trowers & hamlins

savills

Retirement for rent:
aligning the build to rent and senior living sectors

Contents

Introduction

The senior living and retirement village sector continues to build momentum, with organisations like L&G and AXA investing in platforms in this market. A key question is the appetite for growth in retirement housing for rent - for investors, operators and end-users. Savills and Trowers & Hamlins hosted a roundtable in autumn 2017 to explore the opportunities and challenges to growth in the UK build to rent (BTR) retirement sector. Chaired by Jane Ashcroft CBE, Chief Executive of Anchor and ARCO Vice-Chair, we had a range of participants in attendance representing operators (including but not confined to those with a focus on rented accommodation) investors and funders. Details of our attendees can be found in section 6 of this report.

The discussion was deliberately open and wide-ranging, identifying both the opportunities and the challenges in this market. A number of key themes emerged from the discussion and we have set these out on the following pages. Rather than providing a commentary on every point made we have identified and explored each of these themes in more detail. We then offer some concluding thoughts from Trowers & Hamlins and Savills, exploring further issues that we were not able to cover in a single roundtable session. We will consider these issues in more depth at future roundtable events.

The market for retirement housing for rent - Government policy

There is a strong and ever-growing evidence base linking the quality of housing with physical, mental and emotional wellbeing. It was recognised that the retirement sector is now more firmly on the radar of Government and that although it is a lifestyle oriented housing product first and foremost, it has a role to play in addressing the wider issues facing the health and social care sector.

As demographic shifts see the number of people aged over 65, 85 and 100 increase both in real terms and as a percentage of total population, new models need to be developed which address ongoing care and support provision away from hospitals and care homes to reduce the demand on already strained health and social care resources. This is reflected in Government policy such as the NHS Five Year Forward View, recent considerations around social care funding reform and linked proposals to reform the wider welfare benefit system associated with specialist housing for older people and others.

We are seeing the care home market moving towards end-of-life care with average length of stays reducing. The care home service model is institutional and so slightly inflexible. A care home resident is delivered a fixed package of services which are led by the need to meet (CQC regulated) health and/or care needs and a resident generally does not have the flexibility to alter the range of services received and paid for. This is not to say the care home market is outmoded or unimportant - it has been and will remain a vital part of the wider healthcare sector. However, there is also room for a market which sits alongside it, serving those whose needs are less acute and which has scope to offer a greater degree of flexibility as a result. In this context a rental retirement product might in some cases sit “between” the care home market and for-sale retirement products. These are spaces in which the likes of Sunrise and Signature have sought to develop their brands.

> “The breadth of participants made this a particularly valuable and though provoking session – bringing together investor, provider and advisor considerations provided rich debate.”
>
> —— Jane Ashcroft CBE - Anchor, Chief Executive

International comparisons

It was recognised that there is the opportunity to develop an evidence base in the UK as the retirement sector evolves, using international comparators as a guide. Overseas markets are more evolved. It should be possible to learn from those markets rather than repeating their entire learning curve, though in doing so it will be necessary to bear in mind what is not so easily translatable to the UK market because of differences in culture or demography of wealth or age.

An example of this which is familiar to several participants is the evolution of the Australian market. This is a market with not dissimilar age and wealth distributions across older people and a cultural link between home ownership and self-esteem - much like the UK. The model evolved in the 1970s and 80s with independent living units modelled to be sold at around 75% of the cost of a downsizer sale allowing people to free up housing equity on moving into a retirement housing setting. Pension and tax systems at the time made it attractive for retirees to invest in bonds for a tax-efficient income. However, early developers in some cases left residents with too little discretionary income to enjoy their retirement fully, while a large operator failure left that market with a residue of negative sentiment for many years. These issues were a catalyst for sector-specific legislation in Australia, something which many see as both inevitable and necessary for the UK market as it evolves towards the mainstream.

International differences will clearly exist. The US model was noted as an example here, as there is perhaps a greater predominance of retirement accommodation for rent and a less-strong cultural demand for ownership of housing. Of course health and social care systems work differently in the US where people are used to contributing financially to their healthcare costs. Learning is possible from many overseas markets provided both the similarities and the differences are factored in.

