MAY 2021

THE COMMERCIAL IMPACT OF AMENITY SPACES
IN BUILD TO RENT SCHEMES IN THE UK

The Rental Space Race

cast-consultancy.com

Setting the scene

Cast is a specialist residential real estate and construction consultancy with specific expertise in build to rent, later living, student accommodation and market sale tenures.

After years of discussion, Britain's emerging purpose Build to Rent (BTR) sector is seeing its first batch of operational assets open their doors to customers. While many thousands of homes now have planning consent, no clarity or uniform rules currently exist to define what BTR should be.

Indeed, developers and investors vary massively in their approach. Some are focused on delivering bespoke rental buildings – designed from the ground up for their target customers – that typically include a wealth of hotel-style facilities. Other investors and developers are less concerned: many institutional investors have purchased pre-existing clusters of flats that otherwise would have been sold, while others have forward-funded schemes bearing little difference to housing for sale. Yet many now believe delivering schemes with elements from the hospitality and leisure industries can drive additional value – both in terms of their brand and cash flow.

The question over how much a company goes above and beyond offering the basics of an apartment largely rests on the ambitions of that business. But ultimately viability will be driven by a myriad of considerations around target customers, location, demographic, wage growth and many other factors.

For many BTR companies, delivering experiences "above and beyond" a regular rented apartment is becoming central to their offering. The hotel-style experience – with amenity spaces, bolt-on facilities and round-the-clock service – is part of an increasingly popular brand proposition many want to use: the concept of a customer 'renting a building' rather than just the apartment.

Cast

But what are the actual considerations and benefits of making BTR purpose built?

The viability pressures on bespoke BTR schemes piled on them through the planning system are compounded by the upfront capital costs of these additional facilities. As a result, the lines separating traditional residential and modern hospitality businesses haven't become hugely blurred – yet. However, there is a shift in planning (although not ingrained in policy) towards an affordable housing contribution made through the inclusion of rental homes offered at a discount to market rent. There is no clear rule on the percentage discount acceptable, therefore this is not necessarily going to bring BTR schemes on a par in capitalised value terms with market sale.

Investors are understandably risk-averse, with this aversion revealing itself in many of the early "forward funding" BTR transactions – where investors pre-purchased assets from developers either in build or upon completion. Many of the first wave of large scale BTR assets are identical to market sale housing, and exclude the type of amenity space often associated with purpose built BTR schemes.

> "The hotel-style experience – with amenity spaces, bolt-on facilities and round-the-clock service – is part of an increasingly popular brand proposition many want to use: the concept of a customer 'renting a building' rather than just the apartment."

We are now seeing a shift towards a secondary wave of developments funded through integrated platforms (merging investment, development and operational functions) and through conventional pre-purchase transactions. In many instances, the final design of these buildings have not been fixed or design is in its infancy.

As a result, more consideration is being given not only to real world operational performance but also to how internal space can be re-ordered, creating amenities that:

1. Help differentiate these BTR buildings from conventional housing stock rented out
2. Create a differentiated 'customer experience'
3. Drive higher levels of occupancy and customer retention
4. Drive revenue, as part of value 'layering', in conjunction with service levels.

More consideration is being given not only to real world operational performance but also to how internal space can be re-ordered.

This paper considers the commercial impact of deciding to introduce a particular type of amenity, looking at the premium on rental income that would be required to achieve the cost neutral yield return position i.e. identifying the added value that needs to be created.

Lessons from abroad

The US market is a very different proposition when it comes to attitudes and benchmarks for amenities and building provisions outside of the rented apartment. However, there are lessons we can learn.

The maturity of the US multi-family housing sector is characterised by an effective 'arms race' of new or refurbished stock which can, beyond location, only differentiate itself by the level of offer provided by the building and the associated brand promises. Amenities have become a point of difference that has, in some primary urban markets, started to dictate design, efficiency and spatial programming beyond the apartments themselves.

What is interesting is that the actual take up and usage of some of the amenities is varied. The customer, in effect, now expects certain things to be included irrespective of whether they intend to take advantage of them. An ability to talk to friends about what is in your development is part of a 'keeping up with the Jones' mentality – US style. This means that there has been an acceleration of 'amenities obsolescence' with buildings having to be upgraded either within one ownership or at the point of a transaction, often within 10 years of the initial specification.

The importance of this is amplified given the ability to refresh apartment interiors is often logistically and technically easier, (subject to void and re-letting opportunity), than drastically upgrading the communal areas and amenities. The latter tends to be a longerterm decision within buildings to carve out additional or modified amenities at a later date than to convert them back to rented apartments.

The financial dynamics of the US multi-family market enable these choices to be made with a degree of certainty on the investment business case. The abundance of 'cap rate' data and 'comps' ensures that building owners and operators are making informed decisions on capital expenditure driven by occupancy and rental impact precedents. This enables better linkage between the cost of upgrade and cash flow impact, and is based on observations from within a much deeper market. In reality, a decision is often to be made between owning a depreciating primary asset or one that has already become a secondary asset.

As in the broader commercial real estate market, there are specialist "value add" asset repositioning investors who will take a depreciating primary or already secondary asset and look to improve its performance through a capex programme, just as the hotel investor industry does on a regular basis. These are often short term plays and usually combine a more intense programme of amenities upgrade with a longer burn room upgrade plan.

The UK build to rent sector

In the UK there has been much growth in the BTR Sector over the last few years, with significant interest and investment from institutional monies in creating a long term revenue generating asset portfolio.

Those on the journey of delivering the product, whether developers, investors or operators, have been on a steep learning curve in understanding the concept of BTR as a lifestyle choice for the customer and how the brand of the product plays in to customer satisfaction.

We have seen a growth in the number of developments being proposed and a shift in the residential mind-set to one of greater focus on the operations of the asset rather than the historic greater focus around capital expenditure. The decision to include amenity provision and what to include is of much debate with no clear data yet to support making a truly informed decision.

Critical questions around the UK's BTR market will largely be answered when data become available and the attitudes of customers towards amenities become clear.

It will be interesting to unfold how the maturity of an operator and its attitudes towards the experience of the customer can add value through increased rental income or occupancy rates.

Crucially, evaluations will need to consider the rate of lease up and rents achieved relative to:

- Existing second hand rental stock
- New build for sale schemes with 'buy to let' investments
- Other bespoke BTR schemes.

However, a framework for informed decision-making can perhaps start to be created by modelling capital expenditure, operational expenditure and revenue and the sensitivity of amenities space versus apartment numbers.

> "Critical questions around the UK's BTR market will largely be answered when data become available and the attitudes of customers towards amenities become clear."

Considering the amenity provision

Whatever the decision, developers, operators and investors should take into consideration the commercial impact when including non-direct revenue generating services.

The point around the inclusion of amenity space and its ability to sustain high occupancy levels and reduce voids is well discussed but given the current difficulty of objectively analysing this theory the trade-off between amenity and residential can be analysed on a hypothetical basis, as a starting point.

