Investment Property Forum

Mind the viability gap: Achieving more large-scale, build-to-rent housing

A briefing paper

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Mind the viability gap: Achieving more large-scale, build-to-rent housing

Executive summary

- **Housing supply shortfall:** 240,000 new homes need to be delivered annually but current output averages less than 150,000.
- **Build-to-rent contribution to supply:** A key benefit of build-to-rent is to accelerate delivery of housing at scale, making a significant contribution to the UK's new housing supply, and at a mid-market price point to match local housing need. For example, the 1,000-unit development adopted in this paper for illustrative purposes would usually take up to 10 years to complete and sell on a phased basis but could be delivered in only four years via a large-scale, rental-led model.
- **Benefits for all:** The build-to-rent sector would benefit all stakeholders including local authorities, developers and investors, as well as those looking for a good home and saving for a deposit.
- **Barrier/Financial viability gap:** This paper seeks to describe and quantify the principal barrier to this progress; the financial viability gap that exists when seeking to deliver large-scale, build-to-rent housing, when compared to build-to-sell models.
- **Comparative analysis between build-to-rent and build-to-sell:** The essence of the viability gap is highlighted through a worked example – a much lower annual rate of return is generated by the build-to-rent model (7.5% pa) compared to the traditional build-to-sell model (17.5%). As investors and developers require a return between 10% and 12.5% pa to take the development risk, this underlines the challenges faced by institutional investors willing to invest in the sector to accelerate housing delivery.
- **Local authorities offering planning obligation flexibility:** The paper illustrates a number of approaches that may bridge the gap, either through affordable housing allocations and classifications and/or an adjustment to levels of acceptable land receipt for vendors, most obviously public bodies, who are seeking to attract large-scale, build-to-rent stock to their regeneration sites.
- **Understanding and innovation:** The viability issues illustrated in this paper are a financial reality that, if not addressed, may impair an investment sector that has the potential to be a transformational force in the UK housing market. An understanding of the issues and a willingness from all stakeholders to innovate, to deliver financial and political objectives and compromises, will be essential for progress to be made.

1: Context

It is universally acknowledged that the UK has consistently failed, over five decades, to deliver sufficient housing to meet the country's needs. In the words of Lord Kerslake on becoming chair of a new Commission on Affordable Housing in London in June 2015:

"Our inability to build enough homes to meet the country's needs is one of the biggest public policy failures over 50 years".

The impact of this under delivery has compounded and now manifests itself in house prices, locally and nationally, that are unaffordable to much of the population. At least 240,000[1] new homes need to be delivered annually to start to bring down house price inflation to a similar level as general price inflation. In fact, since 2008, output averages fewer than 150,000 homes annually and the 240,000 target has not been achieved since 1980.

These forces are most extreme in the major conurbations, particularly in Greater London, where demand side pressures, in terms of large population growth and significant overseas investor demand, have further distorted market pricing. The issue has been highlighted by many commentators as a major risk to economic growth and social cohesion.

There is also a consensus that the only sustainable way to address this severe imbalance is to increase dramatically the housing supply, year on year, and at price points that respond to local housing needs and earnings. Private capital will need to, and can, play a significant role in funding delivery on such a grand scale. However, the adoption of new delivery models and attraction of new entrants will be essential.

The objective of this briefing paper is to help inform further discussion of the issues impacting the viable delivery of new build, large-scale, professionally-managed residential rental accommodation, now often described as 'build-to-rent'.

This provision falls under the general umbrella of the private-rented sector (PRS) - the acronym referred to widely in national and London policy. However, build-to-rent is distinct from 'buy-to-rent' (currently more synonymous with PRS), in terms of the scale, physical stock and participants in the market.

Stakeholders in build-to-rent are drawn from a broad field; local authority members and officers (and their electorate), developers, investment managers, valuers, development consultants, designers and funders.

Significant progress has been made in policy terms, most particularly at a national and London regional level, as outlined in Appendix 2. However, considerable challenges remain in actually delivering the large scale of new housing supply the UK desperately needs and on a financially viable basis.

This paper explores the viability of such development through a comparison with the usual house builder 'build-to-sell' scenario. It also highlights examples of where build-to-rent projects have been enabled by innovative approaches by local planning authorities.