> "Despite the complexities we identified, the potential demand for this product suggests the opportunities will grow and early movers will learn quickly."
>
> —— Jane Ashcroft CBE - Anchor, Chief Executive

Customers

The customer is the most important part of the retirement for rent equation as it is in the wider retirement industry or indeed any other sector. If the offer is not right for customers the most robust business plan will not stand up to scrutiny. Having considered the wider policy context it is only right to consider what customers might be looking for.

A significant question to be addressed within a retirement for rent product is the "running out of money" concern. How can customers be assured of a home for life offer that they will continue to be able to fund? Annuity concepts could be a solution, although these have some negative connotations historically in the pensions market. For any operator able to offer a positive solution to this issue, the rented market is likely to open up much more quickly.

A related question is the form of tenure offered. It seems likely that operators need to offer more than the short term assured shorthold tenancies offered in the mainstream BTR market. Customers in the retirement for rent sector will demand more security than those kinds of tenancies offer, compared with the mainstream BTR market which has shown no real interest in such products. This links to a wider debate in the retirement sector about the forms of tenure available and their relative inflexibility compared with those which apply in other markets internationally such as the license to occupy in New Zealand.

It was noted that there are often broad assumptions made about the nature of our housing market. While it is the case that large numbers of people over 65 own their own homes and that large numbers of those people own it unmortgaged, this is not universally the case. Not every older person is either a home owner or eligible for state-funded social housing and if current trends continue the numbers within this market segment are highly likely to increase over time. Some recent research led by Octopus Healthcare and Strutt & Parker - Housing Futures: The Platinum Generation - indicates that 17% of older people would consider living in a professionally managed rental product if it was available. There appears to be a latent market for this product if developed around the right offer.

However, the experience of operators in attendance remains that, thus far, people moving into a bespoke retirement setting tend to want to own rather than rent. Use of rented products has often been to bridge a financial gap to avoid a delay in moving e.g. where a family home is being sold, rather than being a permanent solution. Emotional attachments to housing and the wealth it has allowed people to accrue remain strong, as do desires to provide an inheritance to children and, increasingly, grandchildren. Discussions among participants around these issues noted the need to provide a quality, secure (financially and otherwise) housing and care offer and the scope for downsizers to release equity immediately rather than waiting until they pass away - which may in some instances bring inheritance tax benefits. In some cases the costs of a purchase including stamp duty land tax and possible event fees, may make a rented option more attractive, particularly to people within certain age or acuity ranges or those looking at freeing up equity.

It was noted that care is less and less a "dirty" word for older people who increasingly acknowledged it as a necessary element of a service offer. A product built around these benefits and with the right mix of services could, over time, offset cultural mindsets focussed on ownership and encourage downsizing into a rented product.

Investors and operators

The retirement sector in its widest sense has immense room for growth. This was acknowledged by both operators and investors/ funders who described the sector as a booming opportunity and a nascent market. This is the case across all market segments but is particularly so in the rented sector.

While two thirds of the wider housing with care market is rented accommodation, that is almost exclusively social rented (extra care) housing with 1% or less available for rent in the private sector. There is no real supply in this space at present. For those who can establish brands and products as first-movers there is real scope to become market leaders within a relatively short timescale.

However, as well as meeting the customer's aspirations, new products and business models will need to meet investor expectations. Progress in development of a new product which drives the sector (both for-rent and more widely) remains slow which means the sector lacks size and there are fewer platforms in which to invest or to use as exemplars when funders and investors are selling the sector internally. As the market is so small it can be difficult to build models as there are no standard assumptions. People are very much testing the market, making the market and looking to serve the market - all at the same time. It was pointed out that there is a growing advisory sector which helps with consistency in messaging and consumers and operators knowing what "good" looks like.

As with any housing product, location and affluence in local areas will impact what is viable. Some areas will support the development of new facilities based on rent levels but not all. However, there was a desire among participants to find ways to unlock delivery across all geographies not just those which are in traditionally more affluent areas.

Another factor for funders can be the nature of the product and where it fits within internal risk management and approval processes and the wider regulatory burden which applies. From a banking perspective, for-sale retirement is treated as commercial real estate. Senior living models represent an increased risk with valuations constrained on construction lending as a result. Capital risk exposure is greater as far as regulators are concerned and so the returns required can become too high for operators working on for-sale models. Given this, BTR retirement models may be an easier place to start.