The analysis in context

This paper is based on the assessment of the commercial impact on performance, through the creation of amenity space within a hypothetical building scenario. The focus of this analysis is in demonstrating the importance of understanding the aggregate commercial impact when including a variety of amenities as opposed to a standalone space for one use.

The analysis has been undertaken on the basis that all amenity uses assessed are non-direct revenue generating i.e. non-commercialised assets.

It is recognised the 'softer' side of value added through great customer experience and satisfaction plays a key role in achieving rents, but assessment against local market rents must be the starting point to identify the target rent necessary to achieve the required return. A review of feasibility in terms of confidence in achieving the target rent can then follow.

The assessment has sought to test, in a hypothetical scenario, the commercial impact of amenity space inclusion in BTR developments. Particularly, where this negatively impacts on the base yield it seeks to demonstrate the commercial impact of a provision and the premium required on rental income to return to a cost neutral yield return position.

BTR developments are not restricted to London. Developments are being proposed and delivered throughout the UK which is evident through the vast amount of activity going on in the regions. The findings of our research are largely focussed on London but we have sought to compare this a same development in Manchester, which shows the relationship between capital cost and rental income in comparison to London.

"It is recognised the 'softer' side of value added through great customer experience and satisfaction plays a key role in achieving rents."

Note:
The analysis does not consider subjective factors and how these impact value and cost for example:
- Neglected amenity spaces, for example untidy residents' lounge, and how they impact the attractiveness of a development
- Inclusion of amenity space and its link to increasing occupancy and rental levels
- Greater customer service and overall customer satisfaction.

Delivering amenities in London developments

The assessed amenities

Our analysis has assessed the inclusion of a range of amenity spaces, from those being considered in most BTR developments to those that are perhaps more extreme. The amenity types analysed include:

- Swimming pool
- Dry gym / fitness area
- Cinema room
- Dining room
- Residents and business lounge
- Crèche
- Rooftop
- Storage
- Enhanced concierge facilities.

The findings are reported against each of the metrics in the table below.

The metrics

Apartment loss	The number of apartments lost with the introduction of amenity space. In the instance that the space required is not equal to the full area occupied by an apartment we have rounded to the nearest whole apartment for example an amenity space of 80m^2 equates to 1.30 apartments which in the analysis would maybe be shown as 2nr apartments lost.
Development expenditure % movement on £ value	Change in total development expenditure when removing residential apartments and replacing with fitted out amenity space.
Achieved net rental yield	The return position based on the loss in rental income and movement in both development and operational cost with the trade-in of amenity in lieu of residential.
Rental premium	The difference between base rental value of £1,500/month and the rental value needed to achieve a commercially neutral yield position of 5.00%.
Target rental income	The value of the rental premium expressed in monetary (£) terms.
Gross: net operating income	The operational costs expressed as a percentage of revenue. The operational costs are inclusive of any amenity provision, and the revenue is inclusive of the rental premium.

The hypothetical building

The illustration overleaf provides an overview of the base position for this analysis, which assumes a standalone building for rent with no concierge service i.e. effectively a traditional for sale development operated as a single landlord Private Rented Sector scheme.

Income and expenditure allowances

The analysis value allowances for rental income, development and operational cost have been set at current day prices for a development in the outskirts of London Zone 3 / Zone 4.

The base rental price point

The location reflects a mid-market sales price point of approximately £500/ft² and a base rental price of £1,500/month. The base rental price already includes an 18.75% uplift on London Median Rents in Zone 3 and 4 which broadly reflects rents in new build developments as achieving higher than local rents. This uplift assumes no amenity space other than basic concierge services.

The cost of development

The capital cost has been priced at circa. £240/ft² which includes the cost of shell and core, communal fit out and apartment fit out. Our analysis assumes a base construction cost of delivering a building excluding any amenity provision. The construction costs for amenity uses are based on fit out costs inclusive of a budget for loose FFE.

The cost of operating amenity space

The operational cost impact of the provision of amenity space has been set based on discussions with investors involved in the BTR sector. It should be noted that the cost for operating an asset is directly linked to how the space is used, how it is managed and the level of specification therefore is not a 'one size fits all' cost impact. The operational costs included take into consideration staffing, cleaning, maintenance, repairs and an allowance for other running costs. Our operational cost does not include for a sinking fund. A sinking fund is important to hold for major repair works but for the purpose of this analysis the yield has been assessed exclusive of a sinking fund.