1 Target cited in a number of sources, e.g. Barker, K (2014) 'Housing: Where's the Plan?' London Publishing Partnership

2: Large-scale delivery of housing – an alternative approach

The current system of housing provision is often focused on phased delivery of highest value stock at one end of the spectrum in order to pay for provision of extensive infrastructure and 'affordable housing' delivery at the other. This is an important route to housing delivery.

However, the cost structure implicit in this established model places a greater financial strain on alternative, larger-scale, delivery models of homes priced at levels that people on average earnings in a local economy can afford – the 'mid-market'. As a result, the levels of return achievable are less likely to attract the new capital and entrants to the market required to have a meaningful impact on addressing the UK's housing shortage, particularly given the significant delivery risks involved.

Large-scale delivery of homes for the 'mid-market'

This paper focuses on a housing delivery model that is large-scale (say 1,000 units per location/site, albeit that it is by no means a cap on potential activity), rental-led and professionally-managed[2].

The rationale for focusing on this housing delivery model is:

- The potential quantum of development, multiplied over numerous sites, would have a meaningful impact on the UK's housing supply problems;
- Major financial institutions seeking to add residential holdings require large-scale lot sizes to achieve a meaningful sector allocation within their existing significant real estate portfolios. These institutions, globally, represent an obvious source of substantial private capital. A professional approach to management will allay concerns over reputational risks too often associated with residential management and achieve greater operational efficiency.
- Financial institutions are generally long-term investors and are more attracted to the rental income over time, rather than the build-to-sell model, as their core investment strategy.

The fundamental feature of this model is the delivery of more homes more quickly than via existing conventional models. In delivering housing stock on a large scale and over a more rapid timescale, funding institutions will need to let these units, and keep them let, so they will be priced at a level that is affordable to the largest market segment – the mid-market – and at a local level.

This mid-market generally comprises people working in the local economy and on levels of earnings that are prevalent in that economy. It is possible to ascertain sustainable rents for residential accommodation as a proportion of those earnings.

In this context, the nomenclature of private-rented sector (PRS) is potentially misleading. Instead, the term 'market rental' and discounts thereon is more relevant and representative. In combination, there is a strong case to classify the delivery of this housing as tenure-blind, intermediate housing stock when defining planning obligations and considering financial viability in planning.

2 The model is applicable to projects of 200 units and above

3: The attractions of large-scale, build-to-rent

Build-to-rent has significant attractions to all stakeholders in the development process as set out in Figure 1.

Figure 1: **Why consider long-term, build-to-rent?**

Local authority

- Enables rapid place-making for large regeneration sites
- Supports delivery of targeted number of homes, even during downturns
- Delivers more accessible market housing
- Stimulates growth and employment
- Creates a new income flow for the local authorities that have land holdings

"Build-to-rent is a fundamental part of accelerating residential regeneration in Manchester's city centre"

Paul Beardmore, Director of Housing, Manchester City Council

"I want to see a bigger and better private rented sector offering more choice for working people. That's why we're investing £1bn in a build-to-rent fund and have established a £3.5bn guarantee programme to deliver homes specifically for private rent.

This paper sets out some interesting ideas around driving up supply through the planning system."

Brandon Lewis, Housing Minister

Community/People

- Provides access to good-quality market housing for people saving for, or unable to raise, a deposit for a mortgage
- Supports economic growth and local development
- Creates sustainable and vibrant communities owned by long-term investors
- Improves mobility of young professionals
- Fosters customer-focused landlords for tenants well-being

"Local planning authorities should consider build-to-rent in their local plans, and the distinct viability issues the sector faces. Our national planning policies enable them to do that"

Steve Quartermain, Chief Planner, DCLG

"I am pleased to be a resident in modern rented accommodation – I pay a fair and predictable rent linked to inflation"

East Village Resident 1

"The quality of the management is second-to-none compared to renting from a individual landlord"

East Village Resident 2

Developer

- Provides a complementary route-to-market in addition to private sales
- Provides early 'de-risking' of development schemes
- Accelerates delivery
- Maintains output delivery during an economic downturn
- Enhances the value of build-for-sale plots on large developments when the build-to-rent element completes earlier and contributes to place-making

"Build-to-rent provides us with the opportunity to accelerate our delivery rate and longer term growth strategy. On our larger strategic sites it adds another dimension to place making and the creation of sustainable mixed use communities. "

