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A question of risk – why the UK Private Rented Sector now?

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Jamie Kellett
Business Development Manager

What are the risks associated with investing in long term rental housing in the UK? In this post we'll consider how risk factors traditionally associated with residential investment can be mitigated, taking into consideration the new world we find ourselves navigating in light of Covid-19.

Contact us

Institutional business:

+44 (0)20 7011 4444

institutional.enquiries@
bmogam.com

What are the typical concerns we hear from investors?

Demand Disruption

As a nation we are simply not building enough homes to keep up with demand. The government identified the national net annual housing requirement as 300,000 in 2017. In 2018, The National Housing Federation and Crisis put forward that 340,000 homes per year are required, of which 145,000 must be affordable, through to 2031. Last year (2019) 255,000 new homes were delivered, forecasts for 2020 are for 171,000 completions.

Key Considerations:

1. Assuming 260 working days in a year, the government target implies 1,153 houses need to be delivered every day for the next 10 years. This year we have lost at least 50 working days so far through lockdown, equating to a shortfall of 50,000 new homes this year alone.
2. Private house builders are the main source of housing delivery in the UK. Facing falling sales rates mostly due to affordability and obligated to achieve best price, supply will slow impacting the delivery of all tenures. Even where house prices fall, availability of mortgages and volume of savings can prevent home ownership.
3. If the house builders are unable to meet demand, then other routes to market must evolve to mitigate housing pressure. New housing suppliers and construction methods can contribute positively to the green recovery.

Traditional Real Estate Risk

Resilience of income is key for real estate investment. Income holds up where demand for services is inelastic. A safe and secure home has and always will be essential. The importance of this necessity has been amplified recently with homes taking on the role of workplace and school. No property sector is totally immune, but the difficulties may well be more acute in other property sectors.

Key Considerations:

1. **Income risk** – Housing is essential. Households will forgo other lifestyle choices before they default on their rent. This can be further mitigated by focus on delivering housing at the correct price point and focusing delivery on the deepest occupier market (the mass market and low to middle income households). New household creation continues and there is a growing requirement for long term rental accommodation to meet this need. This is illustrated by the growing number of overcrowded homes where people cannot afford to move out. It is estimated that there are currently 3.6m people affected by overcrowding alone.

2. **Construction Risk** – New housing supply must be built, and this provides further opportunity to mitigate future building resilience risks. Management of this risk can be addressed by working with well-funded counterparties fully aligned to the success of your product and agreeing fixed price build contracts with Contractors. Modern methods of construction can mitigate workforce shortages and supply chains can be localised to support local employment and reduce further supply chain risk.

3. **Operational Risk** – Designing from the outset to reduce resource consumption and using new technologies can help mitigate obsolescence and reduce the likelihood of large capex items in the future. Incorporating smart design with an awareness for climate change and committing to operationally efficient homes which are designed to be rented can result in low or no cost utilities. Working with trusted partners with shared values on ESG and high customer satisfaction should help reduce tenant turnover.

Reputational Risk

No investor wants to be associated with being a bad actor within the residential sector. However, investment into responsible long-term rental can present the opportunity to create many more positive outcomes for stakeholders – residents, operational partners, Local Authorities and the local community.

Key Considerations:

1. **Evictions** – the institutional private rented sector has historically had very low eviction rates. Landlords value the assets from income and are therefore incentivised to retain renters. Institutional Funds are well capitalised and structured to cover larger forecast capital expenditure. This stands in contrast to the behaviours seen in the unregulated private rented sector where buy-to-let landlords capitalise house price growth or avoid large repair costs by using section 21 notices (no fault eviction).

2. **Poor Quality Property or Service** – Relationship management is the key factor here. Consumers complain when there is no accountability. Institutions with sensitive investors are mandated to ensure wellbeing of their residents and this is monitored by strict governance processes. The growing importance of ESG further ensures that responsible property management is central to the operational approach, so residents have any problems dealt with immediately. As noted previously, maintenance of the building fabric is closely monitored with professional management.

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3. **Stakeholder Engagement** – The opportunity to be a positive actor through the communal nature of long-term rental housing. To safeguard income through the retention of residents, the manager will focus on creating a sense of community and embedding the development into the community.

This can be achieved by new development with a focus on local housing need, sharing of facilities, improvement of the local surroundings, contributions to local initiatives, creation of new employment, innovation of delivery methods and sustainable operational models reducing consumption.

In Conclusion

The current environment presents much uncertainty but reminds us to focus investment on the basic fundamentals of need and risk adjusted return. The Build to Rent sector is one of the first real estate sectors to have the 'Material Uncertainty' clause lifted by the Valuers. In our view, the supply and operation of social infrastructure across the UK for the deepest occupier base (low to middle income households) offers a defensive approach to scalable real estate investment and the creation of sustainable income streams.

Key risks

Capital at risk and investors may not get back the original amount invested.

The value of directly held property reflects the opinion of valuers and is reviewed periodically. These assets can also be illiquid and significant or persistent redemptions may require the manager to sell properties at a lower market value adversely affecting the value of your investment.

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