Income and Expenditure Base Figures

Gross Monthly Rent (GMR)
£1,500/month

Rent Premium
GMR includes 18.75% new build premium

Operational Costs
22% of Gross Rental Income

Construction Costs
Circa £240/ft² including contingency

Section 106 contributions
£3,500/unit

Fees
10.00%

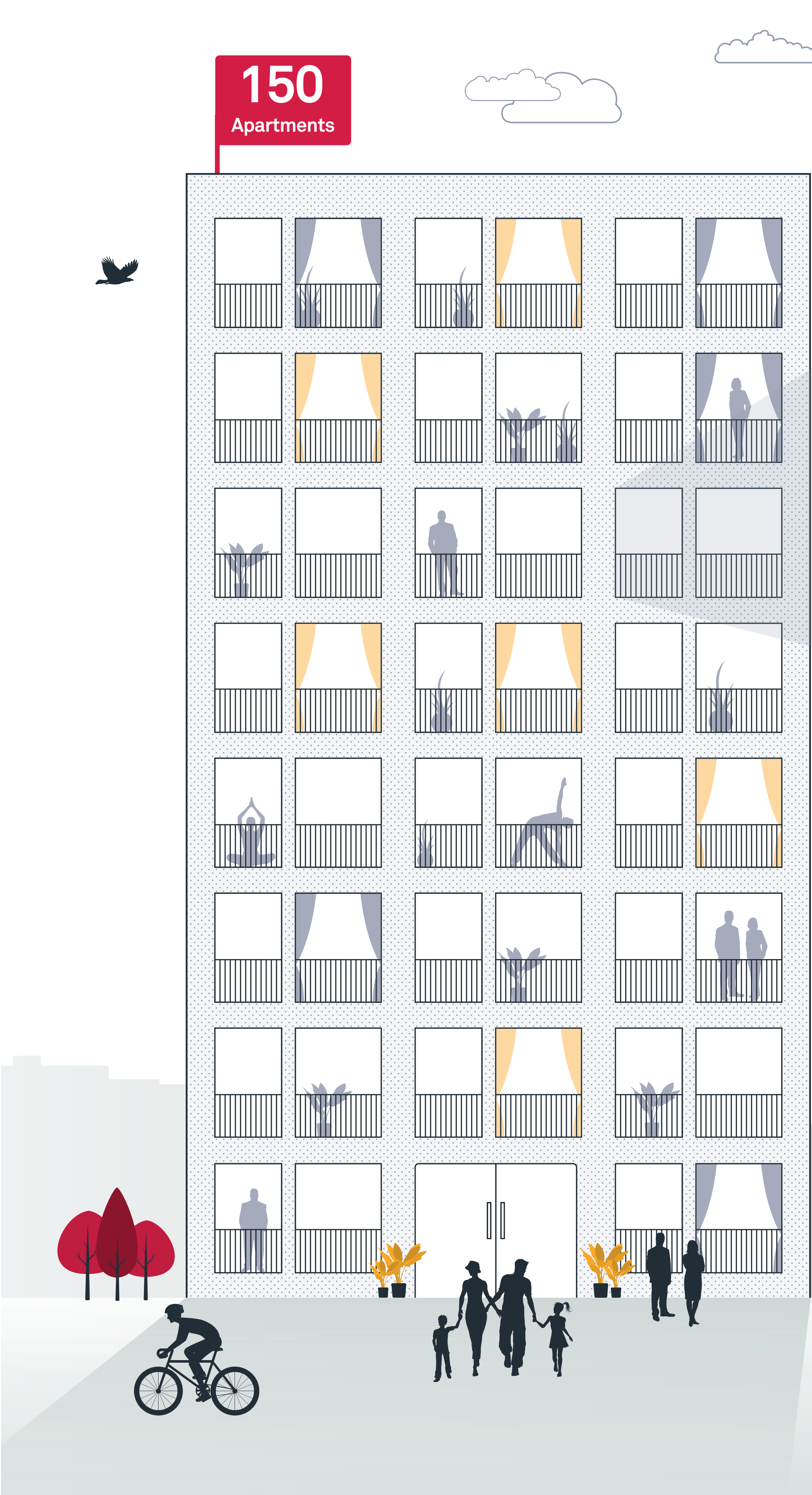
Land Payment
£60/ft² on NIA

The target return

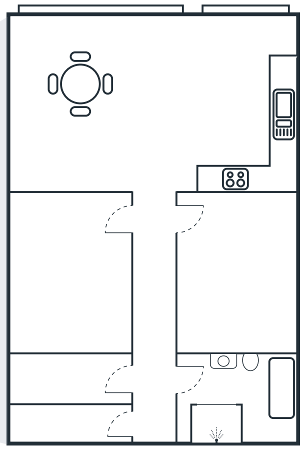
The level of return achieved, based on the allowances outlined above, is 5.00% as a net rental yield on total development cost. The introduction of amenity space and loss of residential apartments generates a lower return due to less rental income and/or greater capital and operational costs.

This report goes on to demonstrate the rental premium required, when introducing amenity spaces, to deliver a neutral yield position.

Building details



80%
Building Efficiency



62m²
Building Efficiency

20%
Affordable Housing
(discount market rent)

5.00%
Net Rental Yield on Development Cost

Wet Leisure

Perhaps the most extreme example of where amenities have migrated to in the US is the provision of swimming pools and spa facilities.

The reality is that this has been pretty much off the agenda for mainstream BTR investor / developers in the UK due to the prohibitive cost provision. Where such amenities have been built into central London for sale schemes, this is supported by a straight service charge reimbursement regime. Where the additional capex is subject to an often unproven assumption that rents will increase to cover the initial cost then the risk becomes much greater. There is the double hit of the operational cost implications of such facilities through maintenance, staff and energy being a significant part of ongoing cash flow.

To take the example of a 10m swimming pool, typically within a basement but within this scenario located on the ground floor, the spatial take up and commercial impact could result in the loss of up to 2nr apartments. This includes area for a pool filtration plant, and changing areas with shower and WC facilities. In analysing the cost of operating a swimming pool it, as with other amenity uses, is dependent on:

- How the space is defined to be used by the customer
- How the space is fitted out.

Typically, in discussion with operators, views on cost have been suggested at approximately £100,000 and upwards per annum.

> "Where the additional capex is subject to an often unproven assumption that rents will increase to cover the initial cost then the risk becomes much greater..."

Performance Impact

Apartment Loss
2 units

Development Expenditure – % movement on £ value
1.50%

Achieved Net Rental Yield
4.60%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
8.00%

Target Rental Income
£1,620

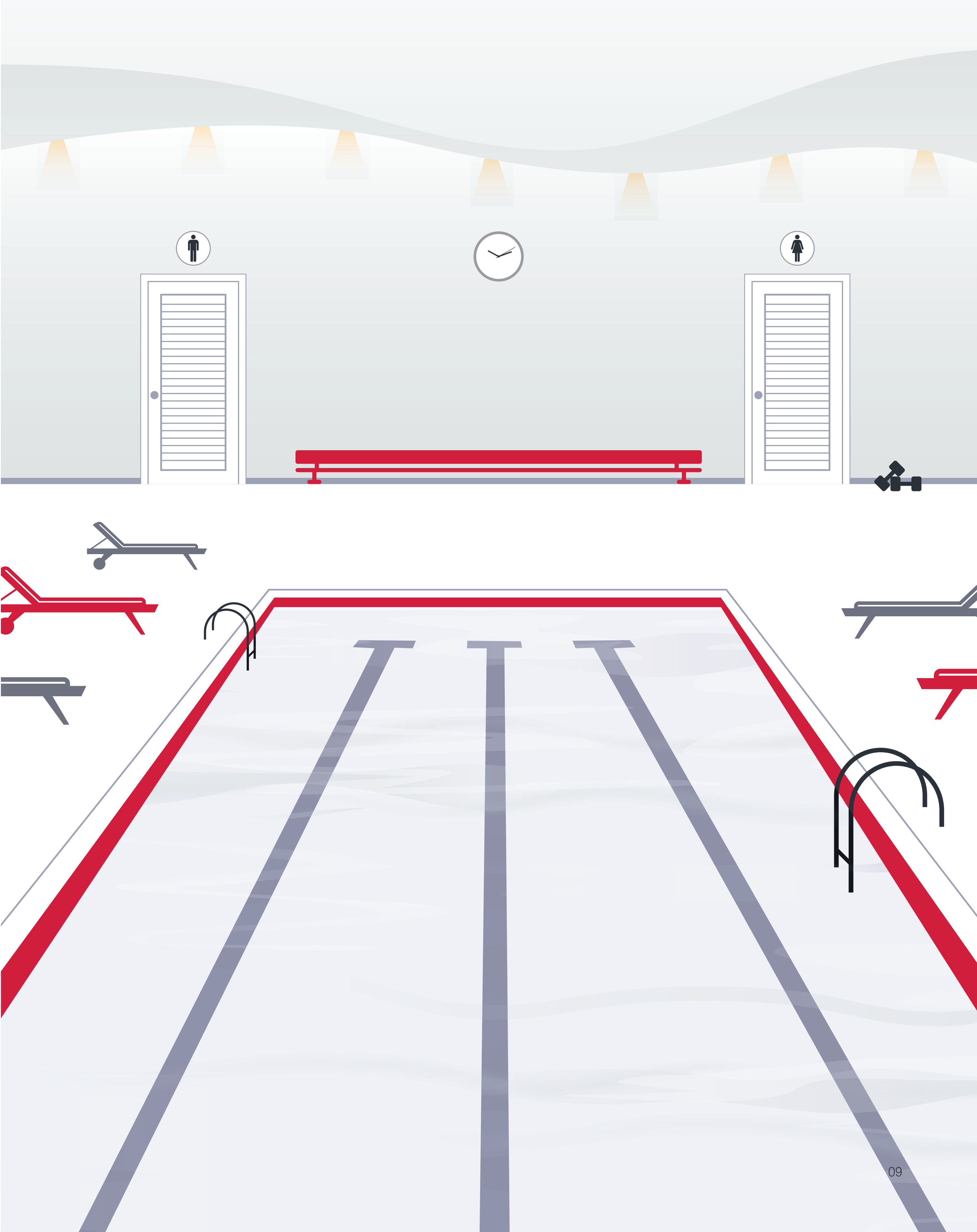
Gross: Net Operating Income – base position at 22%
26.00%