Stephen Stone, CEO, Crest Nicholson

Investor

- Good risk-adjusted long-term returns
- Rents growing in line with inflation
- Diversification beyond commercial property
- Low return volatility

"Build-to-rent would allow us to deliver the long-term, risk-adjusted returns required by our shareholders"

JM Vandevivere, Head of Residential, The British Land Company PLC

"PRS will help us achieve a better match to long-term annuity liabilities than existing fixed income assets"

Bill Hughes, Head of Real Assets, Legal and General Investment Management

A key benefit of build-to-rent: Acceleration of housing delivery

One of the most important benefits of build-to-rent is to accelerate the delivery of housing on large-scale sites. For traditional house-builders, the pace of development is determined by the rate at which homes can be sold, which is usually less than 1 per week in the regions and 1.5-2 sales per week in London.

The pace of development for a build-to-rent scheme can be much quicker because the letting rates are much higher than the sales rates. The market has seen letting rates of 10-15 units per week, i.e. 5 to 10 times faster than the sales rate.

Comparative delivery times for build-to-sell and build-to-rent

The impact of more rapid letting rates on delivery times for a 1,000-unit development project is demonstrated in the simplified illustration below (see the graphs in Figures 2a, 2b and 2c). The assumptions upon which the graphs are based are outlined in Figure 2.

Figure 2: **Assumptions for delivery of 1,000-unit development**

	Type of development		
Assumptions	**100% Build-to-sell**	**70% Build-to-rent 30% Build-to-sell**	**100% Build-to-rent**
Build period per block	2 years	2 years	2 years
Sales rate	2 units pw	2 units pw	n/a
No. of pre-sales	All sold prior to practical completion	All sold prior to practical completion	n/a
Letting rate (conservative)	n/a	5 units pw	7 units pw

Figure 2a: **100% Build-to-sell**

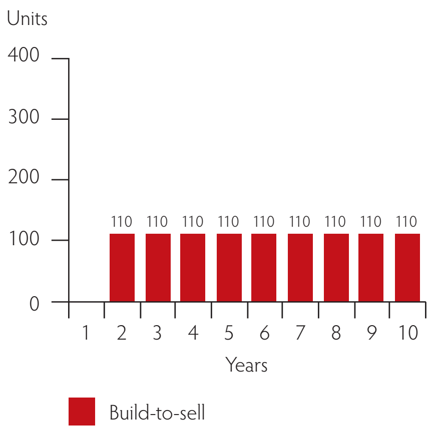


Figure 2b: **70% Build-to-rent, 30% Build-to-sell**

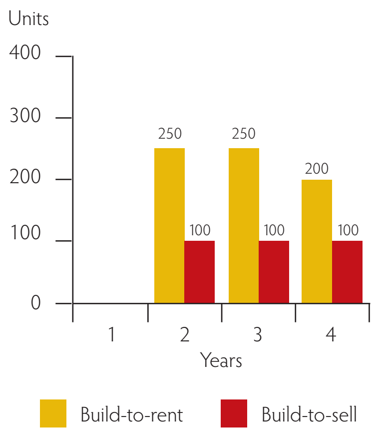
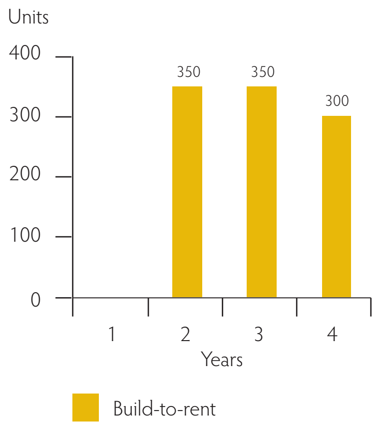


Figure 2c: **100% Build-to-rent**



Figures 2a-c show that a 100% build-to-sell development scheme will take 10 years to be delivered, whereas a 70% or 100% build-to-rent scheme will take only four years, accelerating therefore the delivery of housing critically needed in the UK.

4: The viability issue – The financial difference between build-to-sell and build-to-rent

Financial Viability in Planning Definition – RICS Guidance Note – GN 94/2012

"An objective financial viability test of the ability of a development project to meet its costs including the costs of planning obligations, whilst ensuring an appropriate site value for the landowner and a market risk-adjusted return to the developer in delivering the project."

