

FUNDING AND DEVELOPMENT OF MODULAR HOUSING

A view from the public and private sectors



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Foreword

How far have we come in the adoption of modern methods of construction in the provision of housing in the public and private sectors? The Government's Construction Playbook highlights the use of MMC as key to improving quality in public sector construction. Homes England require their Strategic Partners to deliver 25% of homes using MMC and encourage the use of MMC on the Affordable Housing Programme and the Greater London Authority welcomes bids with an MMC pipeline.

But what impact is this having on the sector? Trowers & Hamblins conducted a survey in August 2021 to gauge views on and experience with MMC (and in particular Categories 1 and 2 (volumetric and panelised systems)) within the affordable and private housing sectors. And, as part of a deeper dive into the topic, is conducting a series of roundtable discussions with registered housing providers, local authorities, private developers, house builders, manufacturers, funders, valuers, insurers and consultants.

The results of the survey and roundtables so far indicate a shift in thinking since Trowers' last modular housing report in 2019. There are still issues to overcome to the wider adoption of modular construction, but it is generally viewed more positively as an alternative to traditional build.

This is a snapshot of some of the key findings, how easy it is to get funding, the motivations for using MMC and where there is work still to be done. The full report will be published after the conclusion of the series of roundtables.



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Motivations for using MMC

Build quality and costs are among the key drivers across the public and private sectors. The need for less labour when building with volumetric and panelised systems was also a motivator, which isn't surprising given the construction industry is facing a skills and labour crisis.

Equally, the argument for sustainable development and energy-efficient homes was very high on the list as a driver for using MMC. This undoubtedly reflects the increasing move towards and pressure for funders and developers to transition to net-zero carbon.

Martin Williams, Portfolio Management & Risk at Maslow Capital, pointed out that over the last six to 12 months, there has been a shift in investor behaviour:

“There's been a massive emphasis from those base investors into the funds to make sure that any key investments have got strong ESG credentials.”

Research is ongoing into the broader cost savings of using MMC (especially volumetric modular), including the whole lifecycle costs, which was also cited as a key motivator.

For Selina White, Chief Executive of Magna, using modular housing helps solve two key problems: quality and supply. She said:

“Quality of homes is coming right up the agenda now, and I guarantee it will overtake concerns about the supply of new homes. I think that the attractiveness of MMC and off-site construction is a very compelling argument for overcoming that crisis.”

For the private sector, there is tension between homes for sale and rent. The use of volumetric modular and panelised systems can significantly reduce build time – Greystar knocked 18 months off the build time at its development in Ealing, West London, for example. This has greater advantages for build-to-rent and other purpose-built products such as student or affordable housing, where the quicker you can move people into the finished product, the better. Whereas for developers of homes for sale there will always be the pressure not to bring too many new homes on to the market at the same time.