Exit routes will be a factor for funders and investors alike and these will be different to mainstream BTR. Some of our participants have considered these and noted that the issue is not uncomplicated. Age restrictions may apply which is one factor. In addition the planning use class, with many new developments falling within class C2 rather than C3, may be an issue for alternative uses - it may not be possible simply to convert to general market rent or market sale as a result. For-sale retirement housing is of course one obvious exit route. Adaptable designs may cost more up-front but offer flexibility around possible need to change approach.

The sector's reputation will of course be a consideration. Concerns around event fees have largely been resolved as a result of the Law Commission's recent findings, though there is a need to be vigilant in maintaining standards around transparency of charging structure and the proper disclosure of costs information to consumers. More recent press around resale values must also be interrogated carefully as different retirement for sale market segments perform very differently - though in a BTR setting this is less relevant, save perhaps in respect of alternative use exit-routes as noted above.

Roundtable

List of participants

Anchor	Jane Ashcroft, CBE - Chief Executive (Chair)
Aviva Investors	Andrew Appleyard - Head of Specialist Real Estate Funds
Trowers & Hamlins	Andy Barnard - Partner
Birchgrove	Honor Barratt - Managing Director
Clydesdale Bank (CYBG Plc)	Derek Breingan - Head of Health & Social Care
Trowers & Hamlins	Kyle Holling - Partner
Amicala	Helen Jones - Chief Operations Officer
The Blackstone Group	James Rosenfeld - Real Estate Private Equity
Savills	Samantha Rowland - Director
Standard Life Investments	David Scott - Real Estate Research Analyst (Alternatives)
ARCO	Michael Voges - Executive Director
Savills	Victoria Wallace - Associate
Octopus Healthcare	Richard Williams - Director

> Customer understanding and insight was at the heart of the discussion – focussing on this and looking to international experiences provides a great platform."

—— Jane Ashcroft CBE - Anchor, Chief Executive

Concluding thoughts from Trowers & Hamlins and Savills

Contrasts

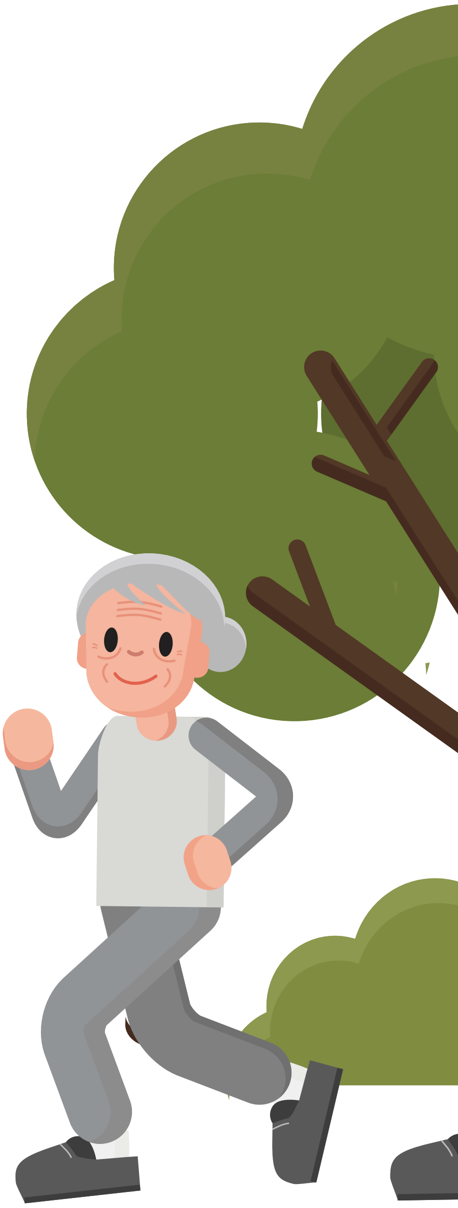
There are some interesting contrasts apparent when considering the development of a BTR retirement product. The first is to compare it with retirement housing for sale. Some of the considerations were worked through in our roundtable and are discussed throughout the report. The return profile is quite different between these products. A rented model may suit investors from that perspective, but would need to be modelled to be viable at realistic rent levels, notwithstanding the likely need to provide a range of village style facilities and amenities to ensure there is demand for the product. This is an issue also faced in the for-sale market segment.

In overseas jurisdictions event fee models have opened up the for-sale market as additional development costs can be recouped over time rather than on the initial sale as with traditional housing for sale. They can also be used to reduce or fix occupation costs to provide customer certainty. Event fees are less compatible with rental models and so other solutions will need to be considered.

