overcoming market and regulatory failures, delivering additional new homes, and realising the positive externalities of BTR include:

- Clarifying the role of 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 the 3% SDLT surcharge;
- Zero-rate VAT on repairs and management to make BTR more competitive.

All of these policies can be implemented together. The combined effect of these policies may be greater than the sum of the individual policies as collectively they will help to boost confidence in the sector, decrease risk and lower IRR hurdles.

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 $1bn in 1992 to over $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 has 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 the 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.

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 as set out in section 2.5, 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).

Expansion of this scale will require a step change in the supply of land and finance for BTR. An effective planning preference for BTR on large sites would have enormous potential to achieve this higher rate of delivery. It requires local authorities to work with delivery partners to bring forward later phases of a multi phased development to an earlier date, via BTR. The negotiations would prioritise the acceleration potential of BTR when agreeing the s106 obligation to allow higher and faster rates of delivery. On large sites there will be minimal displacement and high additionality of overall housing supply. There is likely to be displacement of affordable housing in the longer term but this will be offset by a more immediate supply of DMR. The minimal short term displacement of affordable housing needs to be better understood by local authorities. The longer term displacement of affordable housing can be offset by ensuring that a five year land supply is maintained and delivered.

Evidence of additionality is inevitably incomplete in an immature market. However, the piecemeal evidence that is available does indicate that there are very high levels of additionality of supply (at close to 100%), with minimal displacement of build for sale, on large multi-phased sites, well connected to employment markets, and in markets where the risk profile of build for sale developments makes them undeliverable. The recent slow down in rates of sale of new homes to buy to let investors is a significant downside risk to the delivery of higher density schemes, increasing the importance of BTR as a route to delivery and emphasising the additionality of BTR.

The policy measures considered in the study would increase the viability of BTR schemes relative to build for sale. This would increase the risk that some schemes would come forward as BTR and displace build for sale, more than is apparent in the current market. Any displacement would be minimised by targeting the policies at appropriate sites. Considering the very high levels of additionality that is evident on large sites and in marginal build for sale markets, our best estimate is that the additionality of BTR to overall housing supply is in no less than 80%.

The distributional costs of replacing affordable housing with DMR need to be acknowledged. To the extent that BTR is additional these distributional costs can be offset by maintaining and delivering a five year supply of housing land and ensuring affordable housing is provided on the for sale sites.

9.10. Fit with Five Case Model

The analysis summarised in this chapter is most relevant to the ‘strategic case’ and ‘economic case’ of the five case model. The strategic case should demonstrate ‘that the spending proposal provides business synergy and strategic fit and is predicated upon a robust and evidence based case for change’. This is largely covered by the overall objectives and review of the role of the BTR sector and the qualitative assessment of the scale of additional housing enabled by the policy options.

The economic case ‘is to demonstrate that the spending proposal optimises public value (to the UK as a whole)’. This is addressed in the assessment of the cost-effectiveness of the options. In addition, there will be positive externality benefits arising from improved labour market flexibility and enabled local jobs.

9.11. Equity / Distributional Impacts

'Distributional impacts' is a term used to describe the distribution of the costs or benefits of interventions across different groups in society. Proposals might have differential impacts on individuals, amongst other aspects, by the following groups:

- Women
- Black, Asian and ethnic-minority people
- Young people and children
- Older people
- Disabled people
- Lesbian people, gay people, bisexual people and transsexual people, and
- People from different faith groups[4].

The most important distributional impact relates to the extent that lower income households may gain or lose as a result of policy changes. The question is most relevant in the context of:

- Changes in the numbers of traditional affordable housing with administrative allocation of units and their replacement by DMR properties allocated by BTR owners and managers
- Changes in the numbers of schemes coming forward - and therefore the possibility of additional affordable housing arising from more viable schemes
- Any offset in terms of viability and throughput on non BTR schemes

In circumstances where BTR displaces for sale, the delivery of affordable housing is affected. Under this scenario there are distributional costs. However, the package of measures outlined in this chapter if implemented appropriately (on the right types of sites) should help to deliver distributional benefits from an increase in overall supply which have the potential for outweighing the cost/loss of affordable housing.

