Questions on Build to Rent

Views on the current situation of BTR market and its influencers in 5 articles

The Effect of COVID-19 on BTR (4 of 5) and Is the BTR model sustainable? (5 of 5)

In this last instalment of the series , Sebastian Moritz - Director of MORICON, will look at the impact COVID-19 has had on the industry, its effects for tenants, property owners and investors and highlights possible solutions. Closing this, he will look at the sustainability of the BTR model, the financial considerations, processes and highlights possible solutions.

Contents

1. Effects of COVID-19 pandemic on our business

The current pandemic will create a shift in the rental market – for businesses as well for tenants - in more ways than during the financial crisis in 2008 or SARS in 2003.

1.1. Effects for Tenants and Landlords

The financial impact will have several facets: tenants being furloughed or made redundant will impact their rent payments[1]. Once the government's ban on evictions on August 23rd[2] (extended from 25th June via MHCLG) is expired, the market must make some difficult decisions[3] - especially for younger tenants: will evictions be the norm or is the industry opting for a phased payment model similar to the commercial tenants? There is however a sentiment that the situation is not that desperate: the Home Let Rental Index reported, that despite COVID-19 rents in UK grew in May, except for London and Northern Ireland.[4] In the last statistics from the Office of National Statistics (ONS), the level of rents have risen to the highest level ever[5] – which will create a many tenants vying for a decently prices accommodation and thus creates a new higher barrier to rent.

The other facet is a higher mobility –

- people leaving or moving from jobs
- shared accommodation in favour of single units
- students moving back home
- changes in work patterns result in more work from

This all has created a sharp increase of rental applications and movement on the market.

How someone is looked after in a time of crisis will be remembered and capturing this insight and sentiment from residents now will be powerful for longer-term brand reputation and loyalty. Now is a good time to be speaking to residents, getting feedback, and making sure residents' needs are met. How property owners deal with rent-arrears, repairs, customer satisfaction etc. will have significant impact on their cashflows but also on their reputation and perception in the market.

Making the most of your property's amenities can also help to create a better functioning community for the building, thus strengthening the income stream because of reluctance to move away and enjoy more referrals that way.

Lastly – the traditional high street agents will struggle with marketing and conversion: a well-rehearsed virtual walk-through and subsequent advertising on social media will confirm the growing shift from outdoor above the line (AIL) to online through the line (TTL) campaign via social channels.

1.2. Effects for Investors

The latest research from Property Hub has revealed, that 98% of property investors still consider property to be a good long-term investment. Many investors will ride out the challenges, but others are eager to exploit market conditions, with 80% saying they are likely to invest over the next six to 12 months, compared to the 19% who have shelved their plans for the time being. [6]

The survey continues that only 6% of investors surveyed expected rental values to drop, while 19% are expecting an increase. While the report initially thought investors might start to have a bias towards income-generating properties, this indicates their strategies might not change at all and investors will still be in two categories: those who invest primarily for capital growth (long-term) and those who invest for income - although there are those who combine the two.

The BLT property owner on the other side is more under siege: falling rents, unemployment, lack of suitable BLT mortgage products – those with over-extended borrowing might be forced to sell.[7]

Investors / Owners can combat this pressure in adapting to the new market conditions, by:

- Reviewing building design: smaller communal spaces in favour or work pods, fast and stable internet infrastructure, creating of rentable mini-offices
- Access different sources of credit: think about REITS, establishing closed-end fonds to secure capital, researching new loan structures[8]
- Perfecting the sales process: well-rehearsed and choreographed virtual viewings, simplifying contracts, implementation of digital signature tools to close deals faster and with confidence in technology.
- Reworking current standards and communication protocols: enable tenants to be fully informed, being close to your tenants means keeping them in the building, establishing fast customer feedback and problem resolution mechanisms to demonstrate you care.
- Revisiting sites that benefit from PDR regulations and that are currently valued less due to pressure on the office retail market.
- Negotiating pro-actively with tenants: it is better to agree a planned rent-payment schedule, deferral schemes and rent-holidays on your terms, than accepting insolvency of tenants, long void periods and additional overheads.
- Employing higher BREEAM standards to lower operating costs and to attract clients – this will be mainly around air-filtration and general sanitation/hygiene equipment.

