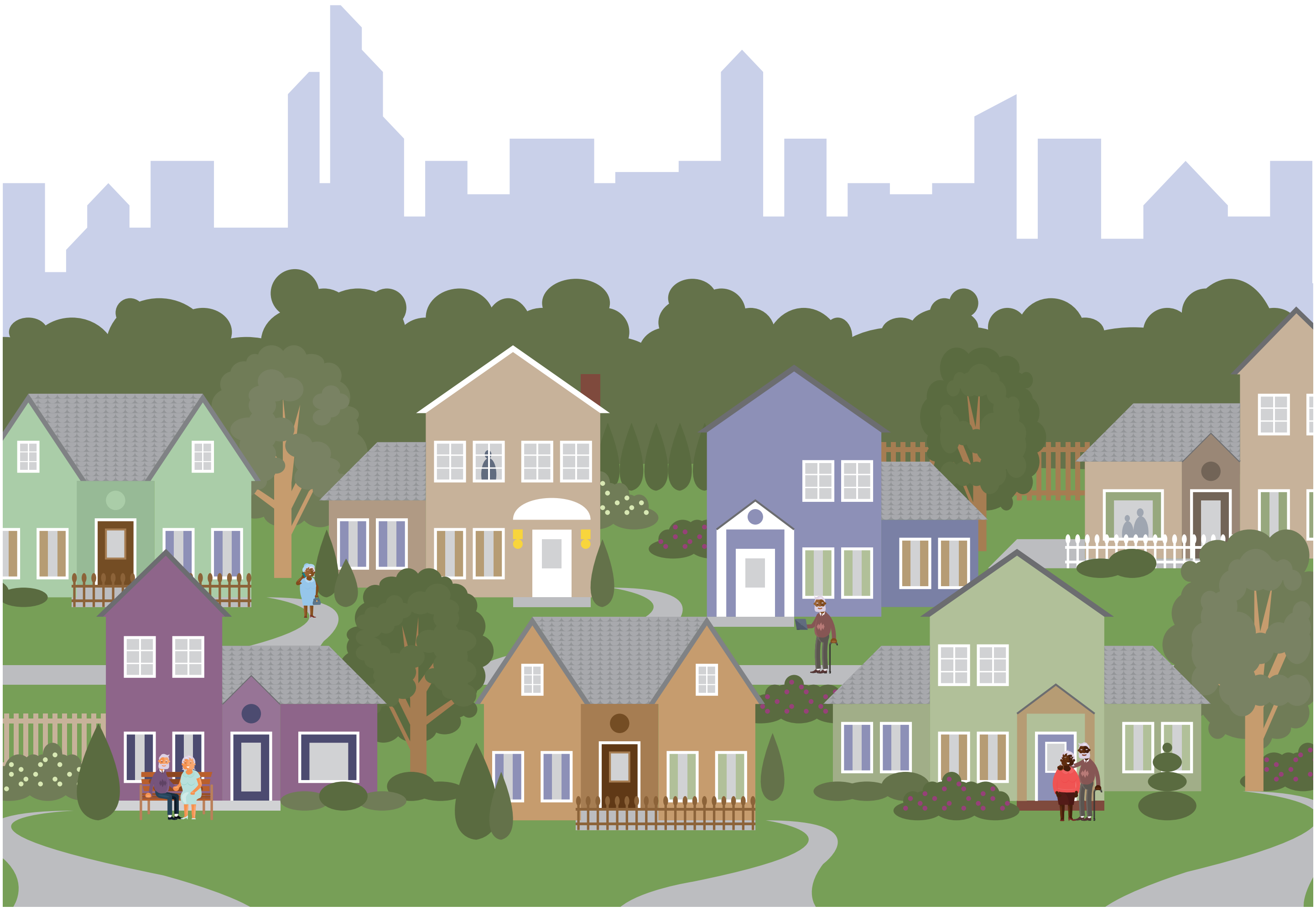
Tackling tenure:
balancing operational flexibility with customer certainty



