



Private Rented Sector

MAKING RENTING VIABLE

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WHY IS THE PRIVATE RENTED SECTOR IMPORTANT?



Peter Hardy

Partner at Addleshaw Goddard

Attitudes to renting have shifted hugely over the last couple of years. Having seen how successful America's multifamily letting sector has become, investors are now entering the market, while the government has created an array of measures to support build-to-let. Consumer demand for renting has soared over the past decade and 2014 could well be the year in which a professional rented sector finally emerges in the UK.

The government's endorsement of the role renting has to play in addressing the UK's housing shortage has been welcome. Through large-scale, institution-backed rented developments, we all agree that a wholly new evolution of the private rented sector (PRS) could emerge. Pension funds and other institutional investors have begun committing to schemes that offer long-term income returns and which enable them to both diversify their investments and take a defensive position against blips in the economy.

Councils too now recognise that a professional rented sector can drive out rogue landlords, create better housing stock and offer real customer service. As well as the obvious benefits of having a single owner for a whole block who is committed to the local area, the PRS offers valuable choice for those caught between ownership and social housing.

Yet, despite an increasing amount of activity, barriers to creating the professional rented sector many talk about still exist. They include:

- ▶ Confusion that build-to-rent is the same as buy-to-let
- ▶ Competition with housebuilders for land can price out PRS
- ▶ Confusion over the differing business models of PRS and regular housebuilders
- ▶ A lack of understanding around the benefits of build-to-rent
- ▶ A lack of focus on those caught between home-ownership and social housing

We have produced this report with the British Property Federation, along with leading market players and public sector leaders, in the hope of addressing some of these issues. We wanted to highlight some of the exemplar schemes already out there with a view to showing others how barriers can be overcome.

OUR HOUSING SHORTFALL IS GROWING

The profound demand-supply imbalance in the UK housing market isn't news to anyone. The DCLG estimates that in 2012 there were over 220,000 new households created in England alone, but only 115,620 new homes built to house them.

Population growth, more one-person households and continued immigration will see the shortfall in housing continue to grow. While government initiatives to boost the market are welcome, they alone are unlikely to make housing more affordable.

From 2001 to 2011 the number of renters in the UK almost doubled: from 2.4m to 4.7m. This has fuelled a buy-to-let boom, but not offered the professionalism and customer service many other countries benefit from.

The UK's growing rental population accepts a significant variation in quality, service and rental levels because it has no choice. While some laws exist to protect tenants, agents remain unregulated and enforcing action against rogue operators is often extremely costly and time consuming for local authorities and tenants.

The solution is a professionally-run sector financed by institutional investors.

INSTITUTIONS CAN EASE BRITAIN'S HOUSING CRISIS

A change in the attitude of large and institutional investors has created a growing interest in the development of homes solely for rent.

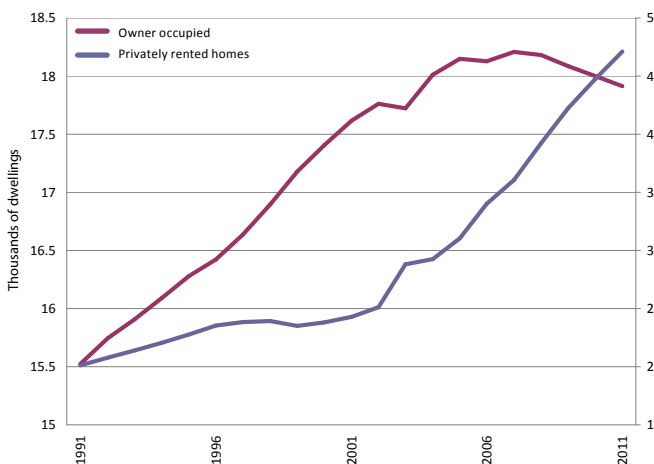
While traditional housebuilders profit from immediate sales, institutional investors are driven by the desire for secure, long-term returns where income correlates alongside wage growth. Pensions have to pay out, so avoid volatile investments. While demand for office space may fluctuate with the economy, people will always need a home. This is why demographically-driven real estate is becoming more attractive to investors.

