Summary Document: Single Family Housing: The Home of Residential Investment

Introduction

In this summary, we highlight some of the points in the full paper for digestive ease. We recommend reading the paper in full which can be found here: https://marketing.howsy.com/wp-content/uploads/2021/06/SFH-the-home-of-residential-investment-final-June-2021-3.pdf

As with the full paper, we assume the reader to be broadly familiar with the BTR sector and the canonical ideals by which the sector identifies itself, and from which it evolved. BTR is broadly analogous to the significantly more mature US Multi-Family sector and took much of its early learning from researching this.

It is generally assumed that the catalyst for BTR was Sir Adrian Montague's government sponsored report, "Barriers to institutional Investment in the Private Rented Sector", published in 2012 alongside subsequent government support packages: the HCA BTR funds 1 & 2 including the creation of the PRS Task Force. Whilst this may be broadly true, there were earlier pioneers. Most notable of these was Fizzy Living that had incorporated prior to Sir Adrian's report. Delancey plc & Qatari Diar who, in 2011, signed a £557m deal to take over the Athlete's Village (Now known as the East Village) following the 2012 Olympics.

So, the BTR opportunity had been identified and the movement was afoot prior to 2012. Sir Adrian's report focussed attention on the sector, intimated a structure and outlined some of the PRS's deficiencies to be corrected.

The argument for 'scale' in the sector is well rehearsed and understood. Since the beginnings of the British Property Federation (BPF) and Savills BTR index in 2016, the average scheme size has grown and continues to grow. An alternative source, Knight Frank & HomeViews reports that the average scheme size for completed schemes stands at 212 homes, whilst those under construction and in planning stand at 264 and 320 homes respectively. This is broadly in line with the trend identified by the BPF and Savills.

To be clear on the numbers

The BPF and Savills report on schemes greater than 20 homes in size, whereas Knight Frank & HomeViews use a scheme size threshold of 75 homes and above.

Broadly speaking, scale tends to run hand in hand with density, and density with urban environments. Therefore, we have seen most BTR schemes located in London or regional centres. This correlates with target cohorts, building typologies and the service provision identified by the BTR sector as necessary and appropriate.

But whilst scale has operational advantages and economies, it is, in general, limited to cities and large towns which have populations and cohorts sufficient to support a BTR development or, indeed, competing developments.

Single Family Housing is not similarly constrained. Comparing UK BTR development with UK housebuilding development (which we shall do later in this paper) illustrates how BTR is largely constrained to densely populated areas, whilst house builders are able to build more broadly and more evenly across the UK. This breadth of delivery has the advantage of offering greater opportunity, but disadvantage of, what has been determined to be "investible scale", that is: scheme sizes of sufficient size to attract institutional attention.

But, as our research demonstrates, SFH investible scale cannot be judged against BTR investible scale. The two asset classes are very different and the approaches to each are not directly interchangeable. However, they are complimentary.

As I mentioned at the beginning of this introduction, whilst what much of the US residential does and also how it is formed is analogous to the UK residential market, care must be taken in the translation. Learning from US markets is valuable, but it is important to ensure direct comparability. Something that is not always as obvious at it may seem from sector nomenclatures. We are, after all, "Two nations separated by a common language"[1].

Thanks to the support from Howsy.com who have sponsored this paper, to researcher and editor Vivienne Neale and my colleague Adam Ali for their valuable input. Thanks also for vital contributions from Mark Farmer of CAST, the Government's Modern Methods of Construction Champion in housebuilding and Brendan Geraghty of Centred Architecture for his valuable insights in design and sustainability.

Paper Summary

Houses: the choice of the nation.
Despite substantial institutional investment in apartments, houses remain the dominant typology in the UK. Current housing stock and the population who live in them outweigh flat dwelling 80%-20%. A survey reveals that the national preference for living in houses is even higher: 90%-10%.

[1] Attrib George Bernard Shaw 1942.

The Changing face of Desire.

The pandemic has changed what we need from our homes. The working from home experiment has been largely successful and we will see greater numbers of knowledge-based workers working from home as much as three days a week.

This reduction in office working reduces the need for commuting and allows individuals the opportunity to choose a home based on a wider criterion: defensible space, flexibility of configuration and a reduction in cost that non-urban living brings. As a result, this also has increased a reliance on local consumer infrastructure and online resource. Both of which have proven dependable.