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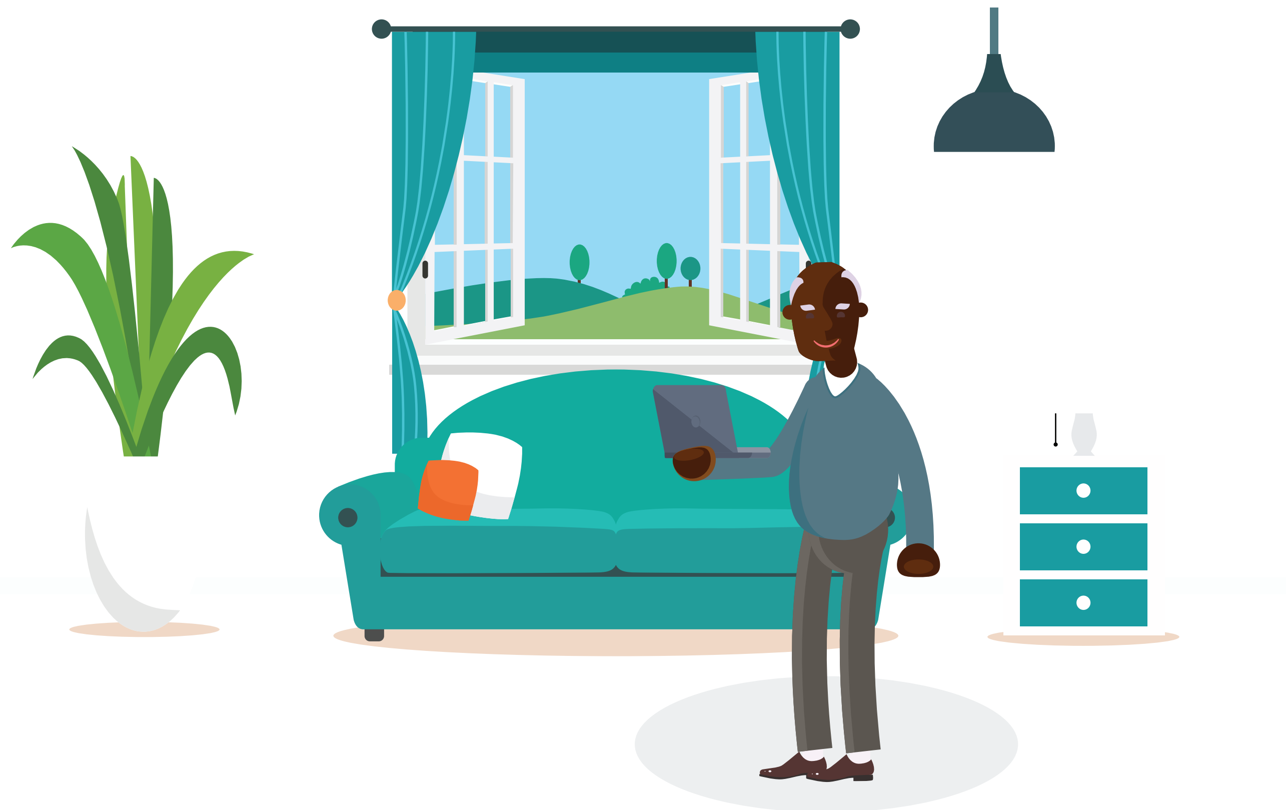


Introduction

Following Savills' and Trowers & Hamlins' successful retirement for rent roundtable in late 2017, chaired by Jane Ashcroft CBE, we reconvened for a further discussion in spring 2018 to move the conversation forward. The theme for the discussion was "tackling tenure" with a focus on framing the ideal balance of operator control and customer security and considering ideas from other jurisdictions with more established retirement living markets.

Attendees included some of those at our first session and some new faces to bring a range of perspectives to a discussion grounded in but moving on from the first roundtable. This lively discussion was led by our chair for the day, Stuart Garnett of Savills.

As with our first roundtable on the retirement for rent sector, we have drawn out and discussed key themes rather than providing a detailed commentary on every point made. We have then offered some concluding thoughts from Trowers & Hamlins and Savills.

> "It will be important to slot retirement for rent into the planning system in a way that works for investors. It has taken a long time for the build to rent market to achieve that. Similar drivers will exist to ensure that assets can be retained in single ownership and that exit routes exist if demand falls away."
>
> —— Andy Barnard, Partner, Trowers & Hamlins

Thoughts from the Chair - Stuart Garnett

The pace of change in recent years within the retirement housing sector has been remarkable and we are witnessing increasing activity, particularly over the last 12 months. We are seeing operators delivering a wider choice of housing including more varied and larger homes, mixed tenure schemes, superb on-site facilities including restaurants, gyms and spa's and the expanding choice of different tenures from affordable through to higher end private housing.

In the mainstream housing market we have seen a surge of activity in the private rented sector in London and in the regions. It is therefore, not surprising that the retirement sector should be a focus for private rented housing too. Investors are watching with interest, particularly with Birchgrove being one of the first to develop the private rental model for retirement housing and with others looking to follow suit, such as Auriens at their development in Chelsea with assured tenancies provided.

Early indications suggest potential renters are prepared to look at alternatives to home ownership, particularly once they have a true understanding of the significant annual costs of running their own home, e.g. repairs and maintenance against the all-in cost. A rental property can be considered to provide residents with peace of mind for the rest of their lives in secure and accessible accommodation, enabling them to age in place with the ability to free up equity for their children and grandchildren.