Set out below is a simple illustration as to how the financial viability of a development changes when a scheme is delivered for build-to-rent, rather than build-to-sell, the latter being the model usually adopted by the volume house builders.

Comparison of development viability – build-to-sell vs build-to-rent

The illustrative scheme comprises a development of 1,000 units, which is of sufficient size to make an impact on housing delivery but, at the same time, the capital sums involved are not prohibitive to major institutions and investors.

- The scheme's location is within Greater London zones 2 to 4, in an assumed regeneration area, already benefitting from excellent public transport links. The build costs have been benchmarked against market data and values/rents have been taken from an actual development scheme.
- Both the build-to-sell and build-to-rent scenarios assume a mixture of one- and two-bedroom flats, with approximately 30% 'affordable' by floor area.
- The financial appraisals have been run on a 10-year basis, to reflect such matters as phased sales in the case of the build-to-sell scenario and an investment holding period in the build-to-rent scenario. This enables a simple comparison of the internal rates of return (IRR) for both scenarios.
- All figures incorporate 3% pa cost and value inflation.
- All figures are ungeared/without debt

An outline of the resultant costs and values associated with the two scenarios are shown in Figure 3 and further details are in Appendix 1.

Figure 3: **Viability of build-to-sell vs build-to-rent (long-term investment scenario)**

	Build-to-sell	Build-to-rent	Comments
Land cost	£50m	£50m	Build-to-rent developer required to pay the market price based on build-to-sell
1,000-unit scheme	700 market sale 300 affordable	200 market sale 500 market rent 150 intermediate rent 150 social rent	Build-to-sell assumes that affordable units are sold as a land parcel to a registered provider. Investment scenario: 150 intermediate rent @75% of market 150 social rent @25% of market
Delivery	Market units delivered in 3 phases over 10 years.	Developed in a single phase over 4 years.	Build-to-sell assumes 50% pre-sold off-plan by the completion of each phase.
Market sales	£750 psf	£750 psf	
Market net operating income (NOI)	N/A	£25 psf	
Investment yield	N/A	4%	'Day 1' figures for the investment scenario include a 6-year investment period following completion of the scheme.
Cost	£350 psf	£325 psf	Cost for build-to-sell relates to the market units
Resultant IRR	**17.5% pa**	**7.5% pa**	Over the 10-year period

The resultant 17.5% pa return from the illustrative build-to-sell scheme is in line with general market expectations, given the level of associated risk involved. Figure 4 sets this in the context of a risk-return framework, which shows the indicative levels of return that developers/investors will be expecting for a given amount of risk.

Figure 4: **Risk-adjusted returns framework**

Participant	Type of investment	Type of risk taken: Planning	Develop-ment	Sales	Letting	IRR required
House builder	Development (with planning risk)	✓	✓	✓		20%
	Development (no planning risk)		✓	✓		15%
Developer/ Investor	Development and long-term ownership	✓	✓		✓	10%-12%
Investor	Existing building				(✓)[1]	8%

1 The property may have some vacant space within it that requires letting/re-letting.

Risk-adjusted returns for build-to-rent

The illustrative build-to-rent scheme shown in Figure 3 generates an IRR of 7.5% pa. This is significantly below the 17.5% pa IRR achieved in the build-to-sell model as a result of lower values and tying up higher levels of capital for longer periods.

The 7.5% annual return is also not sufficient to attract large-scale institutional investment. The assessment of an appropriate target IRR for institutional capital in the build-to-rent development and investment strategy outlined above is not only dependent on the level of risk being taken (as illustrated in Figure 4) but also the comparative rates of return available in other property and investment sectors and the macroeconomic and market outlook.

The risks associated with a development/build-to-rent strategy are significant. These include (but are not limited to) planning, infrastructure costs, building costs, programme, leasing rates, rental levels, operating costs, and investment yield. Against this background, and factoring in the other considerations outlined, investors are likely to require a target IRR of at least 10% pa if they are assuming higher levels of risk than those associated with a standing investment. This is a competitive cost of capital when compared with conventional models.

In addition, investors have to be aware of the sensitivity of their expected IRR to variations in land costs, rental discounts from the market level and other factors. Figure 5 illustrates the impact on the IRR of the illustrative build-to-rent scheme as a result of changes in land costs and/or rental discounts.