For a smaller market at the higher end of affluence a second home rental model might be attractive for example for those keen to maintain a local base near family but also to have access to city centres and the leisure activities they offer.

A second contrast is the differences which might apply between a BTR retirement product and mainstream BTR for working age tenants. Arguably, from an investor perspective retirement products have several advantages over mainstream BTR:

- a greater interest from customers in the overall quality of the place as they are likely to spend more time in it
- less regular voids as customers are less likely to want to move for reasons connected with career, family, etc
- when voids do occur turnaround costs may be lower
- lower chance of non-payment of rent as sources or level of income are unlikely to change
- an ever-growing market share due to an aging population.



Considerations

As well as overcoming customer desire to retain a capital asset and the British preference for home ownership as a source of wealth and a sign of status, investor interest in a BTR retirement product would need to be increased. There are some challenges here. The need to provide a full-service solution may make investors less comfortable funding such assets as the social care element and regulatory regime in particular may not be something with which they are familiar. This may require new partnerships to develop between investors and operator platforms able to offer the full-service care, hospitality and lifestyle offer needed to attract the baby boomers, who have much more demanding expectations than the silent generation that preceded them. As one of our participants put it, the sector needs to talk more about “we” and less about “they” when referring to the consumers who will access this housing.

The need for new partnerships may well provide a market entry point to care home operators interested in expanding into the retirement market as the income model is more aligned to this, than it is to a for-sale product. Another result of these kinds of partnerships might also be the need for a new approach by investors, which have typically been comfortable and indeed preferred a direct landlord and tenant relationship with occupiers in mainstream BTR, employing professional housing managers to deliver the necessary services.

Rent levels and services offered may differ between retirement and general BTR. In the latter, services tend to be inclusive with rents covering the majority of occupation costs. Retirees may be more open to flexible pricing menus or more willing to pay a higher rent which includes a wider range of services than mainstream BTR typically offers. There will need to be a focus on the differences between customer expectations on services and charging structures between different age demographics accessing rented housing. This includes considering income profiles which are much less likely to increase over time in retirees compared with those of working age progressing through a career path.

Exit routes are inevitably a focus for investors, touched on in our discussions. The possibility of more complex relationships and service models with experienced operators will influence how these are viewed. At present there is a very early emerging secondary market for existing covenants (e.g. AXA and Retirement Villages Group, BUPA and Richmond Villages) compared to the mainstream BTR market which is much more established where assets and portfolios trade regularly. Flexibility and exit routes are essential and could be provided in future from a planning perspective under C3 use or alternatively provide a special use class solely for retirement as seen in international markets such as New Zealand. The current Government consultation on planning and affordable housing for BTR is of particular interest in this regard as it proposes a new form of affordable tenure for BTR schemes, which need not be sold to housing associations and may be retained by the building's owner. In turn that means that entire buildings may be retained under single management, which is much more attractive to investors.

A key legal consideration in delivering a new product is VAT the treatment of which is significantly different within BTR, a VAT exempt business activity. This will influence the approach to everything from site acquisition to development costs and design, to services structuring. Issues addressed in the growth of the mainstream BTR sector will be capable of being applied in many cases, but new thinking will be necessary within a retirement product.

Conclusions

It is clear that attitudes have already changed in relation to home ownership in the UK and the private rented sector continues to increase in size each year. It is expected that one in four of us will be renters in 2021 according to a recent report from Knight Frank – Multihousing 2017 PRS Research. As a result many more of us will continue renting into retirement and will be looking for the best places to do so.

Incentivising existing homeowners to sell and enter the rented sector seems a more difficult proposition in the UK, but is more usual in other markets. Such moves are supported elsewhere by some kind of annuity, so that retirees can be confident that they will not "run out of money". This is a potential barrier as the market for such annuities in the UK are not supported to the same extent at this time.

Investor interest in residential assets in the UK has never been higher. However, with so little stock in the market it is currently difficult to provide evidence-driven answers to challenging questions on the level of customer demand and therefore on the overall scope for growth in rented retirement products. In order to address those barriers there appear to be good reasons and plenty of scope to create a flexible mix of assets that are capable of attracting both the growing pool of renters attracted by the professional management of the BTR sector and those interested in retirement for rent.

Further information

If you would like further information from Towers & Hamlins or Savills then please see contact details below.

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