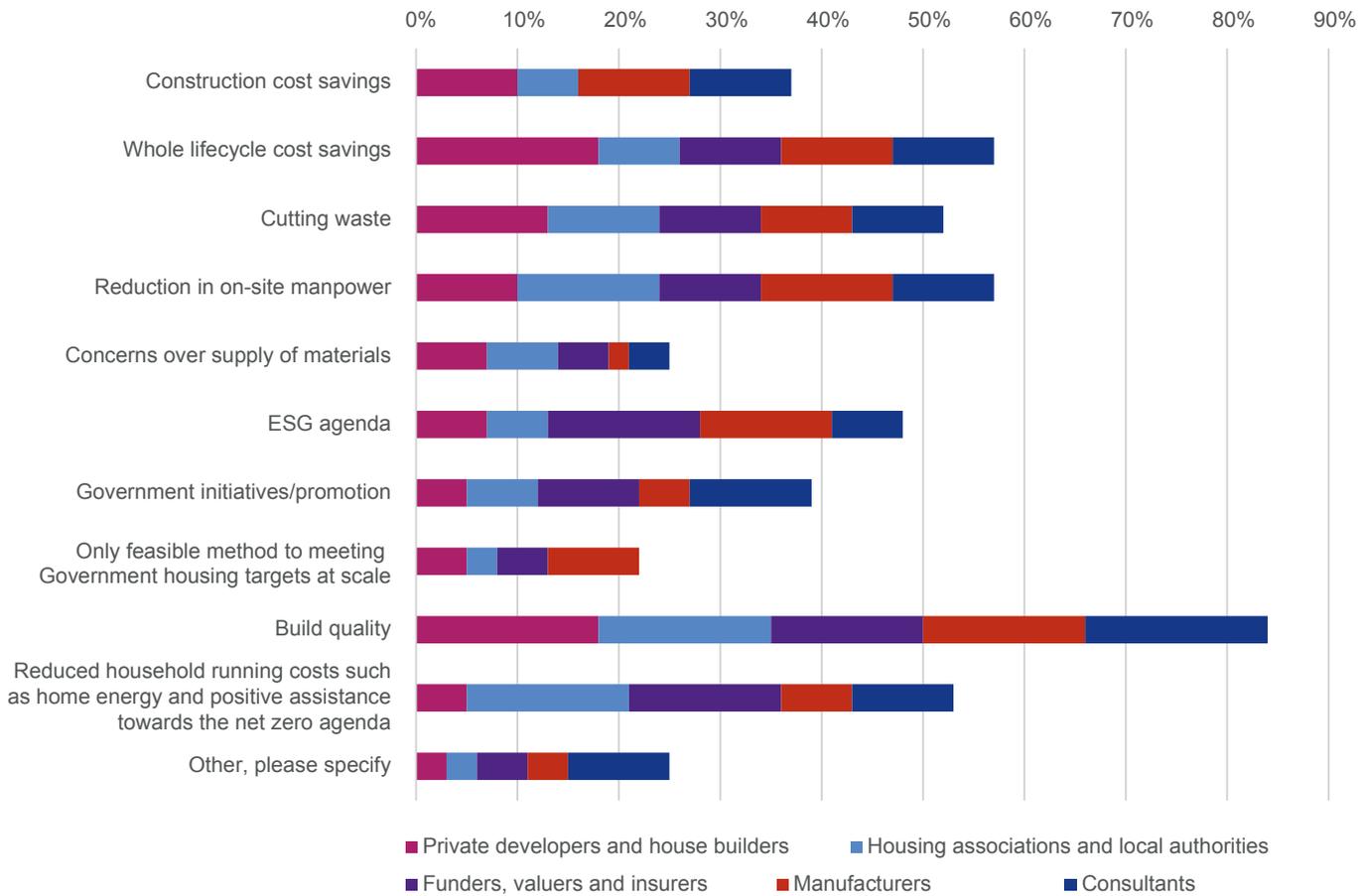
James Pargeter, Senior Advisor, Global Apartment Advisors, pointed out that:

“Even where MMC is slightly more expensive than traditional build, which is not always the case, the speed of delivery to occupation can mitigate the extra costs.”

Contrast this with homes for sale, where developers often prefer the finished product to be drip-fed onto the market.



Figure1. What were your main motivations for using MMC?



Funding: A conundrum?

While there is a push from investors to put funds into projects which have good ESG credentials, modular housing construction is still relatively new, which makes some funders nervous.

Traditional build is tried, tested and understood with established warranty schemes and certification plus an established model for drawing down funds linked to the progression of works on site. This is backed by well known suites of guarantees and warranties plus as works progress on site, the value of the site/development (over which funders will have security) will typically increase.

Modular housing, by comparison, is still in the process of developing certification, there are concerns about standardisation, and the flow of money versus progression of works on site is different. The upfront costs are greater than a traditional build, and the majority of the work is undertaken in a factory before being transported to site.

But solutions are being found. For example, Maslow Capital has been able to de-risk the upfront costs. Ben Colling, Director Portfolio Management, explained:

“On the financing aspect, we were fortunate in that the parent company of the modular manufacturer obtained a Trade Finance Facility agreement to cover the cost of production.”

This meant that instead of funds being released on day one of manufacture they were instead released as works progressed on site.

Adam Penney, Financial Planning and Strategy Director, EcoWorld, said getting funders comfortable with the change in cash flow was important: “But the benefit was having a faster construction period and not having the loan out for longer.”

From the roundtable discussions, those who had a track record with modular/panelised systems found the path to securing funding easier. EcoWorld’s Kew Bridge development is a case in point, their funder had previously financed modular/panelised works. And some developers and funders are taking a stepped approach, starting with individual modular elements (such as bathroom pods and utility cupboards) to build confidence and learning about the process before embarking on full-scale modular.

Since our 2019 research, there has been a shift with greater use of equity and development finance to build using modular construction. However, it is a slightly different story for local authorities and housing associations which have access to GLA/Homes England grants. This makes up their biggest source of funding.

This undoubtedly influenced the survey results, with 67% of public sector respondents stating that securing funding for MMC was no more difficult than for traditional build.

With the requirement to use MMC as a proportion of an overall development, there is an element of certainty and a step-change in attitudes. However, there was some concern in the public sector about how acceptable modular properties are as security for funding.

