JLL Achieve Ambitions

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Evaluating *Build to Rent performance*

Analysis of stabilised BTR data

It has been a long journey, but Build to Rent has finally arrived in the UK.

For years we have been anticipating the emergence of an institutionally backed purpose built and managed private rental sector.

Now, with 125,000 units either completed, under construction or with planning, there is a clear pathway towards critical mass in the nascent sector. The challenge now moves to measuring the underlying assumptions behind the growth of BTR.

This paper does something that has not been possible before – it explores completed BTR operating performance. It also explores the 'who' question of BTR, analysing the occupiers who have been living in these buildings for at least 12 months.

There are factors that have encumbered the rapid growth of BTR, ranging from viability concerns to a lack of appropriate data sets that would improve transparency. The latter has made underwriting potential opportunities particularly difficult and has also led to a lack of policymaker understanding on the sector.

However, with over 20,000 units completed and a smaller sub-section of that total now stabilised, the lack of transparency in the sector need not be an issue moving forward.

Our research focuses on 7 completed schemes, encompassing a total of 911 units. Our sample group includes schemes from all over the country. We have only included stabilised schemes that have been operational for at least 12 months and have reached at least 90% occupancy.

We have then undertaken a local market analysis of the area within 1km of our schemes to provide a benchmark for performance.

Our sample includes purposely designed and constructed rental stock, converted office buildings and retrofitted old residential blocks.

There is one thing in common though – they are all under single ownership with professional management. The question facing the sector has long centred around whether professionalisation can lead to positive gains for investors and renters alike? Now, at long last, this report can start to provide some answers.

BTR schemes analysed
7

Total units
911

Average scheme size
130 units

Average rental growth past 12 months
3%

26.6%
Average gross to net

9.3%
Average rent premium achieved

Performance analysis

Rent premium

Our analysis found the 7 BTR schemes achieved an average rental premium of 9.3% when compared with the rental markets within 1km of each location.

But can that rental premium be attributed to the operational nature of BTR? Put more simply, are occupiers willing to pay for services and amenities?

It is likely that some part of the premium is simply due to the sample group being new or recent refurbishments compared with a wider secondary sample group – the more simple 'new build' premium. As our case studies age, how they perform against the wider market will be crucial to understand whether occupiers will pay more for the services and amenities on offer.

Replicating this exercise in the future with a larger sample size will allow us to see how much more people are willing to pay or whether rental premiums will gradually be eroded.

9.3%
Average rent premium achieved

8.4%
Average rent premium achieved in London schemes

12.0%
Average rent premium achieved in regional schemes

Average 1 bed rent premium achieved

-6.8% to 22.9%

Rental growth

The case studies have all seen rental growth compared with the local market over the past 12 months ranging from 0.2% to 8.8%, and averaging 3% across all schemes.

There will inevitably come a point where an affordability ceiling is reached in any given rental market. It is possible that a tiered system of classification may emerge as more BTR stock is completed in the UK.

Initial investor appetite for the sector undoubtedly focused on the premium end of the market. However there is now a definite polarisation of product emerging – some stock is being targeted towards a premium luxury rental market, the majority towards a mainstream mid-market rental tenant and some towards the affordable market. Accreditation bodies have been monitoring the growth of BTR already and it seems likely that a rankings and ratings system will emerge.

In the digital age, it also seems likely that renters will be able to review their experiences in BTR developments, just as they have done for many years following stays in hotels. The quality of product, services and amenities will inevitably drive rental growth going forward.

Average rental growth
*3%**
**past 12 months*

4 out of 7 schemes
outperformed local market rental growth

Operating costs and vacancy rates

The 7 case studies averaged a gross-to-net margin of 26.6% with a range of 21.3% to 35%. To put this performance into context, the IPD Residential Index reports an average of 32%. But much of the stock included in the IPD index is older property, with a heavy weighting towards Central London. It is therefore not likely to benefit from the efficiencies and economies of scale that a BTR scheme should enjoy.

Until now the industry has been modelling a theoretical gross-to-net margin for BTR of 25%. Our sample group shows performance is broadly in line with these models. Our analysis indicates that purpose built assets retain a greater percentage of their gross rental income than schemes that were originally designed and built for home ownership. A factor that obscures this relationship is the age of these schemes.