Figure 5: **IRR sensitivity to changes in land cost and rental discounts**

	Land cost	
	£50m	**£30m**
Affordable discount to market rent	IRR pa	IRR pa
0%	10.5%	12.0%
20%	9.5%	11.0%
40%	8.5%	10.0%

Addressing the viability gap

On a like-for-like basis, a different and innovative approach is required in assessing the financial viability of build-to-rent compared to build-to-sell models in order to deliver a market risk-adjusted return acceptable to an institutional investor, for example:

- Including the market-rented element in assessing the level of affordable housing: The affordability of the market-rented elements of a project to average earners should be a material consideration when assessing the level of affordable housing contribution delivered by a build-to-rent project.

  The market rental levels indicated in the financial illustration above would total between £22,500 and £25,000 pa for an average two-bedroom apartment. This reflects about one third of an average joint gross salary in Greater London (£70,000 pa) This is a standard ratio adopted by independent referencing agencies in assessing a prospective tenant’s ability to service a rental.

  Furthermore, at the price assumed in the illustration, buying the same two-bedroom apartment may require a cash deposit of over £100,000 (20% of the cost) and a salary of over £100,000 pa to qualify for the mortgage required to finance the purchase. Monthly outgoings would include service charges (inclusive to the rental charge) as well as interest servicing and repayment.

- Considering a range of discounts to market rents: A range of discounts to market rents, targeting specific salary levels and housing needs, could be set, rather than requiring a uniform provision of affordable housing. Ongoing viability tests to measure a target investment yield against value would also enable this package of rental offers to be flexed over time

- Reducing land costs in return for housing delivery commitments: Where land is being offered for sale by a public body that is actively seeking to accelerate housing delivery and deliver a rental tenure-led model, the level of receipt for the land could be adjusted downwards in return for a commitment to achieve these objectives.

In conclusion, the issues of financial viability illustrated here reflect a financial reality that, if not properly considered and addressed, may impair an investment sector that has the potential to be a transformational force in the UK housing market.

5: Build-to-rent projects enabled by planning conditions and covenants

A key recommendation of the Montague Review was the encouragement of local authorities to use planning conditions and covenants to promote build-to-rent projects and overcome the viability challenge relative to build-to-sell.

Montague stated:

"Use planning tools such as conditions associated with planning permissions or covenants on the land to ensure that new homes remain in the rental sector for a fixed period of years. Most of our respondents agreed that any restrictions should be for at least 10 years. Others felt that 15-20 years would be more desirable, and some major institutional investors argued for very long periods of up to 30 years. By analogy with the commercial market, a term of 10-21 years seems a sensible benchmark for authorities to aim at. Whatever the period selected, this should mean that land values used in calculating developers' and investors' business plans would reflect the land values based on rental tenure rather than theoretical valuations based on sale. It would also mean that the local authorities themselves could be sure that the resulting housing would continue to meet their local communities' needs." (Montague Review p. 20)

A number of local planning authorities have recognised the benefits of build-to-rent and, following National Planning Policy Guidance ((NPPG) – see Appendix 2), have offered planning obligation flexibilities for particular schemes. Under 'Viability' in the Guidance, paragraph 18 acknowledges explicitly that viability will vary with housing type, including housing for sale or rent and the requirement on local planning authorities to take this into consideration:

"some privately rented homes can come from purpose-built schemes held in single ownership which are intended for long term rental. The economics of such schemes differ from build to sale and should be determined on a case by case basis. To help ensure these schemes remain viable while improving the diversity of housing to meet local needs, local planning authorities should consider the appropriate level of planning obligations, including for affordable housing, and when these payments are required. So these homes remain available to rent only, local planning authorities may choose to explore using planning obligations to secure these schemes for a minimum period of time".[3]

M&G, Acton

Set out below are a number of examples where flexibility has been exercised. In the main, this has been lead by London boroughs, where the first schemes are coming through. In each case, the examples provide the location of the development, the parties involved, the number of units, the policy background and the requisite planning obligation imposed.

3 www.planningguidance.planningportal.gov.uk/blog/guidance/planning-obligations/planning-obligations-guidance

Examples of flexible approaches to facilitate build-to-rent

Intermediate housing only

2014
Investor/developer: M&G / HUB Residential
Location: Acton
LPA: London Borough of Ealing

No. units	Background	Solution
152	The original S.106 agreement required 20 of the properties to be allocated for a combination of social rent and shared ownership housing. M&G's preference, as end investor/purchaser of these units, was to purchase the freehold interest of an unbroken block.	Ealing agreed to allow the conversion of the original S.106 affordable housing requirements to 20 discounted market rent units, so enabling M&G to manage the complete property as a single entity but with some tenants paying a percentage of market rent.