For the private sector, 45% of respondents reported that securing funding was no harder for modular schemes than for traditional build, which is an improvement on the previous report. Nonetheless, there was a sizeable proportion of respondents reporting it is still either harder or much harder to secure funding.

Figure 2. How have your projects been funded?

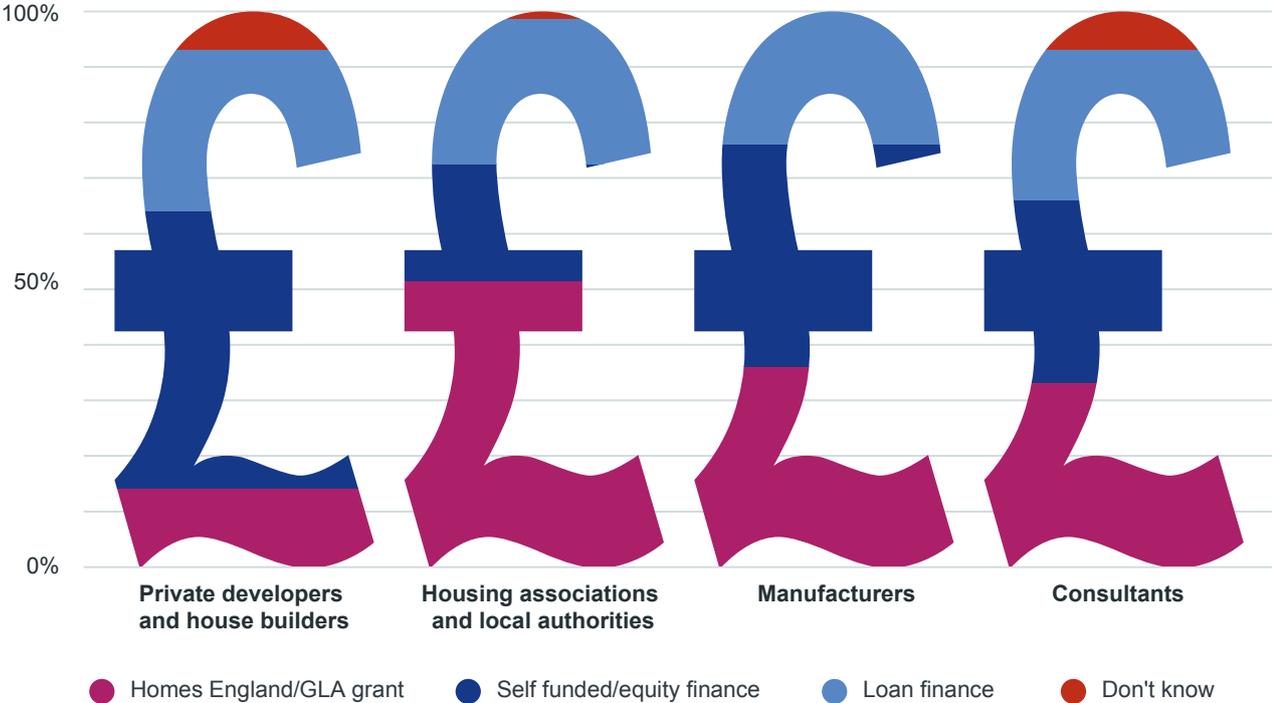
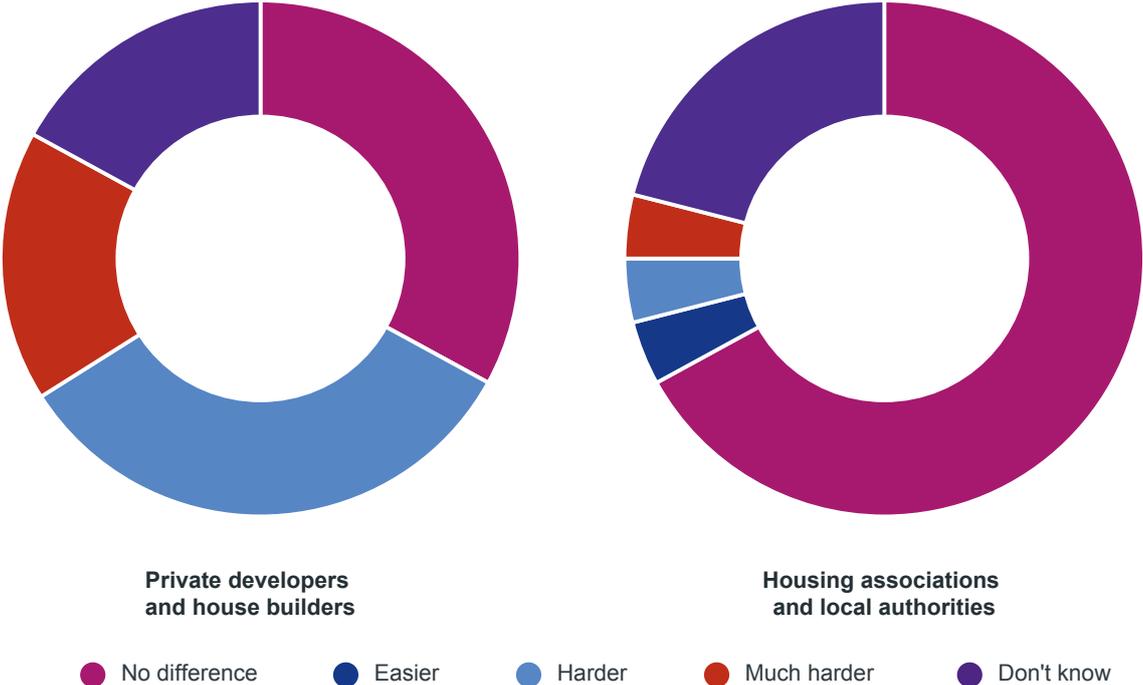