Summary

Wet Leisure amenity space requires circa **8.00%** premium on the base rent to achieve the yield neutral position of **5.00%**.

8.00% premium reflects an additional rental income of **£2.15/ft²** or **£120/month**.

Spatial requirement 100m²



Dry Leisure

The integration of a gym is perhaps viewed as more palatable when considering spatial take and capital cost.

Similarly to wet leisure above, the real issue is whether the UK renter market expects such facilities within their development or whether local external gyms are sufficient to meet demand. A lot will depend on the level of social integration being achieved in a typical UK BTR development.

The US market tends to assume much more communal integration and friendship forming than perhaps the more conservative UK market. Although we are seeing some way towards a shift with the introduction of some BTR operators encouraging socialising through the organisation of social gatherings within the building. We are seeing many BTR developments include gym facilities within the building where the costs for use are included within the rent.

A gym is probably the most common amenity space compared to other amenity types within this paper. The spatial provision for a gym varies but needs to be of sufficient size to allow for an increase in rent that would have otherwise been spent by the customer on an external facility.

Our analysis is based on the provision of a 60m^2 area that includes a range of cardio and strength training equipment. The introduction of a gym has minimal commercial impact on the yield and in our example requires a premium on rental income of only £30/month to achieve the target return. It is likely that £30/month extra rental income is a price a customer would be willing to pay for the provision of a gym given external gym prices in Zone 3 / 4 could be in the region of £40 plus for a gym membership.

> "We are seeing many BTR developments include gym facilities within the building where the costs for use are included within the rent."

Performance Impact

Apartment Loss
1 unit

Development Expenditure – % movement on £ value
0.50%

Achieved Net Rental Yield
4.90%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
1.80%

Target Rental Income
£1,530

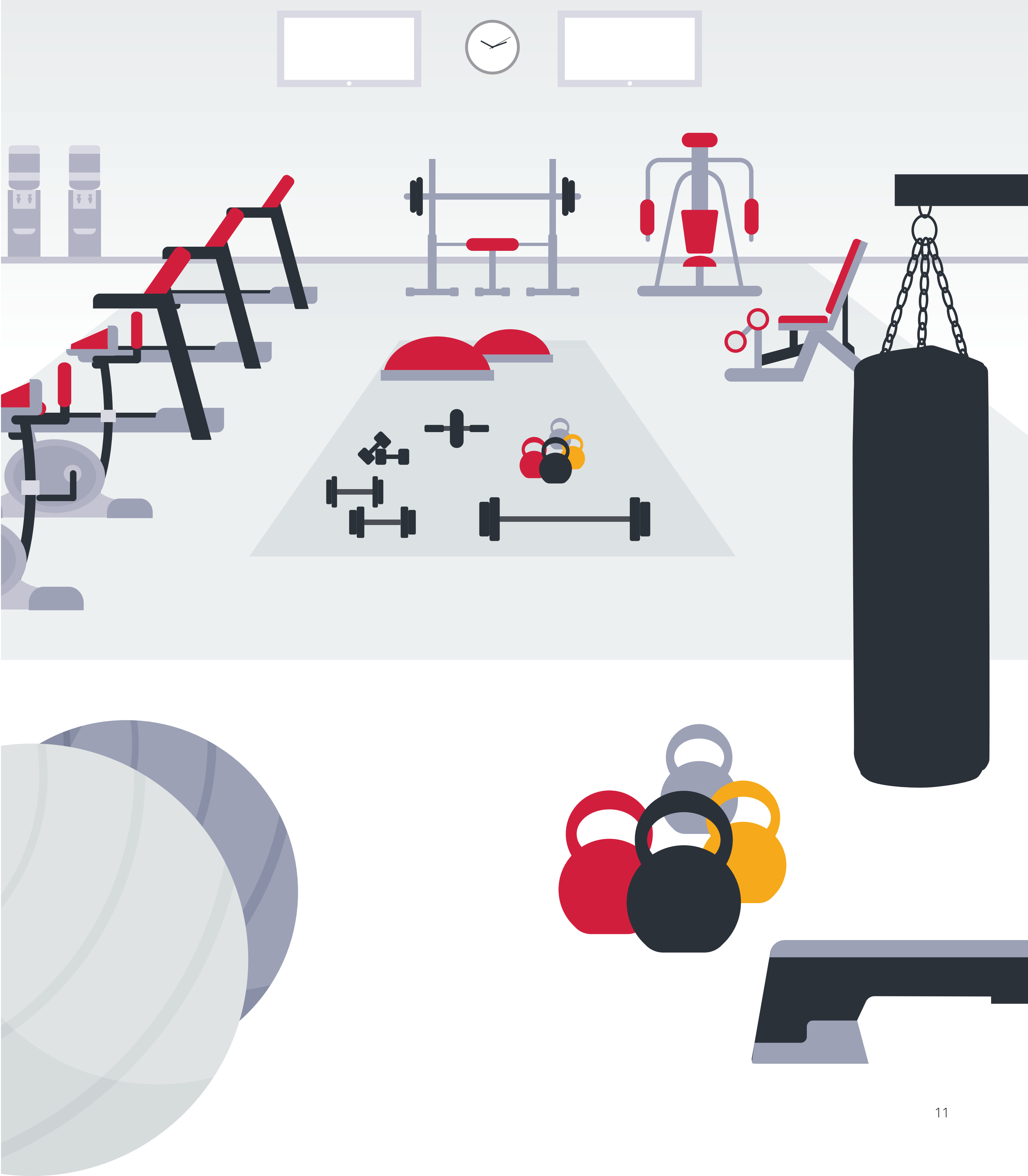
Gross: Net Operating Income – base position at 22%
22.50%

Summary

Dry Leisure amenity space requires circa **1.80%** premium on the base rent to achieve the yield neutral position of **5.00%**.

