Edison Explains

The UK build-to-rent market

Has build to rent taken control of the UK housing market from traditional build to sell?

How quickly is build to rent expanding?

Build-to-rent homes are constructed to generate rental income rather than to be than sold outright. The market has picked up momentum over the last three to five years.

According to the British Property Federation in London, the final quarter of 2018 saw 14,801 build-to-rent homes completed, with another 19,304 under construction and 38,662 in the planning stages. Only three years earlier around 4,000 build-to-rent homes were completed in London and another 6,000 were planned. This compares to 24,070 under construction outside London, with another 28,000 planned.

This momentum shows no signs of slowing as price pressures and the cultural norms of 'generation rent' continue to attract investment to the rental market. The number of households in the UK private rented sector increased from 2.8 million in 2007 to 4.5 million in 2017, a trend that is unlikely to slow according to ONS projections.

Why is the build-to-rent market growing so quickly?

The UK housing deficit has been well documented and heavily reported. The Office of National Statistics said that in 2018 an average full-time worker in England and Wales could be expected to pay, on average, 7.8x of their annual earnings on purchasing a home.

This is a significant increase from the 3.6x of 1997, but preferable to the average 12.25x in London, up from 4% in 1997. The increased cost of buying a home naturally increases demand for short-term rentals, driving the build-to-rent market.

Alongside the financial incentives, the demand for rental space is moving forward at the behest of 'generation rent' – young workers who, according to popular sentiment, are using rented property as a flexible living solution that give them the freedom to move easily in an environment where careers and lives are less static than before. Today the average age of first-time buyers is edging closer to 40 than 30.

Although the build-to-rent market remains small compared to traditional build-to-sell markets, its considerable growth over the last few years can also be attributed to its favourable profile when it comes to investors.

Why are investors attracted to build to rent?

The attraction of build-to-rent as an asset class, especially large pension and insurance funds, is relatively transparent.

For those who have the capital to construct rental homes, build to rent provides a steady long-term income stream better aligned with their models and more consistent in its returns. Build-to-rent developments are also considered to be a separate sub-class within property asset investing, providing diversification in returns generated versus more traditional areas.

There are risks for the build-to-rent developer that are not present when buying outright. However, they can be mitigated, notably through forward funding or by entering into joint ventures, using government subsidies or forward purchasing.

Forward funding is one of the most common solutions to de-risking build to rent, especially in volatile property markets. In forward funding, a plot of land is sold to the investor alongside an agreement for developing the property, which the investor agrees to fund. Once the construction is complete and the development is handed over, the final account is settled.

Evening out of development costs provides a good deal of security to the developer.

Where is the build-to-rent market centred?

London is a very active build-to-rent market, with the number of build-to-rent homes constructed on par with the rest of the country combined. This is unsurprising given that all except

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'Some commentators expect owner-occupier and private rental tenure proportions to continue to converge (reducing and rising respectively) and the build-to-rent subsector is well placed to grow disproportionately quickly in this scenario. As a final comment.' Toby Thorrington, industrials analyst one London borough (Tower Hamlets) has above-average affordability ratios (median new house price divided by median workplace earnings).

According to the Mayor's office, to tackle the housing shortage 65,000 new homes will have to be built per year in London over the next 20 years, starting in 2017.

Meanwhile, the number of owner-occupier and social households barely grew last year, whereas the private rental sector almost doubled.

This does not mean London dominates the market. A number of regional build-to-rent centres have appeared, such as Manchester, Birmingham, Leeds and Liverpool, with Manchester and Liverpool planning considerable new housing supply.

Which companies are entering the build-to-rent market?

Some of the largest UK developers such as British Land and Grainger have shown considerable interest in build to rent.

Late last year, British Land highlighted its plans to develop 4,000 potential build-to-rent sites in suburban London and Grainger has been selected by Transport for London (TfL) as a build-to-rent partner. The TfL scheme plans to build over 3,000 homes on its land for rental purposes.

Telford Homes, a London-focused developer, has also refocused towards build to rent, having partnered with M&G Real Estate and Invesco Real Estate in build-to-rent schemes for over 400 properties.

Outside of the developers, a number of build-to-rent funds have appeared over the last four years. One of the first, Legal & General's UK Build to Rent Fund, is working with Hawkins\Brown on a £500m, 1,000-home development.

More recently, Greystar announced its plans to raise £750m for the launch of its first build-to-rent fund and PFP Capital has said it plans to raise £550m for its fund.