The defensive and diversification benefits of PRS are also attractive. As a result, a growing pool of capital is willing to enter the sector. Such investors generally take a meticulous interest in

managing their assets – which can only be a good thing for local communities often concerned that absent landlords contribute nothing to the public realm.

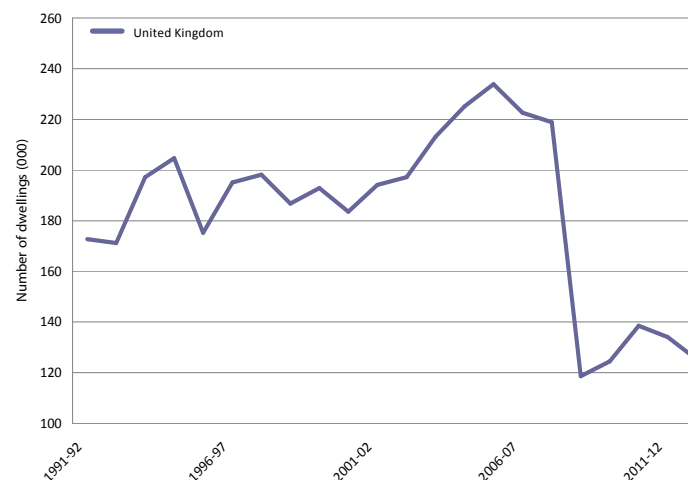
Development of an institution-backed PRS has the potential to substantially ease the UK's housing crisis, through bringing new capital into play and building new homes. Since PRS developers are eyeing a long-term investment - not just a quick sale – the homes will be built to last, the developments well managed and service placed high on the agenda. The landlord won't be an anonymous individual living overseas, but a company smart enough to recognise well maintained buildings and satisfied tenants lead to less vacancies, better returns and happier communities.

Number of privately owned occupied homes in the UK (ONS/DCLG)



Source: (ONS/DCLG)

Housebuilding starts in the United Kingdom



Source: (ONS/DCLG)



POLICY CHANGES HAVE RECOGNISED THE ROLE RENTING HAS TO PLAY



Ian Fletcher

Director of Policy (Real Estate), BPF

Policy success in supporting the PRS

The last few years have seen the PRS receive the growing support of national government and key policy makers – with all three main political parties now recognising the sector’s ability, with institutional backing, to bring a much needed new supply of homes to market.

The disaggregation of stamp duty, the Montague Review, the establishment of the PRS taskforce and successive rounds of build-to-rent funding, have all given a tangible boost to the sector’s development.

Debt guarantees for development, planning reform (in the draft National Planning Policy Guidance), and the growing use of public land partnerships for PRS development are all in the pipeline – and this momentum needs to be maintained to continue to attract development and private financing.”



Richard Blakeway

Deputy Mayor for Housing, Land and Property

The GLA’s support for the PRS

London’s population is now growing faster than at any period in its history, and therefore housebuilding needs to double to keep up with demand. There is capacity to deliver at least 42,000 homes within London’s boundaries. Bringing in new forms of finance for housebuilding is essential to the future growth and development of the capital. This has led to three decisions around our London Housing Strategy:

An annual target for purpose-built PRS: 5,000 new homes per annum, alongside a target of 15,000 affordable homes within the 42,000 homes target

An expectation that there should be a PRS element to multi-phased schemes, which will accelerate the delivery of homes

A ‘rental covenant’ (agreeing that a scheme must be rented not sold) with an expectation of a 15-year minimum length building on what is already in our supplementary planning guidance

To us, this represents a sizeable shift and a very clear statement in policy.

THE CHALLENGES WE NEED TO OVERCOME

Despite the sector's growth, obstacles remain to development, not least in the dialogue between local councillors and developers. At a round table hosted in late November, developers and councillors defined the key barriers to the viability of the PRS.