The issue of tenants "running out of money" was explored at length with agreement that some form of insurance policy is needed. This could see a resurgence of annuities, providing further reassurance for retirees to make the switch. Associated Retirement Community Operators (ARCO), Aviva and other organisations are closely looking into the delivery of specific policies which would see the potential for the sector to expand.

What is clear is there is no "one-size fits all" approach. Private retirement housing for rent will be a further option available to retirees providing much needed choice. What is important is to ensure the process is clearly explained as too much complexity will discourage uptake from this emerging sector.

The role of rented retirement

The discussion began around a point which was debated in our first roundtable: the role of the rented model in the wider retirement market. Culturally and from a consumer appetite perspective, particularly among older people who own homes which have increased in value dramatically over many years, home ownership remains the norm.

This contrasts with some other jurisdictions with well-established senior living sectors, where the mindset differs. However, it was noted that statistically the number of people renting is on the increase, driven by an increasingly difficult to access and at times volatile residential property market. This is generally assumed to be applicable to those seeking to access home ownership with media attention focused on statistics such as the average age of first time buyers. However, as the average age of the population increases the numbers of people in need of a rented solution in retirement will increase. In addition, there are some specific examples of unexpected demographic cohorts taking up occupation of general build to rent products where offered to the market, because of the combination of flexibility and locality they offer.

Participants noted that more operators are considering a rented offer than has been the case previously. There is already a range of tenure options available across ARCO membership for example, from outright sale and market rent through to affordable rented products and also shared ownership. Shared ownership is an affordable housing for sale offer but is in essence a part rent part ownership product and could be utilised in some settings. Participants noted other offers they make such as “rent to buy” or “try before you buy” and a general sector move towards a rented offer. For some this is to create a balanced offer with a proportion of homes for rent, which is a response to perceptions about demand. For others this is driven by demand with the costs associated with purchase perceived as too high a barrier to offer a for-sale product.

There is also an increasing demand for flexibility and simplicity across British society which a rented product could be pitched towards, contrasting some of the down-sides of ownership – capital outlay (meaning equity release for personal use, or for passing to children and grandchildren is limited), the complexity of the purchasing process, stamp duty land tax, event fees and other costs of both entry and exit. The sector may have to work in part on persuading customers that renting is not the expensive or the

“Resident preferences continue to change so the retirement model too must adapt over time. The ageing population want options, freedom of choice and flexibility. Private retirement for rent could be the next logical step, the question being… is now the right time?”

—— Victoria Wallace, Associate Director, Savills risky option - something which will take time. Approaches may differ in terms of the offer and the opportunities to capture different potential market segments. Operators need to develop clear strategies on the offer they are making to customers and indeed to investors to ensure supply and demand are correctly lined up. For example, someone in their 90s may see a move to retirement specific accommodation to be their last and be content to rent to avoid the complexity and cost that goes with buying, while a younger cohort may rent for the flexibility of knowing they can move again if they don't like the experience or to release capital.

The mainstream build-to-rent sector is further advanced than retirement for rent (or the retirement housing with care sector generally) and has been evolving over the last decade or so. There is cash readily available for investments in to the right products. However investors are not actively pushing forward with retirement-specific products in many cases because of market uncertainty about the likely take up by consumers and a perception that the build to rent model is still only being seen as "the next big thing". This becomes slightly chicken-and-egg: sector growth requires investment, but investment often requires an established market into which substantial capital may readily be deployed.

An offer in the retirement for rent market would also require more detailed consideration around care and support provision, something with which mainstream build to rent operators need not contend. Participants noted that a retirement for rent offer may be more attractive to those with a specific care need (assisted living) compared to those looking at lifestyle oriented independent living. This is linked to a wider point about the customer offer in retirement for rent compared to the mainstream build to rent sector. The range of in-rent and add-on services and amenities may differ, as may the approach to deposits and a range of other factors may need fresh thinking for the target market. Tenure and the level of security people have to remain in place as long as they wish is clearly a part of this.

International comparators

In order to consider the approach which might strike the right balance between operators and customers and facilitate the rapid growth of a UK retirement for rent market, we looked at models from other countries with more established retirement sectors.

In particular we considered the tenure models available, the cultural approach and how easy or otherwise it might be to replicate the structures used, bearing in mind existing legal and regulatory structures.