The majority of non-purpose built schemes in our research are typically older, having been built or repurposed for rental use over the past 15 years.

Greater knowledge of how to run a BTR scheme should improve efficiencies and therefore lower the operating margin – and as we build schemes better they should become easier to run. As with the student sector, the market will be able to understand where efficiencies drop as more units are added.

Vacancy rates have a significant impact on operating performance. The 7 schemes reviewed have an average vacancy rate of 5.2% with a range of 2.3% to 8%. The schemes with a lower vacancy rate were also the ones which are achieving a lower gross-to-net margin. This underpins the importance of having robust strategies to minimise void periods and drive rental take-up.

Average gross to net

26.6%

Gross to net range

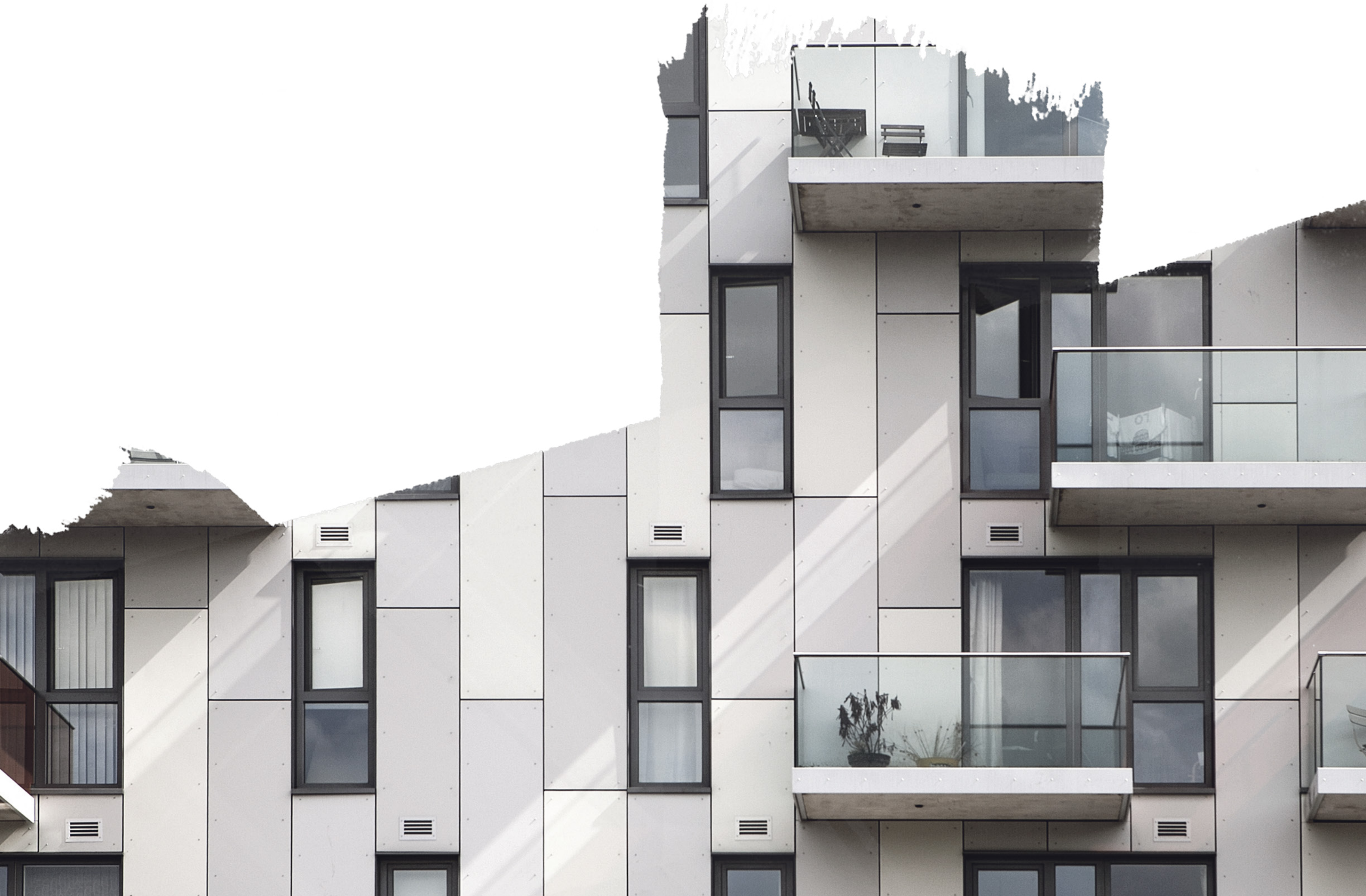
21.3% to 35%

Average vacancy rate

5.2%

Vacancy rate range

2.3% to 8%



Occupier overview

Age profile

There is a misconception that BTR only provides homes for affluent young professionals. Our findings show a much wider section of society is living in BTR. Our 7 case studies are mixed communities with occupiers ranging in age from 18 to 55.

Ensuring community cohesion is crucial to the success of BTR schemes. This means operators may need to be mindful that they must provide services aligned to all ages and life-stages.

Average age across all schemes is

31

years old

Average age at scheme level ranges from

27 to 35

years old

Occupiers across all schemes range in age from

18 to 55

years old

Average income

Average income across all schemes is

£37,321

30% above the UK median full time salary

Average scheme level salaries range from

£32,414 to £43,904

Proportion of income spent on rent

The occupiers of the BTR schemes analysed are broadly above-average earners, earning an average of 30% more than the UK full-time median salary. These occupiers are prioritising location and the services that BTR has to offer.

But in making this choice, the occupiers in our sample group are not over-extending themselves, with the percentage of income spent on rent ranging from 27.2% to 31.2% across the schemes.

The percentage of gross income spent on rent varies from

27.2% to 31.2%

The average percentage of gross income spent on rent is

28.1%

across all schemes

BTR conclusions

As the table below shows and this report has illustrated, BTR has begun life performing broadly as many of the theorists had suggested it would. Annual rental growth is in line with inflation, rents are at a premium to wider local markets, and stronger operating performance is dictated by lower voids and greater levels of service and amenity.