1. Differentiating the PRS from traditional housebuilding

All too often local authorities, councils and planners fail to distinguish between building to rent and building to sell. Essentially, this means they fail to differentiate the key benefits of building long-term homes for rent against those being built for a quick sale.

2. Viability assessments

The current mechanisms for assessing viability in the National Planning Policy Framework (NPPF) are not sufficiently refined to differentiate PRS developments from those built for sale. As PRS schemes derive their profit in a different way from houses built for sale, this means the initial financial contributions and affordable housing obligations required by schemes make building for rent financially unviable – and fail to take into account the longer-term contributions to communities and local areas made by PRS developments.

3. A lack of communication across local authorities

Those setting housing policy within local councils often endorse PRS development, while planners within the same authority reject a scheme because there is no defined use class or flexibility within the NPPF. This silo-like behavior between policy makers and planners continues to cause confusion, particularly when local authorities do not have an up-to-date local plan that provides clear policy support for PRS elements.

4. Quantifying the community contribution of PRS developments

Developing a housing scheme that will be rented and managed over 10 or 20 years requires thinking ahead and consideration of returns over the long term. The fact that homes are not sold on right away reduces the short term financial payback, but this long term view ensures the investor and council both share an interest in maintaining the quality of the area, investing in the public realm and ensuring the happiness of tenants.

5. Distinguishing the PRS as a quality product

Many local authorities view private renting as the refuge of poor quality, badly managed amateur landlords – and with good reason. Given that developments designed specifically for rent are only now beginning to emerge, it has been tough to demonstrate the genuine difference. But in the same way that commercial developers need buildings to look as attractive in five or 10 years as they do at the start, the same will be true of PRS developments. Having quality managers who can deal with problems efficiently, in the knowledge the buildings are designed efficiently, is also key.

6. Short-termism in local politics

There remains a perception among some councillors that encouraging build-to-rent means losing out on the immediate financial gains created by build-to-sell developments. A promotion of 'affordable housing at all costs' means that those who earn too much for social but not enough to buy are left out. Short termism around the fact that, to be economically viable, PRS cannot yield the same short-term financial contributions as build-to-sell, is one of the biggest barriers.

7. Planning and a shortage of stock

A shortage of stock continues to limit investment into the PRS while competition for land is pushing the price up, making build-to-let unviable in many locations. The costly, uneven planning system doesn't encourage the kind of risk taking Britain needs to overcome its housing issues. Although the government has recognised that public land can play a key role in delivering the solution, progress continues to be slow and disjointed.



Essential Living's 360 London development in Elephant & Castle, London

MAKING CHANGE HAPPEN



Dominic Martin
Member of the PRS Taskforce

We at the PRS taskforce hope that in 10 years' time tens of thousands of new homes will have been created. We have been charged with helping to kick-start a new PRS which will comprise large-scale built-for-rent housing schemes held by long term professional investors, such as pension funds, property companies and registered providers.

We wish to create a dialogue between local authorities and developers that brings schemes forward that are viable for communities, councils and developers – meeting the growing demand for renting and providing a better and more professional service for tenants.

A key factor of this has been education.

For local authorities this means not only explaining the role the PRS has in solving their housing shortages, but also how they can use the flexibilities inherent in the NPPF to their advantage to stimulate building.

For developers, this means being making sure they are able to prove and demonstrate they have sound management structures and policies in place to ensure their developments bring the most possible long-term gain – which is also instrumental in attracting more long-term institutional financing.

PRS IN A MULTI-PHASED SCHEME



Andrew Storey
Development Director, Cathedral

“Using a PRS component to accelerate development”
- Cathedral, the Old Vinyl Factory, Hayes

Cathedral's Old Vinyl Factory development will provide over 600 new homes as part of a multi phased- regeneration project on the site of the former EMI factory in Hayes, West London.

By incorporating a PRS aspect into the project, Cathedral will be able to accelerate the delivery of homes in the development. While homes built for sale rely on early phase units to be sold before later stages of construction are initiated, a PRS component can be developed in tandem.

“Bringing in the Willmott Dixon PRS brand Be:Here for the development of the first 132 apartments was instrumental for us in accelerating the site's development. It led to us being approached by a number of other residential development partners for the next 213 homes, which will be built for sale.