1.80% premium reflects an additional rental income of **£0.50/ft^2** or **£30/month**.

Spatial requirement 60 m^2



Cinema Room

The spatial take for a cinema room is more conservative but this can still be quite an intense cost relative to area.

The fitting out and the specialist IT/AV equipment requires a level of certainty as to how it might be used. The US market will oscillate between a schedule of screenings plus the ability to privately hire for a function with external guests or between groups of residents.

Cinema rooms within UK BTR developments are being considered but the layout of these rooms does vary with most taking the form of a traditional cinema with projection screen and single couches rather than large multiple seater couches.

The change in capex between a gym and cinema room is minimal. The actual fixed capex cost is significantly different where the cost to fit out a cinema room is higher than a gym, however this is balanced out with the budget for loose FF&E in a cinema room which is significantly lower than fully fitting out a dry fitness area.

"Cinema rooms within UK BTR developments are being considered but the layout of these rooms does vary with most taking the form of a traditional cinema..."

Performance Impact

Apartment Loss
1 unit

Development Expenditure – % movement on £ value
0.50%

Achieved Net Rental Yield
4.90%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
1.70%

Target Rental Income
£1,525

Gross: Net Operating Income – base position at 22%
22.50%

Summary

Cinema room amenity space requires circa **1.70%** premium on the base rent to achieve the yield neutral position of **5.00%**.

1.70% premium reflects an additional rental income of **£0.50/ft²** or **£25/month**.

Spatial requirement 40m²

Private Dining Room

Sometimes integrated into the residents' lounge, and being able to book out, a private dining room is a step change in cost, and also introduces technical challenges around vent extraction and servicing of a commercial kitchen.

There are also instances in high rise buildings where a private dining room will be located at an upper floor as an add-on to rooftop open space, providing attractive ambience with good views to encourage renters to make use of the facilities.

Our example shows a loss of one apartment with little change in the construction budget and requirement to drive a greater premium.

However, the inclusion of a private dining room tends to be a viewed as a 'grand' space therefore double height with full height glazing may be required. In our example we have assumed the loss of only one apartment.

With the introduction of double height, the premium will be greater to due to impact of losing more residential space.

> "The inclusion of a private dining room tends to be a viewed as a 'grand' space therefore double height with full height glazing may be required."

Performance Impact

Apartment Loss

1 unit

Development Expenditure – % movement on £ value

0.05%

Achieved Net Rental Yield

4.90%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)

1.25%

Target Rental Income

£1,520

Gross: Net Operating Income – base position at 22%

22.50%

Summary

Private dining room amenity space requires circa **1.25%** premium on the base rent to achieve the yield neutral position of **5.00%**.

1.25% premium reflects an additional rental income of **£0.35/ft²** or **£20/month**.

Spatial requirement 60m^2

Residents' and Business Lounge

This option for a Residents' and Business Lounge has started to become an accepted benchmark in UK BTR schemes.

Residents' lounges are perhaps the 'entry level' experimentation into whether UK renters will socialise with each other, as they have a relatively low cost provision of space, bar the opportunity cost of apartments in lieu and the extent to which the space is fitted out.

Any space provision tends to have a multi-purpose use, from relaxation to enabling home working. The fit out of these spaces can be flexible and the space allowed for can be allocated over multiple locations in the development but in our example is assumed to be one large open plan space.

Our example generates a lower total capital cost than a fully residential development as the apartment fit out cost of those units lost is greater than the cost to fit out a 100m2 Residents' and Business Lounge, however the additional cost of operating the space generates a reduction in the overall yield.

> "A lower total capital cost than a fully residential development as the apartment fit out cost of the units lost is greater than the cost to fit out a 100m^2 Residents' and Business Lounge."

Performance Impact

Apartment Loss
2 units

Development Expenditure – % movement on £ value
-0.05%

Achieved Net Rental Yield
4.85%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
2.50%

Target Rental Income
£1,540

Gross: Net Operating Income – base position at 22%
23.00%

Summary

Residents' lounge amenity space requires circa **2.50%** premium on the base rent to achieve the yield neutral position of **5.00%**.

2.50% premium reflects an additional rental income of **£0.65/ft^2** or **£40/month**.

Spatial requirement 100m²

Crèche

As a natural extension of what is being provided in some student accommodation the ability to offer integrated childcare solutions is going to be increasingly relevant for the UK renter who most likely won't buy their first home until their late thirties.

The need to do this in a professional and regulated manner means that this service extends far beyond pure facilities provision into the staff cost of delivering a high quality service.

In majority of developments a crèche would be delivered as a commercialised asset and therefore charged to those making use of the service rather than inclusive of the rent against all apartments.

However for the purposes of demonstrating the impact it could have on operational costs we have included an example of a crèche that is staffed.

Although there is minimal capital cost difference with the introduction of a crèche this will incur a significant increase in operational costs to allow for not only the additional running costs including cleaning, repairs and maintenance etc. but also the costs of staffing.

Of course the decision to include a crèche will be based on the suitability as a service to the target customer. However, if this type of space is provided the findings demonstrate the significant impact it can have on rental yields as a result of higher operating costs. It is for this reason that a crèche tends to be commercialised.

> "Although there is minimal capital cost difference with the introduction of a crèche this will incur a significant increase in operational costs..."

Performance Impact

Apartment Loss
2 units

Development Expenditure – % movement on £ value
-0.10%

Achieved Net Rental Yield
4.65%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
7.00%

Target Rental Income
£1,600

Gross: Net Operating Income – base position at 22%
26.50%

Summary

Crèche amenity space requires circa **7.00%** premium on the base rent to achieve the yield neutral position of **5.00%**.

7.00% premium reflects an additional rental income of **£1.85/ft²** or **£100/month**.

Spatial requirement 92m²

Private Rooftop Space

The inclusion of private rooftop space in the US is a standard approach for almost every development even for those of a low number of apartments.

It has been previously said that in the UK rooftop spaces are not used and therefore shouldn't be provided. The typical UK weather of never knowing when it will shine, rain or snow, but knowing the latter two are more likely suggests no use will be made of the rooftop space.

This view seems to be one UK BTR developers are ignoring which is seen from the number of developments which include open private rooftop space for customers.

The inclusion of rooftop space is a decision taken based on factors including desires of the target customer and location. Our example includes outdoor space on the rooftop rather than as a terrace through a cut back in the building design.

This means no loss in apartments but does assume that planning permission would be acceptable on the increased height given the space in use would be stepped back from the edge of the façade.

"The inclusion of rooftop space is a decision taken based on factors including desires of the target customer and location."

Performance Impact

Apartment Loss
0 units

Development Expenditure – % movement on £ value
0.30%

Achieved Net Rental Yield
4.95%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
1.20%

Target Rental Income
£1,520

Gross: Net Operating Income – base position at 22%
22.70%

Summary

Rooftop amenity space requires circa **1.20%** premium on the base rent to achieve the yield neutral position of **5.00%**.