The exodus from city environments, particularly London, is unlikely to be wholly reversed, particularly as the millennial cohort ages. Some behaviours are likely to remain post-pandemic which will lead to a greater demand for houses. In particular: the suburbs of larger conurbations and cities and on the outskirts of medium to large settlements.

Where and what.

In contrast to the very specific metrics that govern urban apartment block viability, SFH can be built in a diversity of locations across the country. Given the relative simplicity of houses, they can also be delivered by a much wider variety of counterparties. The development risk associated with the delivery of houses is commensurately lower.

Whilst there are more opportunities to build houses, and in a greater variety of locations, it is clear that in less densely populated areas the take-up by renters is likely to be commensurately reduced. This limits the number of SFH's that can be introduced in any one area at any one time.

It is crucial that SFH schemes are seen to be increasing the number of homes delivered each year and not 'cannibalising' the open market sale delivery numbers. Without demonstrating additionality, it is possible that the slow or restricted delivery of open market sale homes and increasing house price inflation will be blamed upon the SFH sector

The Customer.

The customers have grown up. The BTR journey has been their journey and we're all ten years older. So, they have changed. As have their wants and needs. Accelerated by the covid pandemic, they will, more often than not, have children, want defensible, flexible space, both inside and out, will work from home more and have settled friendship groups into which they invest more of their time.

Nevertheless, the picture that is emerging is that renters of houses have very different profiles and priorities to those who rent apartments.

- They are significantly older
- They are likely to have children
- Friendship and interest groups will be well established
- Local community and facilities will be important
- Maturity & the pandemic mean they live broadly autonomously
- They will rely heavily on high quality connectivity
- They require more flexible space and access to a garden
- Sustainability will be a priority
- They require fewer operational management interventions

I remain unconvinced that the 'gated community' model, common in North America, will find significant traction in the UK.

Management.
Management will be the same but different. Learning from BTR will be valuable but not directly translatable. The dispersed nature and the reduced scheme size will mean on-site management and amenity is more often the exception rather than the rule. SFH will be a sophisticated digital first model driven by tech companies.

Renter engagement must be elevated to the next level. Principally as it will not be possible to engage face-to-face. Wider adoption of demographic, psychographic and emographic research and data should become the norm in an effort to fully understand the customer. In any event, further refinement of digital applications will also enhance the BTR experience.

The very different nature of SFH community and the understanding of it will require a different operational management approach. The renter-to-renter community process common in BTR will be supplanted by more holistic engagement within the wider existing community to create a more rooted, organic relationship with the locality. Placing SFH amongst Open Market Sale homes aligns the community aspirations of those renting with owners and they become more invested.

Given the dispersed, heterogenous nature of SFH schemes, routine maintenance and repairs will be delivered by specialist trades aggregators or FM companies performing to specific SLA's. Control and tracking of these processes will be integrated within the management platforms and a number of data points collected and analysed.

MMC.
Modern Methods of Construction (MMC) are looking to dominate the future of housebuilding. Now more mainstream in application and becoming adopted by housebuilders, MMC is an integral part of delivering Carbon Zero homes built to factory specifications and tolerances.

The benefits of speed, certainty and product standardisation and repetition have made this a compelling business case and it should be expected that the market will see more convergence between modular housing and single-family BTR.

It is clear that the alignment between the needs of single-family house investors and the conditions needed to drive change and modernisation in construction is strong. We should expect to continue to see increasing examples of how the Single-Family House sector can show the way to private for sale developers and others when it comes to innovating the build process

ESG.
ESG is no longer simply a buzz word within the industry, a nice to have or a thin veneer of conformity. It has become fundamental to asset performance, value and fund reporting. SFH has to be in the vanguard in terms of sustainability and delivering carbon zero assets. There is no excuse not to be. We know too much about our climate challenge and real estate will be asked to bear a substantial burden in reducing the UK's carbon emissions. Government will legislate for it.

Assets that fail the test, will fall in value. Regulation of green funds; the Sustainable Finance Disclosure Regulation (SFDR) will require elemental change within the industry in terms of ESG transparency. A green fund must be a green fund and all that it invests in must meet ESG criteria. This increases pressure on fund managers to ensure their assets are truly sustainable. Any asset or portfolio that fails this test will quickly become stranded. We have seen that competitive tension amongst investors for Stabilised SFH assets has driven down net yields. This could very quickly reverse if such assets fail to meet the rapidly evolving criteria.