Figure 3. How much harder was it to obtain funding for the project compared to obtaining funding for a traditional scheme?



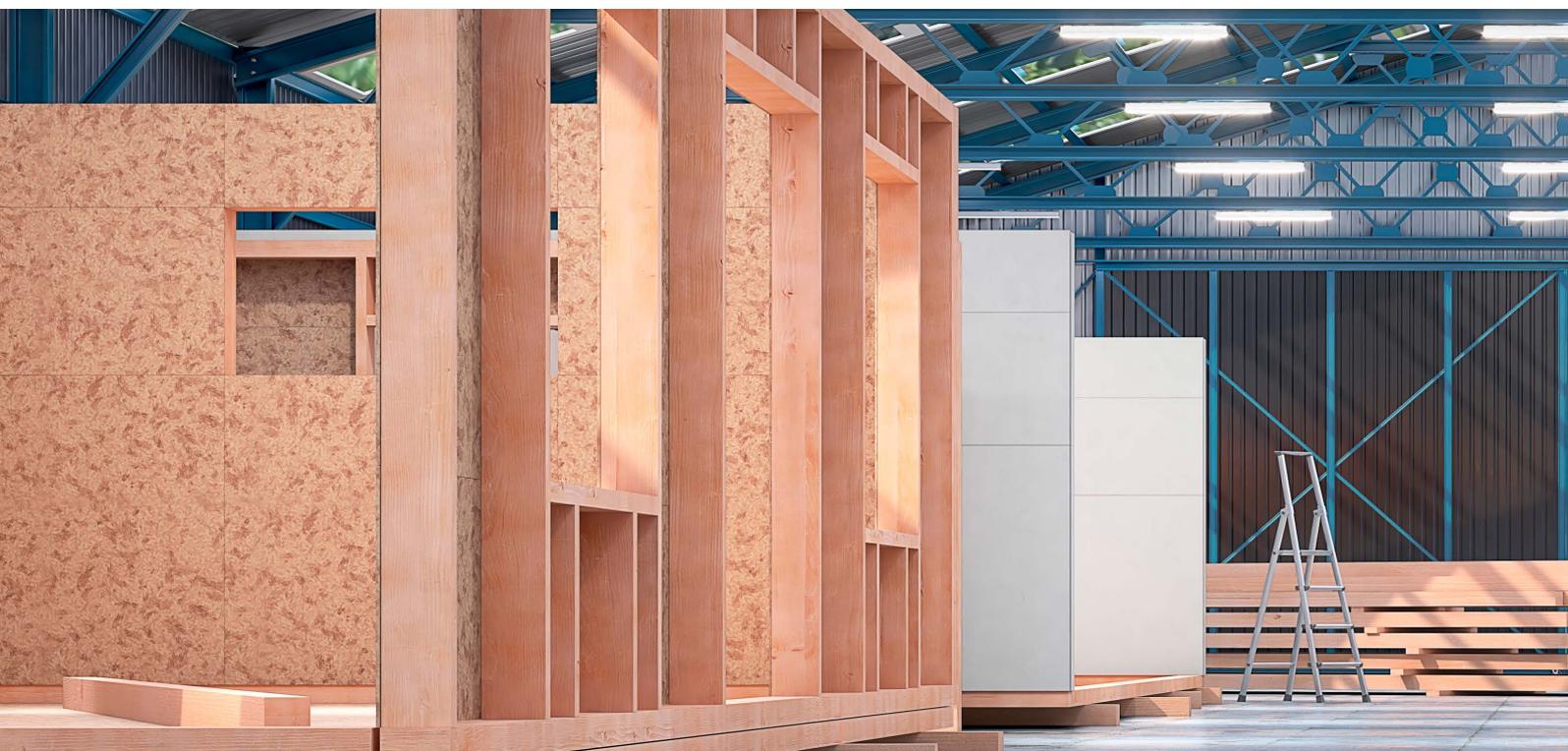
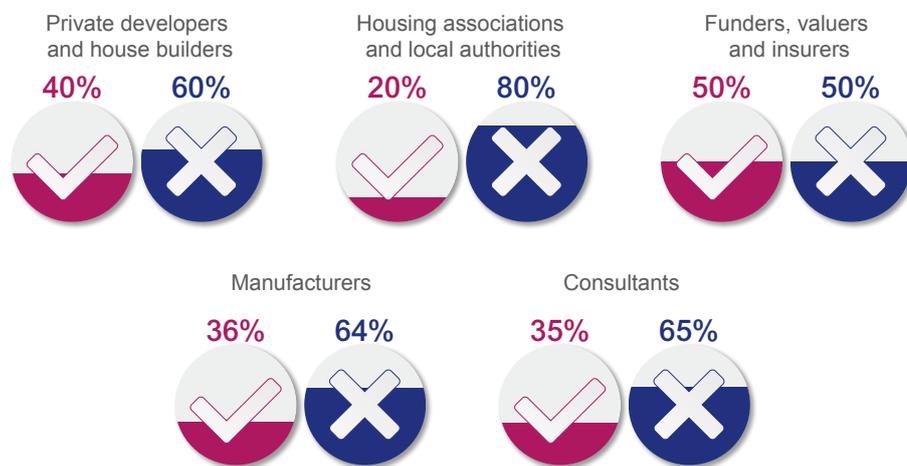
The Government's role in funding

