Can BTR Continue Its Record-Breaking Run?

10 June 2019 The build-to-rent sector is on a roll. The first quarter of this year saw a record £1B invested in the sector, according to CBRE, and a 34% increase in the number of units completed, according to Savills.

The build-to-rent sector is on a roll. The first quarter of this year saw a record £1B invested in the sector, according to CBRE, and a 34% increase in the number of units completed, according to Savills.

At times like this it can be easy to become complacent. Hence the opening question at Bisnow’s Build To Rent Annual Conference last week, posed by Pinsent Masons partner Natalie Harris on a panel examining the next wave of BTR investments: Can this growth continue?

There is much to be wary of. Many of the sites where BTR developers can see off competition from alternative uses actually make bad BTR locations. And some markets are starting to see oversupply.

Bisnow/Adrian Fisk Photography

Pinsent Mason's Natalie Harris, Lendlease's Victoria Quinlan, EcoWorld's Heng Leong Cheong, NHBC's Andy Mullins, Cortland Partners' Andrew Screen

But on the whole, the sector looks set for continued growth. International investors are still desperate to enter the UK. Domestic capital is also active. And the struggles in other sectors like retail are providing a previously untapped source of potential sites.

One of those hungry international firms is EcoWorld London, the Malaysian-backed developer which has forward-funded a portfolio of 1,000 apartments in London in a £400M deal.

“We are very positive on the sector, and we are looking to build our portfolio to 10,000 units over the next five years,” EcoWorld London Chief Executive Heng Leong Cheong said at the event attended by 500 delegates.

There was a net redemption of 70,000 buy-to-let mortgages between Q1 2017 and Q2 2018, during which time there were just 10,000 BTR units completed, he said. Over the past two years new buy-to-let mortgage origination has dropped 40%. People still need to rent, but changes to tax laws mean mom-and-pop investors are pulling back from the market.

“That creates a vacuum, where buy-to-let landlords have vacated, and now is a prime time,” he said. “We are seeing sophisticated financial institutions and managers coming in and filling that void. I don’t think there is any saturation at all in the market.”

Bisnow/Adrian Fisk Photography

Ivanhoé Cambridge's Martine Philibert

“Whether growth numbers of 34% can continue is debatable, because you are coming off a very low base, but in London we are building around half the number of new homes we need each year,” said Victoria Quinlan, Lendlease managing director of investment management for Europe. “Then when you overlay issues of affordability which we are seeing in big cities around the world, we need to build more homes so they are more affordable for everyone, not just some people.”

Ivanhoé Cambridge is one of the world’s largest institutional investors in rented residential. In 2015 it joined up with Blackstone to pay $5.3B for the 11,000 unit, 55-building Stuyvesant Town — Peter Cooper Village apartment complex in New York.

In London it first entered the rental residential sector by teaming up with Apollo Global Management to refinance Bruce Ritchie’s Residential Land business, buying up individual units or small blocks and refurbishing them.

And Ivanhoé Senior Vice President Martine Philibert revealed it has moved into funding BTR developments — it is one of the investors funding Greystar’s giant new scheme being built in Greenford in Ealing.

Bisnow/Adrian Fisk Photography

QuadReal's Jay Kwan

“We can do small deals where we refurbish assets and look to sell them on, a value-add strategy, but we are also looking at development where we fund schemes and look to hold them for the long term,” Philibert said.

Philibert pointed out one problem for global institutions: a UK valuation system which means that BTR schemes are valued on a per-unit basis rather than as an entire building.

“That makes it very difficult for an investor who wants to own for the long term to know what their net operating income is and to measure their return,” she said. “We are a mark-to-market institution, so that is very important to us.”

“We don’t really care about anywhere else in Europe other than the UK,” Atlas Residential Chief Executive Steven Ivankovich said, highlighting the appetite of another U.S. investor, one which has been present in the UK for the past couple of years. “We more or less speak the same language, laws are friendly, and let’s face it, this has been the most dynamic economy even when you take into account Brexit. We don’t see the need to look to the Continent. There is plenty to do here, supply and demand are in balance, people need places to live. You can argue about which city, but there is no reason to be looking to Frankfurt or Paris.”

Not every North American investor shared the all-out positivity of Ivanhoé and Atlas.

Bisnow/Adrian Fisk Photography

Cortland Partners' Andrew Screen

“We have sufficient UK exposure at the moment, and we are looking across Europe and asking, where is there a need for capital, and where can we be competitive,” QuadReal’s Jay Kwan said. The firm has three schemes in the UK and Dublin, including one of the largest-ever single-site UK BTR schemes at Stratford, where it is funding a £675M, 1,200-unit scheme.

However, capital will flow from other parts of the world, as well as North America.

“We have a lot of Malaysian pension funds looking to enter the UK market, and the BTR sector is a good way [of] doing that,” Cheong said. “The trouble is, in Asia it is not a well-known sector. People talk about the North American wall of capital coming, but when the Asian wall of capital comes, that is when things get really exciting.”

Part of the problem for international investors, Lendlease's Quinlan pointed out, is that completed, operational stock is virtually nonexistent due to the new nature of the sector, and the development pipeline is only about 134,000 units in the whole of the UK, which sounds a lot, but is tiny when compared to the U.S.

Innovative joint ventures with public bodies that own land are needed to unlock good sites, she argued. But a new source of land for BTR developers is increasingly becoming available: retail schemes. "In the last six months we've started seeing a lot of opportunities to build over retail, either in town or out of town," Cortland Partners UK Chief Investment Officer Andrew Screen said. It too has an ambition to build up a portfolio of 10,000 units.

Bisnow/Adrian Fisk Photography
Homes England's Sir Edward Lister

"Some of the stuff we're looking at we'll be building over retail, some of it we will be cutting off a bit of the parking and building there. That's because of the falling demand for retail: The big tenants aren't there anymore, and BTR provides the retail landlords with an income stream. We're another tenant: We get a piece of land to build a scheme on, and they get an income stream."

Such developments can be financed in multiple different ways, Screen said.

“We’ll look at whether it’s carved out on a long lease, essentially a land deal, or a lease with a coupon, a kind of rental indexation. We’ll also look at it where the retail owner essentially inserts the whole scheme and it becomes a joint venture where we share the income. For me it’s about location. If it’s a failed scheme that has failed for retail, then it won’t work for BTR either. But a lot of the stuff we are seeing is town centre.”

QuadReal has already struck one such venture: Its Stratford scheme is a joint venture with shopping centre owner Unibail-Rodamco-Westfield, which did not want to undertake the development itself. And it is on the lookout for more.

“One wrinkle we’re trying to add to our strategy is looking for more densification around shopping centres and retail that works,” Kwan said. “Not necessarily buying into the shopping centre, but capitalising with the shopping centre partner on any excess land where they need capital, or don’t want to deploy their own capital in something that’s outside their remit, residential.”

Screen’s warning about sites that don’t work for retail not working for BTR was echoed and expanded upon by Homes England Chairman Sir Edward Lister. The weight of capital entering the sector risks pushing people to build on sites that aren’t viable in the long term.

“We are seeing BTR developers buying sites that build-for-sale developers don’t want. If it doesn’t work for build for sale, why would it work for build to rent?”

Such considerations aside, appetite to put capital into the sector remains high. It won’t stay at 34% growth forever, but for now, growth in BTR looks set to continue.