Off-site affordable contribution / 40-year covenant

2014
Investor/developer: Mercers' Company
Location: Covent Garden
LPA: City of Westminster

No. units	Background	Solution
24	Mercers wished to retain ownership of the entire development and draw an income for its wider charitable obligations instead of selling the individual apartments, including disposal of a component of the development either for shared ownership or to a housing association basis.	It was agreed with Westminster that the rental value was less than vacant possession value and the S.106 included a reduced off-site affordable housing contribution to reflect this. A 40-year covenant was imposed on the development that provided for, where any units in scheme were sold during this period, a pre-agreed, index-linked payment in lieu of on-site affordable accommodation.

Speedier delivery of development

2014
Investor/developer: Bellway
Location: Christies Auction House
LPA: London Borough of Wandsworth

No. units	Background	Solution
114 (Total scheme 510 units)	As developer, Bellway wanted to reduce its overall risk exposure by reducing the number of units for sale on the site. The solution was to allow for the disposal of one block as a standalone investment asset.	The S.106 required one block of 114 units to be for rent only for a 15-year period after practical completion. This block was to be managed by a housing provider and the tenancy terms offered to be between 12 months and five years. Furthermore, the required marketing plan was to prioritise Wandsworth residents and/or employees.

Lower affordable housing target replaced by intermediate rented

2010
Investor/developer: Evenbrook
Location: Browns Green
LPA: Birmingham City Council

No. units	Background	Solution
155	Evenbrook wished to create an infill development at an existing residential investment but sought to retain the integrity of its property in single ownership. In addition, the viability of the scheme was stretched and could not accommodate the standard 35% affordable housing requirement.	The City Council agreed to lower the affordable housing target from 35% to 26%, and for the entire provision of affordable housing to be intermediate rented tenure. This was covenanted for 20 years and thereafter the units could revert to market rent housing.

Appendix 1: Development appraisal of illustrative scheme

As per Section 4 of this paper, the development appraisals below contrast the financial viability of a scheme that is delivered for build-to-rent, rather than build-to-sell, the latter being the model usually adopted by the volume house builders.

A. BUILD-TO-SELL (HOUSE BUILDER SCENARIO)

Assumptions

1. 1,000 units

   700 Market sale

   300 Affordable

2. Land cost

   £50m

3. Gross development value (GDV)

No. units	Net area sf	GDV £psf	GDV £m	Sales rate
700	455,000	750	341.25	1.5 pw
300*	195,000	250	48.75	
TOTAL			**390.00**	

* Affordable element sold as site to registered provider in Year 1.

3a. GDV growth (£psf) @3% pa

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
750	773	796	820	844	869	896	922	950	979

4. Development cost

Gross area	Cost psf	Development cost £m
812,500	350	284.38

4a. Cost growth (£psf) @3% pa

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
350	361	371	382	394	406	418	430	443	457

5. Delivery/Phasing – market sale (700 units)

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
Phase 1 – 233 units			Phase 2 – 233 units			Phase 3 – 233 units			

6. Sales rate – 1.5-2pw – say 50% sold off-plan

7. Development period – 10 years

Resultant IRR 17.5% pa

B. MIXED TENURE/INVESTMENT MODEL

Assumptions

1. 1,000 units

200 Market sale
500 Market rent
150 Intermediate (75% market)
150 Social (25% market)

2. Land cost

£50m

3. Gross development value (GDV) and net operating income (NOI)

No. units	Net area sf	GDV £psf	GDV £m	NOI £psf	NOI £m pa	Yield %	Investment element GDV £m
200	130,000	750	97.5				
500	325,000			25.00	8.13	4.0	203
150	97,500			18.50	1.80	4.0	45
150	97,500			6.00	0.60	4.0	15
Total	**650,000**				**10.53**		**263**