As the survey results show, public funds are already playing an important role in supporting the adoption of volumetric modular for the affordable sector. But there was a view from some quarters, particularly manufacturers, developers and housing associations, that more could be done particularly around supporting SME manufacturers.

As the market adjusts to this new form of construction, Government funds can help de-risk and build confidence in the sector. The stipulation of 25% of MMC for Homes England Strategic Partners is an important driver from which the industry can learn and refine working with modular.

It can also provide security of pipeline for manufacturers (see Overcoming the hurdles on page 10).

Figure 4. Is Government providing enough support for MMC housing?



Valuations

Are modular homes valued differently to traditional build? The research showed that modular and traditional should be treated the same however, each development and mode of construction would be considered on its own merits. If that wasn't the case, there is a risk of creating a two-tier market which Andrew Smith, Director, Savills said could "kill the market".

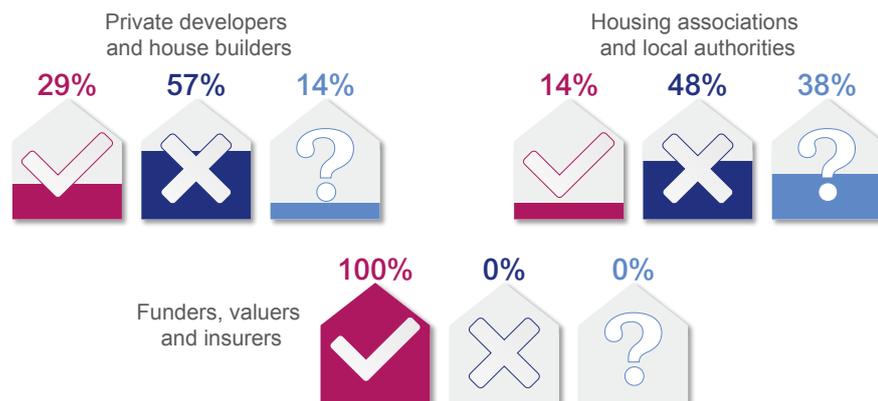
He added: "It is an asset that produces an income that you can independently trade. Our starting point is to value it identically unless there is a significant factor that makes us discount it but mostly, we are treating it the same at day one."

Savills has put together an MMC test case loan security report, which shows the additional checks, balances and advice for lenders.

Richard Houghton, Director - Valuation Advisory - Affordable Housing at JLL, said:

"From a valuation perspective, we approach it similarly to the rest of the stock in the marketplace. There is more work to do on the due diligence side and assuring ourselves we can value this type of product robustly."