“Instead of delivering an initial 132 homes for sale, we now have a pipeline now of 345 homes, which accelerates the community creation aspect of the site, and other development on site, providing jobs and leisure facilities in a shorter timescale – which is of massive benefit to the local borough.”





SHARING RENTAL INCOME WITH THE COUNCIL



Nick Jopling
Executive Property Director, Grainger PLC

“Developing in partnership with a local authority” - Grainger, Young Street and Hortensia Road

Grainger was selected by the Royal Borough of Kensington and Chelsea in 2012 to develop and manage two mixed-use housing schemes.

In a borough with some of the highest land values in London, instrumental to the development of the council-owned sites was the agreement that over 50% of the units would be available for the private rental market, alongside an “affordable” offering and homes for sale on the open market.

Under the terms of the partnership, Grainger will develop and manage both sites under a 125-year lease arrangement, with both parties taking a share of the rental income, and Grainger receiving a management fee.

“By providing a specific component of new homes specifically designed for renting, and by having a proven management expertise, we were able to demonstrate to RBKC that we were developing for the long term benefit of the community, and thus agree an innovative partnership, utilising the concept of build-to-rent that worked in the interest of both parties.”





MANAGEMENT IS KEY



John Carleton
Executive Director, Genesis

“Utilising the management expertise of registered providers” – Genesis, Stratford Halo

Genesis, one of the largest registered providers in the UK, completed the Stratford Halo in early 2013, delivering over 700 new homes in the London Borough of Newham.

Some 401 private rental units were included as part of the mixed-use development, which were sold to M&G Investments’ Secured Property Income Fund (SPIF) for £125m, with Genesis retaining management with a 35-year operating lease.

By selling the leasehold of these flats to M&G, Genesis has been able to secure additional financial headroom and operating capacity to reinvest in its development pipeline and wider business.

“Our management expertise as a registered provider allowed us to attract institutional investment, quite simply because we could prove we had the necessary experience to safeguard the long-term returns of investors.

“Similarly, this experience allowed an immediate dialogue with Newham Council for a PRS component to the scheme - as they recognised Genesis as a developer with the ability to design and manage mixed-tenure, mixed-use development.”



A SHOWCASE PRS SCHEME ON GLA LAND



Martin Bellinger
Chief Operating Officer, Essential Living

“Developing in partnership with the GLA” – Essential Living, 360 London (Newington Butts)

Essential Living, the UK’s first developer and manager of private rented housing, is backed by M3 Capital Partners and plans to build 5,000 rental homes across London and the South East. It was selected by the GLA to redevelop the Newington Butts site in Elephant & Castle in mid-2013.

The scheme, to be developed in partnership with Mace, marks the first time that the GLA has supplied public land to build homes specifically for rent. The landmark deal underpins the Mayor’s strategy to encourage institutional capital in to London to support the creation of a large-scale PRS.

The development, the largest of its kind in the UK, will provide 470 homes, 319 of which will be for private rental, 116 shared ownership and 35 socially rented. Alongside the 45-storey tower, community facilities will include the construction of the Southwark Playhouse theatre.

“Newington Butts will be the largest development built specifically for rent since Dolphin Square in the 1930s. In a competitive tendering process, we were able to show the clear benefits that providing long-term rental housing will bring to the community, and its potential to accelerate the provision of homes in the Borough of Southwark.”