1.20% premium reflects an additional rental income of **£0.32/ft^2** or **£18/month**.

Spatial requirement 200m²

Storage

The US model of 'cage' style storage is a common design feature generally located in unused space on the ground floor.

A modest cost is typically charged back to the customer given the ratio of storage spaces to apartments tends to be low. In the UK model we are seeing the inclusion of storage space in both unused basement space, but also on floor levels. This space tends to be of a size to fit 'bulky' items that tend to be awkward to store inside apartments for example sporting equipment. The storage location in our example is on the ground floor as opposed to including for this in a basement.

As previously stated, our example assumes the asset is not commercialised but rather tests what charge would be required. We have allowed for 125m^2 of storage throughout the building which creates a loss of 2nr apartments. There is the potential for storage space to result in no apartment loss but rather make use of 'unallocated space' however our example demonstrates the commercial impact of ignoring any improvement in the building efficiency.

The inclusion of storage space reduces both the capital and operational costs, however there is still an impact on the return due to the increased position on the gross to net operational income.

> "This space tends to be of a size to fit 'bulky' items that tend to be awkward to store inside apartments for example sporting equipment."

Performance Impact

Apartment Loss
2 units

Development Expenditure – % movement on £ value
-0.30%

Achieved Net Rental Yield
4.95%

Target Yield 5.00%

Rental Premium (above the 18.75% on local rents)
1.30%

Target Rental Income
£1,520

Gross: Net Operating Income – base position at 22%
22.15%

Summary

Storage amenity space requires circa **1.30%** premium on the base rent to achieve the yield neutral position of **5.00%**.

1.30% premium reflects an additional rental income of **£0.35/ft²** or **£20/month**.

Spatial requirement 125m^2

Multiple amenities in one building

The analysis in this paper has previously looked at single amenity provision and the impact on commercial performance. What is evident, in our example, is that a standalone use has a minimal premium requirement to achieve a yield neutral position.

Most examples illustrated a rental premium between 1.00% and 2.50%. There are of course exceptions such as the inclusion of a swimming pool which highlighted a rental premium of 8.00% to increased cost position.

What is evident, from activity in the market around BTR developments, is the many situations where more than one, or even two, amenity types are being considered. The quantity and type of amenity offerings should be reflected of a range of factors such as location, target demographic etc.

The commercial impact of amenity uses should be considered in the aggregate to inform the decision making process and give confidence to the rental premium required being achievable.

Our analysis includes for the analysis of four scenarios of different combinations of amenity provision in a single building.

Scenario 1

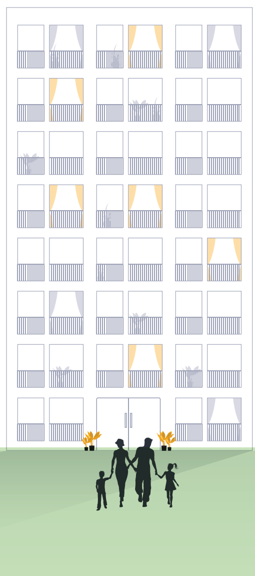
Apartment Loss
8.00

Net Rental Yield
4.35%

Rental Premium (above the 18.75% on local rents)
13.50%

Target Rental Income
£1,700.00

Gross:Net
27.00%



Scenario 2

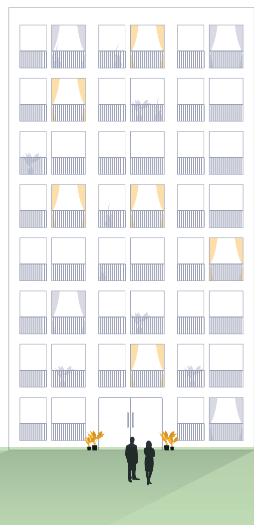
Apartment Loss
10.00

Net Rental Yield
4.35%

Rental Premium (above the 18.75% on local rents)
14.00%

Target Rental Income
£1,710.00

Gross:Net
26.90%



In addition to the amenity use the scenarios include for greater lobby space to accommodate back of house services and a 24 hour concierge service.

These scenarios show the extreme of a having an 'all singing and dancing' amenities offer (Scenario 4) that generates a rental premium of + 20% which is already on top of the premium of 18.75% set on the local rent reflecting a new build development. This is in comparison to a 'lighter' amenities offering that should still be sufficient to drive the sense of community with a lower rental premium of between c. 13% to 15%.

There may be potential to drive a lower Gross to Net Operating Income with an 'all singing and dancing' model through the use of economies of scale in servicing a large portfolio of apartments but in our example we have looked to demonstrate the need to carefully consider the amenities in a building and their market demand.

Lessons learnt from the US, and now being learnt here in the UK, point towards signs of a demand for amenity but investors and developers need to ensure they are aware of the impact, and have a reasonable confidence in being able to achieve the premium rent or have an acceptance for a lower return.

It is worth noting that assuming Scenario 1 did not include for a 'grander' concierge facility and back of house function then the rental premium required would fall to 10% which in itself on top of the 18.75% on local rents equates to a total premium of almost 30%.

> "These scenarios show the extreme of a having an 'all singing and dancing' amenities offer (Scenario 4) that generates a rental premium of + 20% which is already on top of the premium of 18.75% set on the local rent reflecting a new build development."

Scenario 3

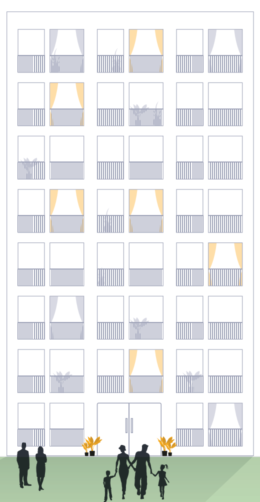
Apartment Loss
10.00

Net Rental Yield
4.30%

Rental Premium (above the 18.75% on local rents)
15.50%

Target Rental Income
£1,730.00

Gross:Net
27.50%



Scenario 4

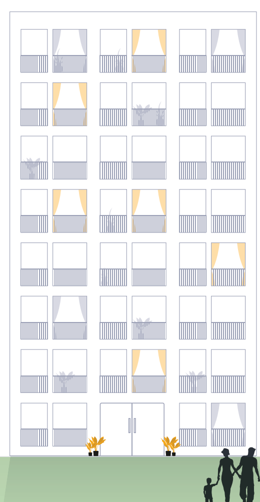
Apartment Loss
12.00

Net Rental Yield
3.90%

Rental Premium (above the 18.75% on local rents)
24.00%

Target Rental Income
£1,860.00

Gross:Net
31.00%



Amenities in the regions

Manchester

We know BTR developments are not just a 'London thing' with many of the regions moving forward in the BTR space with schemes being delivered in Liverpool, Leeds, Birmingham, Manchester to name but a few. The challenge around understanding the commercial impact of amenity space in the regions links to the correlation between Value and Cost in comparison to what we have seen in this paper with regards to London.