Figure 5: Are MMC homes valued differently to traditionally built homes?



Overcoming the hurdles

Naturally, there are still concerns around using modular but what was evident in the roundtable discussions undertaken so far, is that there is confidence within the industry that all hurdles can be overcome.

Fear of the unknown is understandable, particularly when construction has operated the same way for such a long time. Funding structures, valuations and security are based on tried and tested traditional build models.

Lack of familiarity also feeds into risk concerns around how long modular products last, how they are maintained and the impact that has on their value long-term.

Capacity is a separate issue but can be divided into two key areas. Firstly, are there enough factories to deliver modular homes at scale? Secondly, what are the alternatives if a manufacturer happens to go bust?

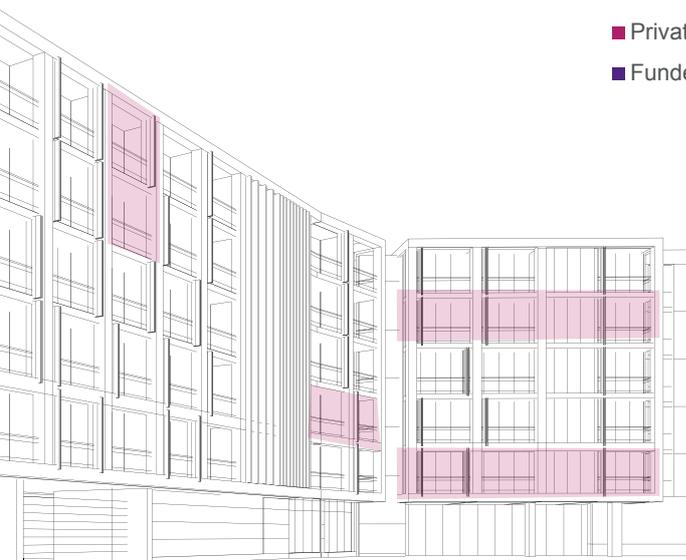
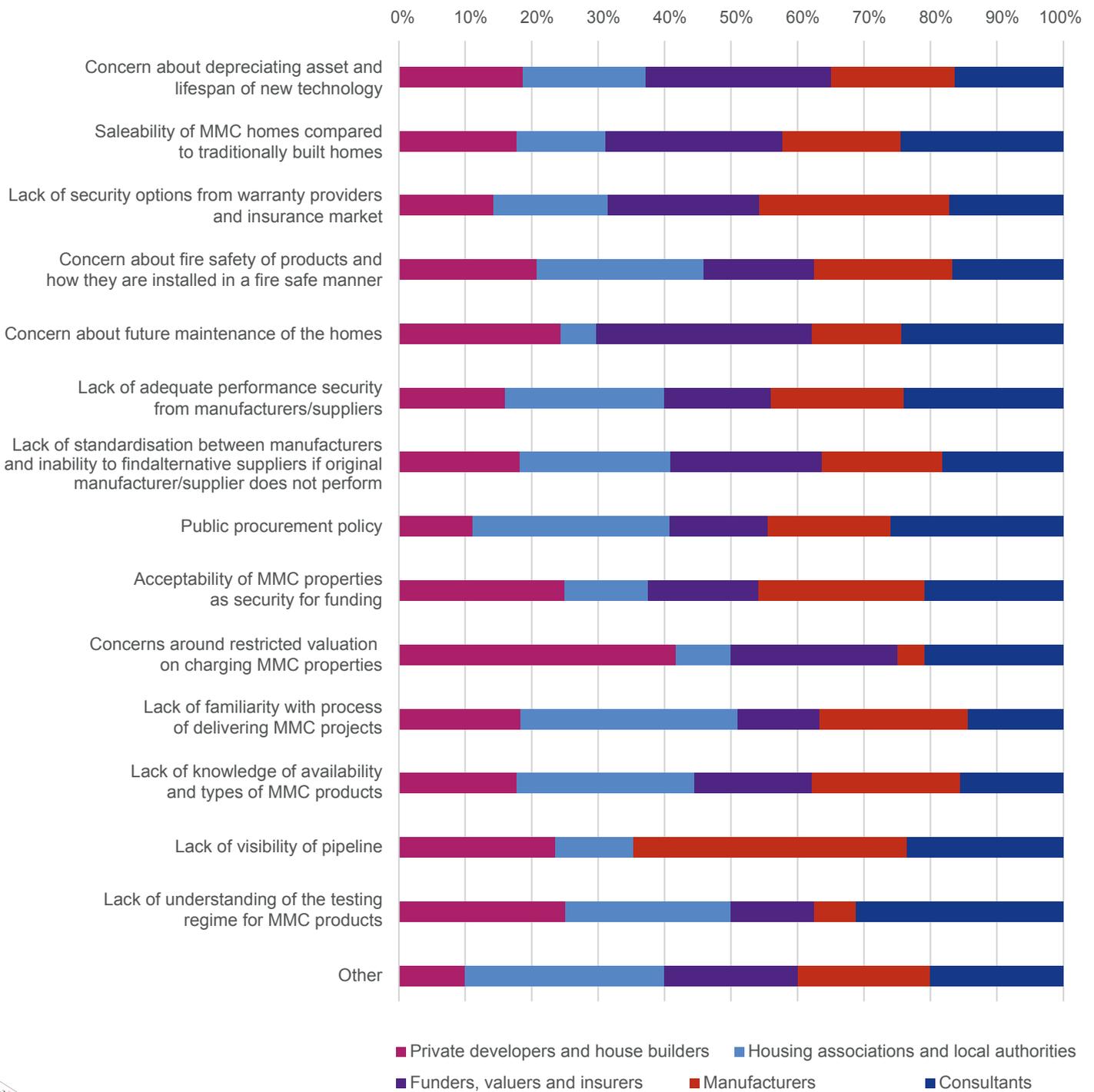
What will help, and is already helping, is having more modular schemes coming forward coupled with the development of standardised warranties and questions for valuers. NHBC, LABC and Build Offsite Property Assurance Scheme (BOPAS) both offer accreditation, but there is a misalignment between what they assess and offer security for, which needs to be understood, for example BOPAS providing assurance regarding the lifespan of the product compared with NHBC and LABC providing insurance backed cover for defects.