But this isn't all about asset value. We are all becoming consciously sustainable in our outlook. Science tells us that we can no longer continue with impunity as we once did. Most of us are now listening. Perhaps fearful for the future of our children and the awful legacy we may leave them if we do not change our ways. SFH is an asset class which lends itself to driving ESG forward and an opportunity that must be grasped with both hands.

Design.
The design of a SFH is perhaps one of the most crucial elements to the success of the sector. It celebrates the house as a typology and the people who live in them. Houses

are infinitely configurability, are suited to a multitude of construction methods and vernaculars and, most importantly, provide us with the framework with which we move towards a sustainable carbon zero future.

The role of technology in future homes cannot be underestimated. Smart Homes and smart technology will increase in our homes. Urban BTR has done well to provide good technology infrastructure applied at a building level and with customer facing technology and interactive applications. If WiredScore[2] provides institutionally recognized standards for office buildings, how long will it be before it is standard in BTR? With Fizzy living having the first Wiredscore rating in BTR. The rest of the industry is likely to follow. SFH will not be exempt, although providing the required infrastructure resilience in housing may present different challenges to that of an urban BTR block. Sub-urban BTR must set high standards for technology in the home.

Investment Characteristics.

We know that SFH investment characteristics are very different to those of BTR. If this paper were written a year ago, we would be talking about capitalising SFH off yields substantially softer than those of BTR. What a difference a year makes. With the Thistle portfolio transaction (Goldman Sachs) at a NIY of 4.1 % we are very close to prime BTR assets. Driven, no doubt, by the superior performance of SFH over BTR during the pandemic.

The difficulty faced by investors is scale. It is not practical to invest in single schemes with the same number of homes as the average BTR scheme. SFH schemes to date, have been less than one third the size of a BTR scheme. So, investors will have to adopt a different strategy. The housebuilder model isn't aligned with that of the SFH investor, although it depends upon market conditions and the perceived value of government incentives. It will be interesting to watch the evolution of the acquisition model. Partnerships with strategic land specialists or SME's may be one pathway.

Phased delivery will create a slightly different financial model as a manageable number of homes will be delivered by the counterparty agent at a regular phased rate. The rate dependant on the method of construction. This allows for early cashflow, better absorption and earlier stability. Generally speaking, the smaller scheme sizes will lease up more quickly and be less susceptible to oversupply in the market. But there will be more schemes of greater variety in diverse locations delivered by a wider range of counterparties.

The dispersed nature of the portfolios will also demonstrate defensible investment qualities as regions behave and respond to economic pressures in different ways.

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[2] WiredScore. https://wiredscore.com/

SFH as an asset class may, at certain times, mirror the performance of BTR, and at others it may behave counter-cyclically as it has done through the pandemic.

Summary

Fundamentally, SFH represents investment in the dominant residential asset typology in the country. Houses. They are, courtesy of their relative simplicity and renter profile, easier to manage and demonstrate, to date at least, superior occupancy levels and reduced management costs. Accommodation is infinitely configurable, fully defensible, costs less than an equivalently sized city centre home and has outside space one can actually use. Surveys reveal houses are more popular and more desirable. As we strive for a carbon zero future and sustainable living, various house types, irrespective of vernacular, can be constructed using myriad modern techniques and materials to deliver homes for the future. Management, now that digital solutions are sophisticated and engagement strategies are a science, has caught up with the idiosyncrasies of managing disparate and dispersed portfolios. Having spent more than two years researching SFH, my strong feeling is that the sector will outnumber BTR by 3-1 by the end of the twenties.

There is one word of caution: additionality. We are entering a phase where, despite government stimulus, affordability is severely hampering the British desire to own. The residential investment sector needs to acknowledge its place in the market as one of providing a place of transitory convenience. Albeit one of quality, security and responsibility. Therefore, if the sector is seen as cannibalising the OMS market, accusations of which are gaining traction in Ireland and the US, the sector will find this government unsympathetic and possibly hostile.

Additionality and relative speed of delivery, enabling the government to reach its target of 300,000 homes per annum is crucial to the health of SFH and BTR. We must be rigorous in doing it, demonstrating it and not just talking about it.