2. Is BTR model sustainable?

Whilst there is no dispute that the property market is going through a major shift, there are a lot of opportunities to invite long-term investment. Investment returns in property performed reasonably well in the last 30 years– especially during 2000 – 2014 while the stock market was very volatile (9/11, SARS, Financial Crisis etc.) and has therefore always been a part of a diversified portfolio.

2.1. Financial Considerations

If you move your company into a REIT structure with the ability to be traded like shares, you can increase your portfolio and access to cash -especially with continued dividend re-investment. For self-financed projects, the government's HCA Built to rent Funds 1 and 2 as well as the debt guarantee scheme for PRS are avenues to pursue, but there is still a long way to go to remove barriers to institutional investment into PRS as the well-known Montague review recommended as early as 2012[9].

Another consideration is to buy into your competitor – during turbulent times under-performing companies might fall prey to the opportunistic operator[10]. Undervalued businesses are equally attractive as undervalued sites – Canada's Brookfield Asset Managment buy of 7.3% of British Land followed Hong Kong based Lifestyle International Holding's revelation of having obtained a £ 50M stake in Land Securities. Since the 1990ies UK real investment trust traded with historic discounts to net assets value which opened the market for buyers in search of value.

Big land projects undergo similar turbulences as the stock-market, however their ability to shield itself from major upheavals has been seen in the past many times over. The attractiveness of larger projects is ticking all the right boxes:

- Long-term stable investment
- Certainty of returns over lifespan of project
- Helping infrastructure on local level
- Attractive to buyers – eco-aspirations, wellbeing, green transport & energy, community, placemaking

This requires positive and actively managed relationships with the Local Authorities – see Barking Riverside Regeneration (L&Q partners with GLA) or Mount Anvils' recent loan from GLA, these positive relationships assisted in integrating the local communities to support the project.

Finally, there is the diversification strategy: purpose student accommodation or senior living projects are still lucrative markets with excellent long-term income.[11]

2.2. Rethinking of Processes

To keep the competitive edge companies might need to revisit a change of their processes – both operational and in construction.

2.2.1. Construction

This includes a closer look into modern methods of construction (MMC) to see if better values and ultimately returns can be obtained. Modular or timber frame construction will cut costs, drive profitability as well shorten the build-process. [12]. With a lot of the European labour force being sent home during COVID-19 as well new immigration laws[13], this method of construction can claw back timelines as well as reducing site costs.[14]

The other component in the approach lies in modular and/or meanwhile construction – to unlock one part of a site fast to build momentum and start the income streams might make this a very attractive proposition - especially for larger regeneration projects but also for smaller niche projects where time or site constraints and highway infrastructure are difficult.

2.2.2. Operations

The BTR is all about service and community – if efforts are made to improve current and future operations this will secure longer tenancies and income streams on one side, paired with re-focusing of space planning and utilisation (less parking in favour of car-sharing, more "in-demand" amenities such as work pods, mini-offices) will attract more potential customers to the brand.

2.3. Summary

Whilst the market is still in turmoil, the sector is best placed to emerge well – after the financial crisis the US multi-family sector recovered the fastest with a decade of growth[15].

This period has also highlighted the resilience of the multifamily sector. Rent collection rates have remained high, and historically rents have declined less and recovered quicker during downturns, giving investors some confidence to proceed.[16]

The industry needs to manage the shift by listening to customers, caring for and curating their communities. If operators are forward thinking and future-embracing and are in possession of agility to change, I believe there are many lucrative opportunities available. It all depends on how quick change can be implemented.

Moving forward, substantial investment is in the pipeline, with just over £1.4 billion worth of deals currently under offer - broadly equivalent to the investment pipeline at the end of 2019, which then translated into £1 billion of investment in Q1 2020.

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His residential experience covers senior management roles at One Hyde Park Residences (Mandarin Oriental Group), Ten Trinity Residences (now Four Seasons Hotels) and Belgravia Gate, before founding MORICON Consultants. He consulted Lodha Group UK on their three London projects – Lincoln Square, No. 1 Grosvenor Square and Kensington Odeon with a combined sales value of £ 1.6B and provided strategic advice for the Amaala Project in Saudi Arabia, a new super-prime resort destination at the coast of the Red Sea.

Professionally educated in Switzerland, he holds an MBA from Henley Management College. Sebastian has Member status at IRPM and Assoc. RICS and achieved Level 4 BTR Accreditation from IRPM.
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