Mike Ormesher, Director & General Manager of Ottersbrook Consulting and Project Director of The Offsite Homes Alliance (OSHA) says there are far too many companies and organisations working in silos where transparent and consistent standards are required:

“What we need to get to is common agreement across DfMA procedures and processes and what is acceptable in terms of compliance for the MMC sector to gain real traction.”



Figure 6. What in your opinion is the biggest barrier to the wide spread adoption of MMC?



More established warranties and product guarantees backed by reputable insurers would also help give confidence to funders. It's a learning curve for everyone involved and sharing knowledge and experience is a powerful driver.

The problem of capacity is something that requires consistent demand. Manufacturers need pipeline consistency, something which the mandate on MMC as a proportion of affordable housing builds will help with but more needs to be done.

Some registered providers have already formed consortia to give manufacturers certainty of pipeline. This also enables manufacturers to standardise their products for the consortium.

For example Pete Bojar Executive Director Sustainable Assets & Repairs at Great Places Housing Group and member of OSHA consortium explains:

“We don't want to do MMC just for the sake of it, we know what the benefits are and we know how it will protect our development programme and supply chains.”

Jake Snell Head of Partnerships and Innovation at Abri Group and member of the Building Better Consortium confirms that creation of long-term strategic partnerships is key to delivering more homes.

Further lobbying of the Government from the industry to generate a concrete pipeline of affordable housing projects may be needed to give manufacturers confidence.

The consortium route (and the aim to standardise products as part of the consortium) could also help solve the problem of insolvency risk. There is concern about what happens if a manufacturer gets into financial difficulties during a project. Could another manufacturer pick up the project and continue to manufacturer the same or a similar product?

Due diligence to check on the shape of the manufacturer's finances has to be the first port of call. But getting manufacturers to come together to improve standardisation in their offerings could help de-risk projects.

David Horne, Director of Housing Finance at RBS and David Stokes Credit Risk Director at The Housing Finance Corporation have witnessed the momentum building within the modular housing sector and consider that the next 12 to 24 months will be critical as lenders refine their policies and procedures to maximise the number of modular homes that are put forward for charge within a registered providers portfolio.

Insurance could provide one of the solutions. Maslow Capital have worked closely with an insurance broker to develop an insurance wrapper for a development facility. The insurance wrapper would cover liability for work carried out on-site and liability for products created in the factory, effectively mitigating against the issues associated with risk allocation between contractors and manufacturers. Martin Williams explained that the insurance wrapper could also be used alongside a working capital facility, where a lender could provide a working capital funding line directly to a manufacturer and the development facility is used to pay for works on site. Together, these go a long way to overcoming one of the key risks with offsite manufacturing.