3a. Increase in NOI (£m) @3% pa*

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
25.00	25.75	26.52	27.32	28.14	28.98	29.85	30.75	31.67	32.62
18.50	19.06	19.63	20.22	20.82	21.45	22.09	22.75	23.44	24.14
6.00	6.18	6.37	6.56	6.75	6.96	7.16	7.38	7.60	7.83

4. Development cost

Gross area	Cost £psf	Development cost £m
812,500	325	264.06

4a. Cost growth (£psf) @3% pa

Yr 1	Yr 2	Yr 3	Yr 4
325	335	345	355

5. Delivery/Phasing – All units

Yr 1	Yr 2	Yr 3	Yr 4
Single phase			

6a. Sales rate – 1.5-2pw – say 50% off-plan

6b. Letting rate – 10-15pw – from completion (Scope for some early pre-lets, but limited)

7. Investment period – 10 years

Resultant IRR 7.5% pa

* NOTE: Potential impact of social rents reductions in July 2015 Budget

Appendix 2: Policy overview

This section provides a summary of build-to-rent planning policy and guidance at a national, regional and local level.

Montague Review 2012

The formation of much of the policy set out below can be credited to the 'Montague Review'[1], which looked at the barriers to institutional investment in private rented homes.

Following meetings with 49 organisations and the receipt of 55 'call-for-evidence' responses, the Review report acknowledged "the potential for communities" that build to rent offers. Indeed, Recommendation One within the conclusion, was that:

"Local authorities should use existing flexibilities in the planning system to plan for and enable developments of privately rented homes, where they can meet local needs."

National policy

In November 2011, the Government published the National Housing Strategy, which set out a package of measures intended to stimulate the housing market in England[2].

Focusing on Section Four, the report notes the essential role that the private-rented (PRS)/build-to-rent sector plays in the housing market by offering choice and flexibility to people and supporting economic growth and access to jobs. The document notes the link between the increasing affordability constraints that prohibit access to home ownership and the increase in demand and subsequent cost of private-rented homes.

A. NATIONAL PLANNING POLICY GUIDANCE (NPPG)

The NPPG recognises that from a plan-making perspective, once the level of housing need has been established, the configuration of different housing tenures should also be identified. The NPPG suggests that the monitoring of private market rents, information from the English Housing Survey, Valuation Office data and other commercial sources are all ways in which PRS/market rent demand in a local area might be identified.

Importantly, the NPPG acknowledges there are likely to be varying economic characteristics that differentiate PRS/market rent and open market private housing for sale, and these characteristics should be considered in decision making for planning purposes. In order to meet local identified housing need, authorities are encouraged to consider consider the appropriate level of planning obligations, including affordable housing, in generating new PRS/market rent supply. The NPPG encourages determining authorities to use planning obligations in order to secure this supply for a minimum period of time to ensure that the intent of the NPPG in this regard, is not abused.

B. DCLG ACCELERATING HOUSING SUPPLY AND INCREASING TENANT CHOICE IN THE PRIVATE RENTED SECTOR: A BUILD TO RENT GUIDE FOR LOCAL AUTHORITIES (MARCH 2015)

This publication reflects central Government intent for the PRS. The document was collated and published following considerable engagement with local authorities by the DCLG's PRS Taskforce.

1 'Private rented homes: review of the barriers to institutional investment' published in August 2012. See: www.gov.uk/government/publications/private-rented-homes-review-of-the-barriers-to-institutional-investment

2 'Laying the Foundations: A Housing Strategy for England'. See: www.gov.uk/government/publications/laying-the-foundations-a-housing-strategy-for-england--2

The publication sets out the background to PRS, current Government initiatives such as build-to-rent and the Debt Guarantee Scheme, provides a profile of investor demand with examples of recent initiatives, assesses the role of good design and construction in the delivery of PRS, quantifies the benefits to local authorities who are seeking to encourage PRS and sets out ways in which local authorities through intervention can encourage a more active PRS in their borough.

Regional polices

A. LONDON

In London, the Greater London Authority (GLA) has been progressing its housing policies, including reference to the PRS/market rent sector, for more than three years. Various documents have been published in this period, as follows:

i. The Mayor's Housing Covenant 'Making the PRS Work for Londoners' (July 2013)

ii. London Housing Strategy (October 2014)

iii. The London Plan (March 2015, incorporating the Further Alterations)

iv. Draft Interim Housing Supplementary Planning Guidance (SPG) (May 2015)

The accumulation of this work is a target is now a strategy which sets an ambitious programme for the capital with a target of 5,000 new PRS homes as part of the annual 42,000 homes target.