COUNCILS IDENTIFIED NUMEROUS BENEFITS OF PRS

Despite the identified barriers, the council-led discussion pinpointed a number of benefits that PRS developments bring to local councils and communities:

- ▶ A VITAL new source of homes to the market
- ▶ Long-term community improvements and regeneration, brought about by a long-term investment model and an influx of new investors
- ▶ Homes designed specifically for renting – with additional amenities and communal spaces, constructed to last over the long term, meaning higher levels of quality
- ▶ Homes built to house smaller households and a changing demographic
- ▶ Secure and professionally managed tenancies (leases, deposits, legal issues)
- ▶ Accelerating the development of existing developments through the addition of a PRS component
- ▶ Helping younger generations create their own home
- ▶ Easing price pressures on the local rental markets and homes for sale

Beverley Nomafo

Head of Housing Development and Regeneration, Croydon Council

We have the land capacity to develop 9,500 homes over the coming years, and we see Croydon playing an important part in addressing the wider London housing shortage. With demand in Croydon across all types of housing, PRS development is an important component of our local strategy. We have used our own initiative and finance to bring forward PRS schemes which we see as essential for future development and growth. For example, we have won government build to rent funding, which has allowed us to secure competitive interest rates, which has made developing the right kind of product viable, as well as allowing us to kick-start stalled schemes. The benefit to Croydon is a mixture of homes that meet the needs and aspirations of all parts of our communities.



SOLUTIONS FROM WORKING TOGETHER

1. By redefining viability assessments

A reconsideration of viability assessments remains essential, and there must be a negotiation between both developers and councils, recognising that PRS is not the same as housing for sale. Social housing, section 106 and community infrastructure levy commitments need to be adjusted, taking account of the nature of the long term approach being taken.

2. By using public land for development

The PRS caters for a wide array of individuals, many of whom earn too much to access social housing and who could not afford to purchase a home. Councils are able to earmark their public land for PRS, just as the Mayor of London has already done, thus speeding the delivery of homes in an area and ensuring that quality housing can be accessed by those in employment who cannot or do not wish to own.

3. By adding a PRS component to larger schemes

A PRS component can accelerate the development of larger schemes, which may enable more homes to be developed up front or speed up the delivery process.

4. By encouraging greater collaboration inside local authorities

Some local authorities can operate within a silo-like environment, but cuts are meaning they have to adapt and cooperate more closely. Forward-thinking authorities, such as Manchester, Ealing, Croydon, Maidenhead and Kensington are among those who have already noted the benefits PRS has to offer.

5. Through a more open dialogue between developers and councils

Local authorities and developers each need to understand the needs of the other, and the mutual benefits that schemes can bring. Successful schemes rely on collaboration between the public and private sector that enable the financial constraints of PRS to be overcome while meeting the needs of councils and their constituents.



Pat Hayes

Executive Director for Regeneration and Housing, Ealing Council

We see the development of a professional PRS as being absolutely vital to support development and growth across Ealing. The number of private renters has risen by 50% and too many are having to endure poor quality and poor standards. We want to see the growth of corporately managed PRS and we want to help. By providing our own PRS product alongside homes for sale and social rent (essentially being the developer), and by taking on some of the risk ourselves we can do this. Looking very carefully at section 106 commitments to help give the edge to PRS over housing for sale will be another way to make a difference. Quite simply, we have recognised the benefits of the PRS, and we are prepared to put our money where our mouth is to bring a better standard of housing to the local community.

THE WAY FORWARD



Marnix Elsenaar
Partner and Head of Planning, Addleshaw Goddard

One of the key factors in increasing the viability of the PRS remains planning guidance. At the moment, the National Planning Policy Guidance contains just one sentence on viability testing. Although deals have been done by those willing to take the initiative, local authorities need more clarity to bring development forward.

The NPPG encourages local authorities to take a flexible approach to PRS developments, and one of the objectives of the PRS Taskforce has been to educate councils about what they can and cannot do within this existing framework. The taskforce's ongoing work with the RICS and HCA to enhance training will be important. But the government could go further by beefing up the advice to local authorities in its guidance to leave them in no doubt they must be flexible and creative to make the PRS deliverable.

A separate planning use class would bring clarity, but limiting future exit routes could discourage investors by reducing liquidity while others believe it could seriously impact land values.

Local authorities should be given tools to enable them to ensure that private rented sector developments stay within the sector for a period of 10-15 years if they allow reduced or zero affordable housing provision.

Councils with an interest in the land they are earmarking for development are already doing this. They are adapting their section 106 agreements to support development with land covenants ensuring the development stays as PRS. But while the sector is emerging it is vital we have clarity and consistency through the planning system, and real support that will allow councils to extract the full value the PRS has to offer.

