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How will build-to-rent navigate its first down market?

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Change is coming and higher interest rates are here to stay

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In the current climate, there could well be a new base rate by the time you finish reading this – not to mention a new prime minister and chancellor. Such a lack of political and economic certainty is adding to spiralling interest rates and construction and energy costs which risks creating an impasse right at the point we should be firing towards growth.

While the student accommodation sector has now thrived for over two decades, the build-to-rent (BTR) sector has yet to go through a down-cycle. The pandemic came and went with rents and occupancy quickly rebounding and growing. But the aftershocks from the flash spike in gilt yields – and the associated drama in the pension market which is still playing out – is set to have a number of effects on real estate, some of which are yet to materialise.

Interesting times

The first is the return of gating, as property funds – which are yet to make up their minds on a better way to market and price themselves despite the FCA reviewing it and kicking the can down the road – restrict outflows to manage liquidity needs of investors on funds of illiquid assets. While on previous occasions this has largely focused on retail investors, now it's one of confidence on the part of institutions.

The second – more of a double-edged sword – is the increase in interest rates. At a domestic level, this is likely to further squeeze a buy-to-let market already under pressure from the impact of the removal of tax breaks. Combined with a lack of housebuilding in areas people actually want to live, the exodus of private landlords, and the lack of mortgage availability (all of which benefit the rental market) the seeds have been sown for a boon for BTR investors now looking at full occupancy and strong rental growth.

If domestic house prices do fall, the reset (pricing remains umbilically tied to open-market supply) is likely to impact how BTR schemes get underwritten, and this could well be beneficial for those wishing to enter the market.

Yet with the supply of BTR – and purpose-built single family housing, as being pioneered by the likes of Apache's Present Made, L&G's Suburban and Aviva's Packaged Living tie-up – still only around two percent of overall supply – the ability to build (with debt) is a crucial element of the sector's growth. So what to do?

> *"It will often be the more risk-averse professionals in the room pointing out risks and erring on the side of caution"*

Just as Liz Truss's government was the mother of a mini-financial crisis, so necessity remains the mother of innovation. As we stare down the barrel of the climate crisis and into the macro headwinds of rising debt, ageing populations and soaring housing costs, changing the way we build is crucial. While different forms of modular housing have emerged – some like ilke Homes tie-up with

Octopus offering “zero bills” – the industry is yet to embrace modern methods of construction at scale.

As lawyer, I have to put my hands up and say that it will often be the more risk-averse professionals in the room pointing out risks and erring on the side of caution.

Get Living has grown to be one of the larger build-to-rent developers in the UK

But having spent the last few years watching Get Living expand and witnessing the widespread innovation occurring in the space, it’s clear that wider adoption of volumetric modular systems – where boxes are precision-engineered and shipped to site – could make a significant impact.

While some lenders may have been cautious on this, it’s an area we believe makes much sense – not least because of the significant impacts offsite manufacturing can make when it comes to decarbonisation.

The elephant in the room

The elephant in the room of course, irrespective of innovation, is the cost of land. While the current climate will embolden those who own large landholdings or who are partnered with public sector bodies, using leverage to build and acquire land to do so will be a challenge.

And for some, it’s the construction costs rather than land prices that tip schemes over the edge. However, as the market begins to see that the next cycle is going to be one of repricing, adjustments will have to be made and agents will need to advise their clients accordingly – as opposed to holding out for massive policy changes.

While a shake-up of planning is promised, the government's inability to get through its first months without several U-turns means that reprising Robert Jenrick's rather sensible reforms (and risk upsetting core voters) is highly unlikely. And without any real reforms, the stand-off with NIMBYs will continue to be as strong as the stand-off over land costs.

Amid all the chaos, three things are certain. Change is coming and higher rates are here to stay. Customer demand is only likely to grow. But while rental demand is soaring alongside inflation, there is a ceiling to what consumers will be able to bear.

I look forward to watching how BTR investors respond.