The demand for housing continues to outstrip supply and ‘Generation Rent’ is still on the rise. 28 percent of households in London are now rented, up from 15 percent since 2004\(^1\). To capitalise on this rise more and more developers and investors are entering the private rented sector, to the extent that Build to Rent schemes (or private rented communities) now make up significant proportion of the development pipeline within many of our regional cities.

What are the opportunities and challenges facing the sector?

Led by central government initiatives since the Montague review, numerous investors have entered the sector with a multitude of investment models. Local authorities have reacted with varying degrees of enthusiasm and often with different approaches to viability, affordable housing contributions and planning covenants. Operators are still looking for inventive ways to attract customers, develop their brands and minimise operational costs. But has anyone truly found the optimum combination of success factors to overcome these challenges and hit the sweet spot?

Ultimately only time will tell when future incomes and running costs become a reality, but a significant factor in delivering these schemes will be how the public and private sector work together to provide consistency of approach during planning and viability. This will allow operators to attract and retain their customers on a level playing field, to deliver high quality rental communities that meet the needs of the customer. This can only be a good thing for ‘generation rent’ and the local community.

Delivering a viable and sustainable rental community is about finding the right balance between development, investment and operational aspects of the viability equation. This paper considers some of the key issues under each aspect in turn;

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\(^1\) Housing in London 2016, Greater London Authority

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and for the future, and what quality, services and management structures they need to compete for their customers and still make a return on their investment.

**Design**

Successful schemes need to emphasise how the resident will live and interact with the building, its facilities and develop strong community identity as priorities. This needs to be achieved without limiting the potential for evolving the design as customer requirements develop and new trends emerge. Such flexibility could include the provision of amenity space that has direct access to non-residents, or is mirrored in size and grid pattern to standardised apartment layouts, allowing flexibility of apartment mix depending on take up. Early input from the operational and management team is essential to getting the brief right. Similarly, customer surveys of the target tenants would be recommended to keep up to date with the trends of the target tenants.

**Planning and viability**

Uncertainty over the most successful approach to viability of a Build to Rent scheme has presented a challenge for investors and developers. Local authorities, with a responsibility for levying development tax to provide much needed affordable homes and other public goods through section 106 agreements and the community infrastructure levy, also appear to be struggling to work out a fair mechanism for evaluating the true value of Build to Rent. This has led to an inconsistent approach to viability and planning covenants by different local authorities, which further adds to the uncertainty.

The Mayor of London has recently issued a draft supplementary planning guidance giving the rental market its own affordable housing classification, which was a welcome move for many. Other local authorities may now follow suit and discount market rent (DMR) could become the standard approach.

**Construction costs and benchmarking**

Early stage cost and schedule planning will always be needed to inform the emerging brief, design and test viability and desired financial return. Our approach seeks to interrogate cost and programme drivers that bring about assurance. See benchmarking table below;

<table>
<thead>
<tr>
<th>Number of storeys (excl basement)</th>
<th>Indicative cost sq.ft (4Q 2016)</th>
<th>Post contract programme duration</th>
<th>Indicative number of apartments per core/floor ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low rise up to 5 storeys</td>
<td>£130-£170</td>
<td>12-18 months</td>
<td>8:1</td>
</tr>
<tr>
<td>Medium rise 5 - 10 storeys</td>
<td>£165-£190</td>
<td>14-22 months</td>
<td>12:1</td>
</tr>
<tr>
<td>Medium / High rise 10 - 25 storeys</td>
<td>£180-£210</td>
<td>18-28 months</td>
<td>12:1</td>
</tr>
<tr>
<td>High rise 25+ storeys</td>
<td>£190-£250</td>
<td>24-30 months</td>
<td>8:1</td>
</tr>
</tbody>
</table>

Some of the key cost drivers to be considered in a Build to Rent scheme are listed below:

- Site constraints and required scheme density
- Apartment mix and apartment types
- Building height
- Parking provision
- Nett to gross ratio – including back of house, front of house and amenity area
- Wall to floor ratios
- Specification of fit out / furniture packs / white goods / sanitary ware / amenity areas
- Energy strategy and level of renewable on site provision
Life cycle cost analysis – optimal capital cost to cost of building in operation