[4] This is a wider definition that given in 'The Green Book', Annex 5, HM Treasury, 2003.

10. Recommendations

1. **Build to Rent (BTR) Definition -** The report concludes that a statutory planning definition will help accelerate and maximise delivery of homes. A statutory planning definition is a prerequisite for implementing other planning policies and to ensure consistency of interpretation across local authorities.

2. **Discounted Market Rent –** National policy such as the National Planning Policy Framework (NPPF) should outline that discounted market rent is an acceptable form of affordable housing for BTR where there is a requirement to provide affordable housing in the same block as the private rented units.

3. **Covenants and Clawbacks** – Provide guidance within National Planning Policy Guidance (NPPG) on the use of covenants to ensure that in circumstances where there has been a concession to enhance viability in terms of the affordable housing provision local authorities are using consistent clawback mechanisms.

4. **Planning Preference for BTR on Large Sites** – national and local guidance should encourage local planning authorities to recognise the significant additionality benefits of BTR when working with developers to bring forward phases of large sites so that they are built out earlier than otherwise planned, alongside the early build-for-sale phases.

5. **Design and Space Standards** – National policies and guidance should promote greater flexibility on design and space standards in high density, town centre, urban locations with good transport accessibility. It should offer guidance for local authorities on the key factors (car parking, unit mix, unit size, single aspect, units per core) that can impact on the viability of BTR.

6. **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 /end buyer finance available to help the market scale up and mature.

7. **Home Builders Fund** – The HCA should 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.

8. **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.

9. **SDLT Amendments** – Exempt large scale investors from the 3% SDLT surcharge. There appears to be precedents set by the Scottish Governments decision to exempt institutional when the surcharge was introduced and this should be investigated further.

10. **VAT Amendments** – Changes to the VAT regime in terms of zero-rating the costs of repairs and maintenance would improve the viability of a large number of BTR sites. These changes should be considered post-Brexit.

The overall conclusion is that the most effective policies in overcoming market failures, delivering additional new homes, and realising the positive externalities of BTR include:

- Clarifying the role of 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;
- Remove SDLT Surcharge for large scale investors and zero-rate VAT on repairs and management to make BTR more competitive.

All of these policies can be implemented together. 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.

11. Glossary

BPF	British Property Federation
BTL	Buy to Let
BTR	Build to Rent
CIL	Community Infrastructure Levy
DCLG	Department for Communities and Local Government
DMR	Discounted Market Rent
FE	Further Education
GLA	Greater London Authority
HCA	Homes and Communities Agency
HE	Higher Education
IRR	Internal Rate of Return
L&Q	London and Quadrant
LSE	London School of Economics and Political Science
MSCI	Morgan Stanley Capital International
NAA	National Apartment Association (USA)
NPPF	National Planning Policy Framework
NPPG	National Planning Policy Guidance
PBSA	Purpose Built Student Accommodation
PDR	Permitted Development Rights
PiP	Planning in Principle
PRS	Private Rented Sector
SDLT	Stamp Duty Land Tax
SPG	Supplementary Planning Guidance
US	United States of America
UKAA	UK Apartment Association (an affiliation of the NAA)
VAT	Value Added Tax

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Important Note

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Our findings are based on the assumptions given. As is customary with market studies, our findings should be regarded as valid for a limited period of time and should be subject to examination at regular intervals.

Whilst every effort has been made to ensure that the data contained in it is correct, no responsibility can be taken for omissions or erroneous data provided by a third party or due to information being unavailable or inaccessible during the research period. The estimates and conclusions contained in this report have been conscientiously prepared in the light of our experience in the property market and information that we were able to collect, but their accuracy is in no way guaranteed.