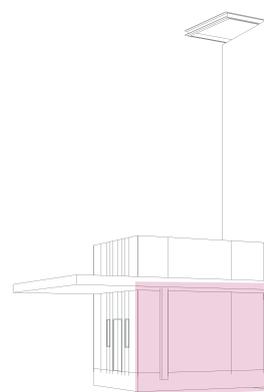
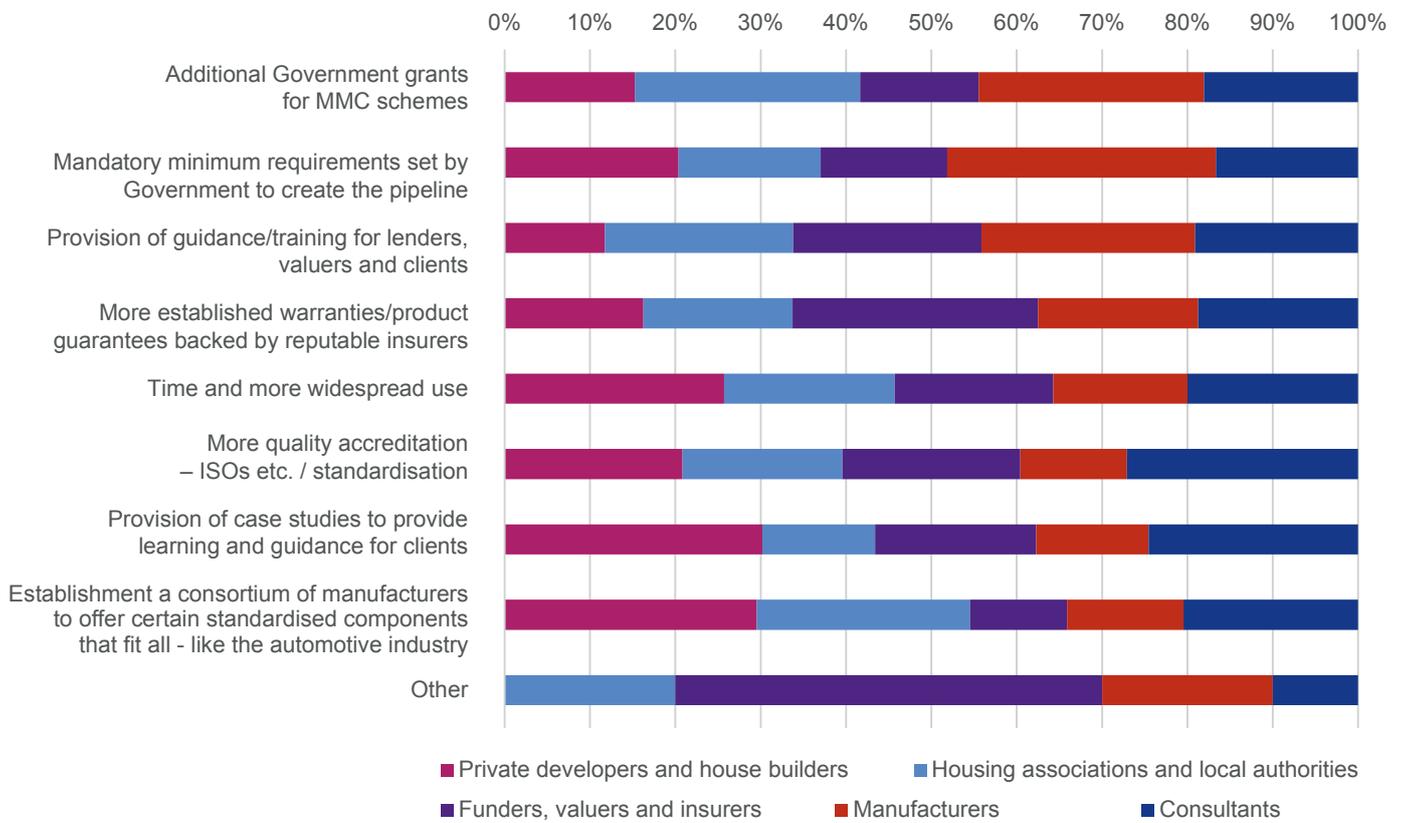


Figure 7. How could these barriers be overcome?



Conclusion

These preliminary findings demonstrate an increasing appetite for using modular and demonstrated that parties across the housing sector are willing to consider innovative solutions to overcome some of the hurdles.

Learning, experience and standardisation are the keys, but the feeling from those joining the roundtables so far is one of progress and a positive outlook and that will continue to increase as more and more companies become familiar with the processes, risks and benefits of using modular housing.

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