If we look at Manchester and delivering the same type and quality of amenity space as defined throughout this paper the level of rental premium required to achieve a similar return (as a building without any amenity) is greater than that in London. The table below provides a comparison of rental premiums in London and Manchester.

Within the Manchester analysis we have set the net yield on cost to 4.50%, compared to 5.00% in London. What is clear from the findings is that even though the rents charged are lower than in London, the cost of construction is relatively similar to London. Therefore the commercial impact on the target yield is more affected requiring a higher rental premium.

Amenity Space	Rental Premium	
	London	Manchester
Wet leisure	8.00	10.00
Dry leisure	2.00	2.00
Cinema room	2.00	2.00
Dining room	1.00	2.00
Residents' lounge	2.00	3.00
Storage	1.00	2.00
Rooftop	1.00	1.00
Scenario 1	14.00	16.00
Scenario 2	14.00	16.00
Scenario 3	15.00	18.00
Scenario 4	24.00	29.00

Conclusion

The cost of including amenity space should be given careful consideration but in the absence of real data to support the demand for services, the commercial risk falls to the operator / investor in ensuring the attractiveness to the demographic of renters in a building. This will tend to involve the inclusion of an element of amenity.

The inclusion of a 'Residents' and Business Lounge' is the highest shortfall for those items within the 0.10% mark. In our example this type of use would require a premium rent of £40/month.

Again, similar to what we see with a Gym at £30/month, this would not seem unreasonable as long as the space provided was filling the need of the customer. For example having facilities within a building that enable home working.

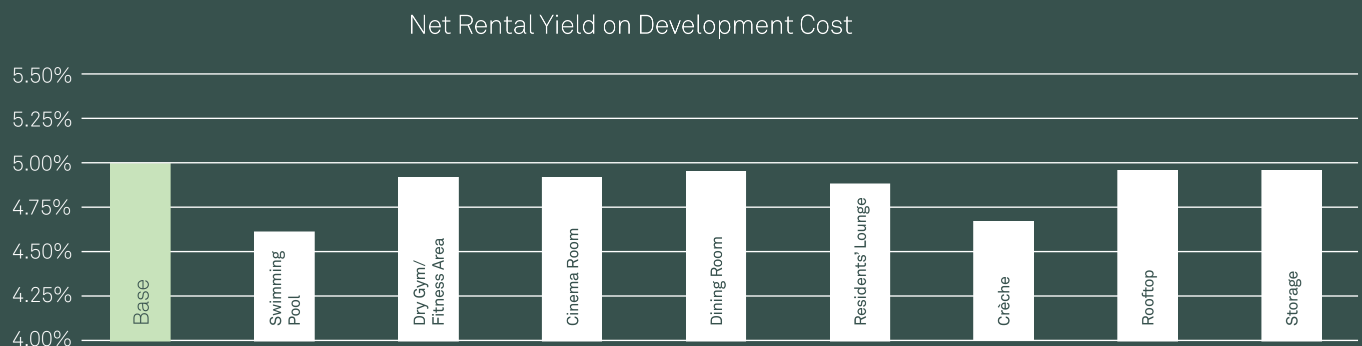


Figure 1 – Net Rental Yield on Development Cost

Individual amenity uses

The findings of the analysis concludes that when providing for a single amenity use the commercial impact on returns would seem achievable. Figure 1 above highlights the comparison between a 5.00% net yield and that returned when including for a single amenity use. The majority of the uses generate a return slightly below 5.00% and within the 0.10% mark.

However, the findings do highlight uses which have a greater impact on returns even when assessed in isolation. As expected this includes uses such as a Swimming Pool and Crèche. Where rent premiums are, in both instances, above £100/month. Figure 2 shows the target gross rent required from the inclusion of the range of amenity types as an isolated use.

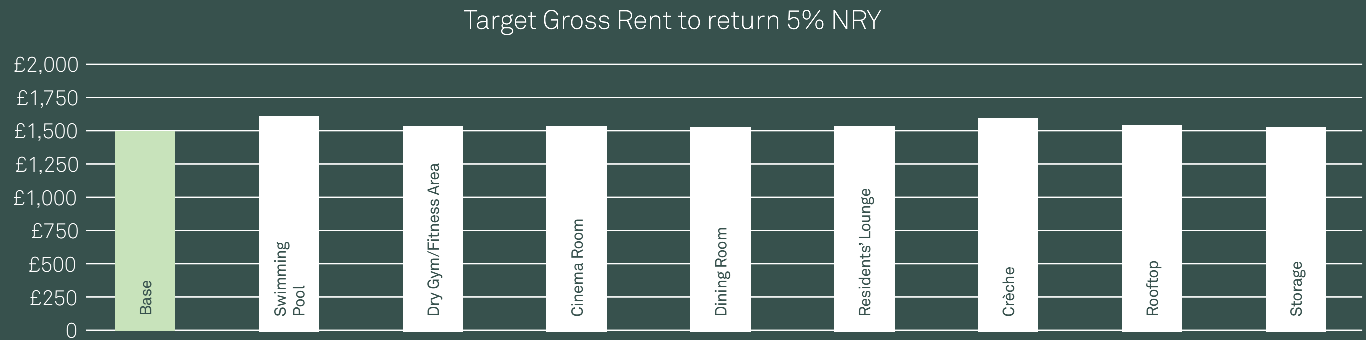


Figure 2 – Target Gross Rent to return 5% Net Rental Yield

Multiple amenity uses

The challenge comes when providing multiple amenity uses in lieu of apartments. A single use may have minimal impact but uses in the aggregate can have a significant impact on the commercial performance of a building.

As previously shown our analysis included the assessment of four building scenarios with multiple types of amenity as shown again in the table below.

Figure 3 below shows the commercial impact on the yield at circa 0.70% or greater than 1.00% reduction where part of the amenity offering includes a swimming pool.

If we take Scenario 2 (gym, dining room, residents lounge, rooftop and storage) as an example of what is being delivered in many UK BTR developments the rental income required to achieve a neutral return would be £1,710/month. This compares to £1,500 base position which has already been uplifted to reflect a new build premium irrespective of amenity space. The total premium for scenario 2 is therefore circa +30% on local rents.

The figure below highlights the rents required, again for each of the single amenity uses, but also for the scenarios which are shown in the aggregate.