Across these documents, a number of themes have emerged:

- **The importance of the sector:**

The latest version of the London Plan (March 2015) includes reference to PRS/market rent in Policy 3.8, Housing Choice. The policy in relation to plan making states that the planning system should, **"provide positive and practical support to sustain the contribution of the PRS in addressing housing needs and increasing housing delivery".**

Furthermore, the Draft Interim Housing SPG provides considerable support for the sector, illustrating the clear intent from the Mayor's office to replicate the guidance coming from central Government to utilise the planning system to promote a more sophisticated PRS in the Capital and across the rest of the country. The London Plan notes that the Mayor will continue to encourage large-scale, institutional investment, and that local authorities should seek to adopt policies that are aligned with the Mayor's Housing Strategy, with the objective of achieving well-managed, good-quality accommodation, mixed and balanced communities and sustainable neighbourhoods.

- **The growth in the sector:**

The draft Housing Strategy SPG recognises that PRS was responsible for providing homes for close to 50% of all households in the early 1960s but that this figure dropped to just over 10% of households in the 1970s and 1980s. It now constitutes the second most dominant household choice after owner occupation (recently overtaking the social rented accommodation as a percentage of households in the capital). The London Plan notes this relative growth in recent years and therefore its important role meeting Londoners' diverse housing requirements.

- **Local plans, market rent and housing need:**

The Draft Interim Housing SPG requires local planning authorities when preparing local plans to provide positive and practical support to sustain the contribution of PRS in order to address housing need and increase housing delivery. Strategic market assessments should quantify the need for market rent provision in their respective areas.

- **Market rent for the customer (Londoners):**

The Mayor's Housing Covenant, 'Making the PRS Work for Londoners' (July 2013) sets out a series of ways in which the GLA can assist in generating PRS supply.

Within the October 2014 London Housing Strategy, Section 3 references the 'Covenant', acknowledging it as a framework for supporting London's workers and for rethinking policies on intermediate housing, the PRS and affordable housing allocations.

- **Viability assessments:**

The London Plan states that the planning system should take a more positive approach to enabling PRS in order to meet regional housing target objectives. The Plan draws reference to the NPPG and the need to differentiate between the viability of open market housing and PRS in plan making and development management scenarios.

Importantly, the Housing SPG recognises the, **"distinct economics of the sector relative to mainstream market housing and take account of this when undertaking viability assessments for covenanted schemes (those schemes that are secured as private rent for a fixed period either through a covenant, a Section 106 agreement or other legal agreement). These distinct economics should also be taken into account when disposing of public land".**

B. MANCHESTER

Manchester City Council published a Market Rental Sector Strategy in March 2015 following on from the launch of the Manchester Residential Growth Plan, which was approved in 2013.

The strategy seeks to promote the quality and quantity of market rent in the city, which in turn will support Manchester's plans for economic growth. The strategy also seeks to improve the quality of existing homes in the sector, as well as stimulate the delivery of new supply through working with housing associations, other public sector organisations and the private sector.

This publication was written by a working group of the IPF's Residential Investment Special Interest Group. The main Group was established in 2009 to look at the potential for greater involvement in the private rented sector by institutional investors and the barriers to their participation in that market.

In 2012, the Group undertook a survey of 42 institutional inventors with total property assets of £180bn in order to provide a basis for responding to the Montague Review commissioned by the Department for Communities and Local Government (DCLG), which looked at the potential for institutional investment in the private rented sector. The results of the survey were published as 'Institutional Attitudes to Investment in UK Residential Property' by the IPF Research Programme.

This survey is now conducted annually and the 2015 results can be downloaded from the IPF website: **www.ipf.org.uk**

The IPF would like to thank the members of the working group listed below for their time and expertise in putting the publication together:

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About the IPF

The IPF is one of the leading specialist property industry bodies in the UK. It comprises an influential network of senior professionals, all active in the UK property investment market.

The IPF's mission is to enhance the understanding and efficiency of property as an investment, including public, private, debt, equity and synthetic exposure, for its members and other interested parties, including government, by:

- undertaking research and special projects and ensuring effective communication of this work;
- providing education; and
- providing a forum for fellowship, discussion and debate amongst our members and the wider investment community.

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