On the tenancy side, the first occupiers of BTR schemes span a relatively wide age range from 18 to 55. They are above average earners, averaging 31 years of age, fulfilling the expectation that BTR will prove particularly popular with young professionals.

Indicator	Average	Range
Rent premium	9.3%	-6.8% to 26.2%
Rental growth	3.0%	0.2% to 8.8%
Vacancy	5.2%	2.3% to 8.0%
Gross to net	26.6%	21.3% to 35.0%
Tenant age	31	18 to 55
Tenant annual income	£37,321	£32,414 to £43,904
Gross income spent on rent	28.1%	26.0% to 31.3%

Final word

Very few people in the UK know about Build to Rent and even fewer people live in a BTR home.

But there will come a time when that changes – when a significant proportion of the population know what BTR is, and more to the point can recall a personal experience of it. And with that change, private renting will have fundamentally altered in the UK, for the better. Over the next five years this change will slowly start to take effect as more and more BTR developments are completed.

The professionalisation of the sector will raise expectations. And those raised expectations will drive standards. There will still be a place for buy-to-let – a very big place given that it currently encompasses about 20% of the UK's housing stock. But unless buy-to-let landlords raise their standards, there will be a flight to quality as renters choose BTR. This could mean we see the worst buy-to-let properties drop out of the market.

But will brand loyalty emerge? JLL's latest thinking in this area is that brands at a corporate level will have more significance to a B2B audience, while brands at an asset level will carry more weight for the B2C audience. The private rental experience should improve and occupiers will become proud of their address.

Transparency needed

Underpinning all of this is a need for better data. A need to share data more openly. JLL set out to undertake an open book analysis of operational BTR schemes.

Thanks must go to Aberdeen Standard Asset Management, LaSalle Investment Management and L&Q who were all particularly helpful in collating this research. However, the majority of the investors we approached were sensitive about sharing their data at a time when precious insight can still provide a competitor advantage.

But we need to be more open in order to inform better decision making, better design and better delivery. It is our hope that the next time this research is undertaken, there is an embarrassment of riches in terms of case studies.

That will ultimately be good for the market, good for consumers and good for planners and policy makers.

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