Tenancy periods and frequency of re-fresh to communal areas and apartments

**Operation**

**Brand and customer service**

The ‘millennials’ or ‘generation Y’ are often said to be the target customer for the large scale, inner city private rented communities. Studies show they are sociable, tech savvy and brand loyal. On the flip side they can also be very discerning and if the brand isn’t ‘cool’ or the customer service is poor they will move elsewhere without hesitation and probably share their opinion on social media. This is new territory for most developers and investors which is reflected in the numerous company mergers and joint ventures being announced, with new brands being created, specifically aimed at the Build to Rent market.

The basic customer requirements from a development still apply, such as location, quality of finish, space and services. However, the long term viability of a Build to Rent scheme, and indeed a Build to Rent business, will depend on customer service and sense of community that is generated by the development and its management activities, which will have a direct impact on rental income, rental security and void periods for instance.

**Operating costs and sustainability**

By considering the need to maximise net rental income it can be seen that minimising operating costs is essential to achieve the required return on investment. The operating costs will be difficult to fully predict before the scheme is up and running, but will need to take into account running costs (typically 8-12 percent), lettings costs (typically 7-13 percent) and long term sink fund (6-9 percent), giving a gross to net rental discount range of 20 percent - 35 percent.

Building in sustainability has historically been seen as a capital cost burden to build to sell developments, with marginal tangible appreciation in sales value to offset the additional up front cost. Most initiatives to date have seen a ‘carrot and stick’ approach by central government, with changes in legislation through building regulations or code for sustainable homes for example, or through incentives such as renewable heat incentives and feed in tariffs.

However, with Build to Rent there is a direct benefit of investing in sustainability and considering life cycle costing and operational costing at the outset. When considering that the most common appraisal approach is based on future cashflow, finding the right balance between capital expenditure, operational expenditure and life cycle costing is paramount. Building Information Modelling (BIM) will play its part in this analysis too, as well as adding value to the investment by providing a ‘full service history’ of the scheme and efficiency in maintenance if used as an asset management tool.

**Investment**

Whilst investment models are varied the common consensus is that viability is still difficult to achieve on many Build to Rent schemes. Investors will normally base their valuations on future income and this is affected by a host of factors, such as local market rent levels, inflation, occupancy levels, void periods and operating costs. Coupled with the uncertainty around planning policy, stamp duty...
and letting fees this is a difficult equation to balance.

Government funding solutions such as Home Building Fund (which encompasses the previous PRS debt guarantee scheme), managed by the Homes & Communities Agency, may provide a solution to bridge this gap by providing development or infrastructure finance for schemes that are struggling with viability.

**What does the future hold?**

Build to Rent is here to stay, and who knows it may become a mature asset class of its own.

Once more established we are likely to see true innovation and market differentiation between the current and future players in the market. Some possible trends are outlined below:

- Brand identity and customer service the main factors in tenant attraction and retention
- Increasing use of technology and faster broadband speeds
- Increase in amenity provision and decrease in unit sizes
- More trade-off between capex and opex/whole life costs
- BIM increasingly used to provide ‘full service history’
- Increasing use of planning policy and guidance, particularly in relation to PRS design & quality standards

The emergence of high quality private rented communities, particularly in core regional city centre locations has the potential to support long term housing demand and is an important fillip to regeneration. Successful schemes are putting the customer at the heart of the design to maximise their communal living experience and increase tenant interaction and retention. However this must be coupled with a keen focus on capital costs, operational costs and the selection of sustainable solutions.

In truth, whilst the dynamics of Build to Rent can provide many investors and developers with viable outcomes, those who can bring forward schemes quickly, provide good customer service and demonstrate reliable net returns are likely to establish strong market leading brands. Finding the viability sweet spot, working with the public sector and developing customer loyalty through branding and service provision will be the key factors in the successful long term aspirations of this exciting sector.

**About Turner & Townsend**

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With 97 offices in 41 countries, we draw on our extensive global and industry experience to manage risk while maximising value and performance during the construction and operation of our clients’ assets.

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