MARKET GROWTH WILL CONTINUE



Lucian Cook
Residential Research, Savills

Where the market is going

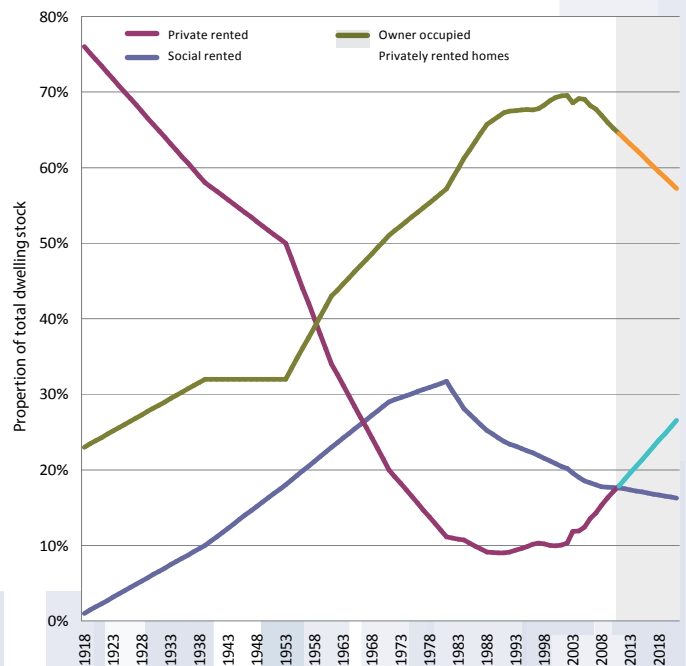
With high house price to household income ratios and restricted access to mortgage debt, we believe the private rented sector should grow by a further 1 million households in the next five years. That would require some £200 billion to be invested in an already undersupplied sector.

The need for better quality, better managed housing stock that meets the needs of generation rent seems to have registered with central and local government, as does the need to account for this within the planning system.

Furthermore, there is little doubt that there is a wall of money interested in this sector, but models for the delivery of appropriate returns are still evolving, as is the view of the investment value of that stock and consequently the land upon which it is to be developed. As that becomes clearer the growth of the sector should gather pace.

Both the private and public sector have a role to play in this. Each needs to understand the needs and objectives of the other and, importantly, the trade offs that will allow the expansion of a sector that is critical to meeting the future housing needs of the country.

The Rise of the private rented sector



Source: (CLG/Savills research)



CONCLUSIONS AND POLICY RECOMMENDATIONS

1. A formal covenant of rental provision

A covenant of rental provision for a minimum number of years would help assuage the fears of councils that developers could quickly flip products, while guaranteeing a long-term supply of rental homes. In place of other financial commitments it would formalise arrangements to kick-start development, without deterring investment.

2. Encouraging a PRS component to larger schemes

These can be used to accelerate development and bring forward the provision of homes, while ensuring a component of schemes remains available to rent on the open market.

3. Strong, formal guidance in the NPPF

Without bold guidance in the NPPF the PRS will continue to be ignored in the setting out of local plans and development objectives, and planners will continue to have difficulty approving development.

4. Earmarking public land for residential development

Public land can be disposed of by local councils within the existing planning guidance, but increasing clarity would allow more land to be allocated for the development of the PRS.

5. Widening the borrowing net of local councils to leverage their balance sheets

Local authorities keen to increase the development of housing provision have already used their own balance sheets to bankroll development, but more could be done to allow borrowing guaranteed by public bodies.

6. Defined quotas for PRS development in each local authority

Defined targets – like those outlined by the Mayor of London – would reduce the potential political backlash against building for private rent. A formal acceptance of the role private renting has to play in fulfilling community housing need would overcome the often polarised approach which considers nothing apart from affordable housing or homes for sale. The Mayor said he would recommend 5,000 PRS homes to be created each year, but formalising this nationwide could greatly increase development.

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