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Amenities	Dry gym	Dry gym	Dry gym	Swimming pool
	Cinema room	Dining room	Cinema room	Dry gym
	Dining room	Residents' lounge	Dining room	Cinema room
	Residents' lounge	Rooftop	Residents' lounge	Dining room
	Rooftop	Storage	Rooftop	Residents' lounge
			Storage	Rooftop
				Storage

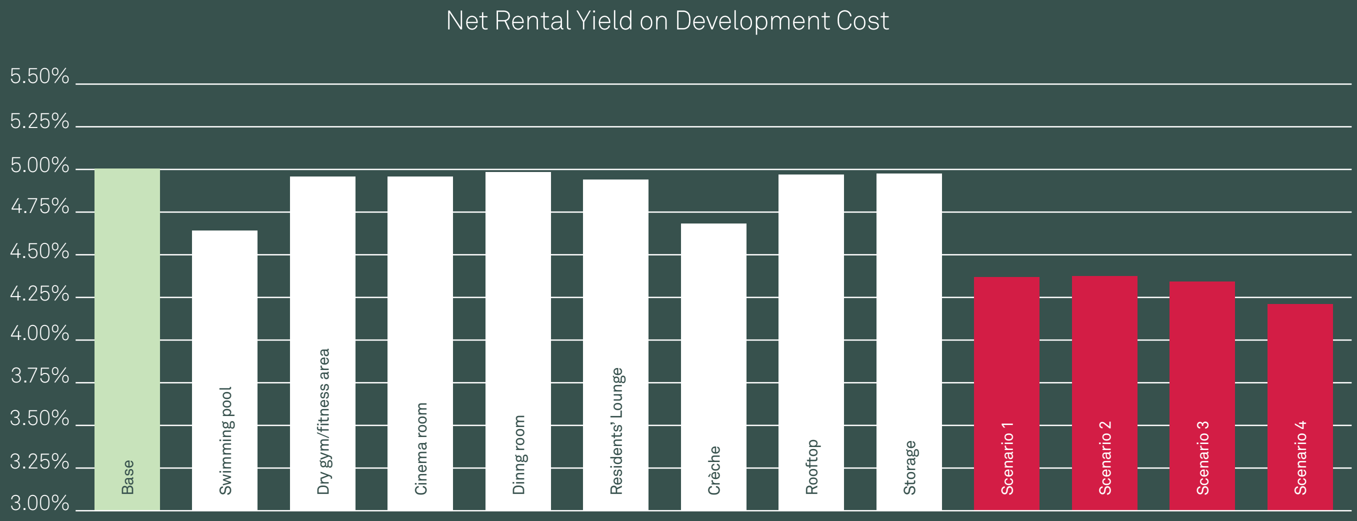


Figure 3 – Net Rental Yield on Development Cost: Single and Multiple Uses

Protecting for a change in use

In the UK a 'conservative' approach is sometimes being taken to allow for future-proofing of spaces that result in lower demand than expected. These spaces are being designed with flexibility to change their use at a later date to attract and retain customers in the building.

Although this is one approach to targeting, or retaining, premium rents it does come at a cost. The cost implication is not one that would necessarily be recouped through or equivalent of the cost of a sinking fund unless the retrospective fit was done at a time the building required refresh rather than being a choice to change due to lack of demand. This could mean a greater fund being set aside to deal with flexible design changes OR could represent a need for greater 'early doors' thinking around how to create a design space that can be modified at a later stage at the lowest possible cost.

In conclusion the findings do not seek to demonstrate what can or can't be achieved for rents, but what is needed to counter balance the impact of non-revenue generating amenities. The key for developers, investors and operators is understanding and considering the benefits of each amenity use from both a 'customer want' perspective, value and cost perspective.

There are some critical questions that should be considered when looking at amenity to minimise the commercial impact for example:

- What can generate additional rent through a direct charge? For example storage.
- How does having amenities impact on voids, turnover etc?
- With much development in the BTR pipeline over the next 5-10 years, how will increased supply impact demand and therefore rents?
- Is there an affordability threshold in certain locations that will limit the rent price irrespective of amenities?

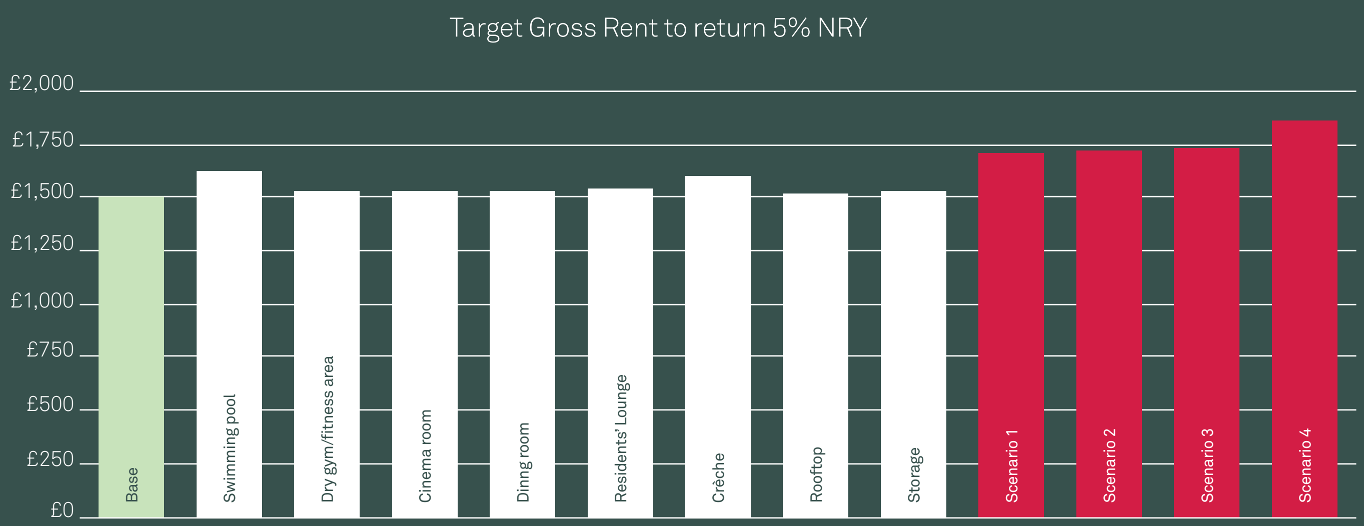


Figure 4 – Target Gross Rent to return 5% Net Rental Yield

Contact us

Cast is a Real Estate and Construction Consultancy providing a range of services in strategic advisory, cost & commercial management, financial modelling and project & contract management.

The Cast team are passionate about driving innovation in product design, procurement and construction techniques that will help clients best navigate the challenges faced in a rapidly changing market.

With a specialist knowledge in residential led regeneration, Build to Rent, Later Living, Student Accommodation and Prime Residential, Cast uses the vast experience of its teams to deliver effective solutions for its clients.

Cast
Real Estate & Construction Consultancy
Black Bull Yard
24-28 Hatton Wall,
London
EC1N 8TE

T: +44(0)20 3931 0200
www.cast-consultancy.com
@Castconsultancy

Keith Brooks
Founding Director & Chairman
E: keith.brooks@cast-consultancy.com

Michelle Hannah
Director
E: michelle.hannah@cast-consultancy.com
@CesarinaHannah