The New Zealand market has a bespoke form of tenure, the Occupation Right Agreement (ORA). This is a consumer rights driven set of principles which apply to and regulate occupation in New Zealand retirement villages. It is underpinned by and forms part of the wider statutory framework governing the sector in that country. Older villages originally sold out on other forms of tenure (primarily unit title, which is the New Zealand form of commonhold, but some leasehold villages too) have seen conversions to the ORA structure as it is seen as striking a better balance of risk and a better means of achieving the typical financial bargain between customers and operators. It was noted that in practice the New Zealand market is very much a for-sale market with consumers generally paying an advance capital payment for their ORA and receiving that sum back less an event or deferred fee on exit. This is driven by the history of the sector and a cultural preference for home ownership. However, it was felt that this form of occupation could apply equally as well on a rented model with occupation payments made on a monthly or quarterly basis.

By contrast the US model adopts a different approach. Renters in this market are more often than not from affluent backgrounds - socio-economic “desirability” makes the rental market ever more appealing. As such a more typical rented product works for that market without the need for a bespoke form of tenure. It is not uncommon for people to rent out the family home and then rent a bespoke retirement village which provides the ongoing income to meet accommodation costs.

UK application

It was noted that in the UK there is a degree of debate over the level of appetite on the demand side of the equation for a private sector rented retirement product. The supply side is entirely achievable given the level of long term funding willing to invest in income driven models.

Different approaches might be taken to the means through which investment is made in the general build to rent and student markets given the care and support provision element of service required and the regulatory burden and reputational risks that carries. Structures akin to the opco-propco models prevalent in care home and primary care investment seem capable of solving this problem.

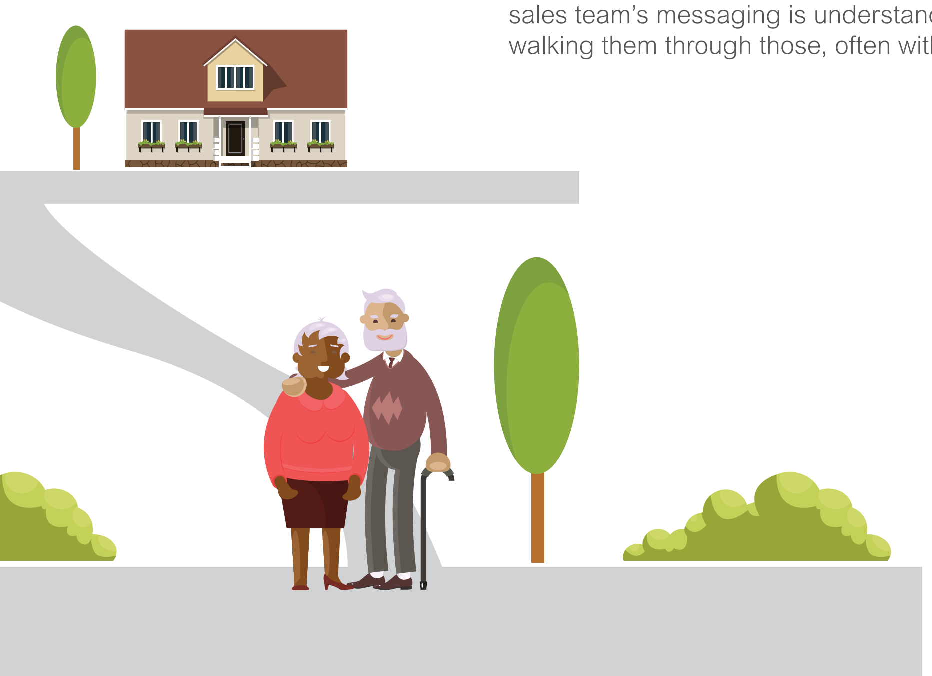
Additional challenges in evolving the current market in this country include:

Clarifying the offer

There are a number of different service delivery models and descriptions for them around housing for older people - retirement housing, retirement housing with care, sheltered, extracare to name just a few. Defining what retirement for rent means is essential. It is very difficult to sell something you cannot describe simply. This links to a wider discussion we know will form part of ARCO's policy agenda going forward about providing a simple definition for their members' offer. Retirement for rent seems capable of forming part of that definition or at least overlapping with it.

Educating the market

This flows from the above point in that understanding of the retirement sector is limited given its low market penetration among housing options for older people. Aligned to this, there is probably a lack of understanding of the rented market offer among the demographic target groups for this product in particular. The sales pitch may differ by comparison to the wider build to rent market, with operators potentially targeting those who currently own a home and don't necessarily need to rent, with the offer presenting it as an "excellent alternative" based around simplicity, low barriers to entry and no capital outlay, as noted above. One participant noted that a key part of their sales team's messaging is understanding what people's concerns are likely to be and walking them through those, often with the result that the concerns dissipate.



Limits on forms of tenure which can be offered

Operators need to be in a position to provide flexible and wide ranging tenure options, adapting to individual consumers rather more so than just groups within a certain demographic. The tenure options available in England and Wales are relatively limited.

Clarifying the target market

A key question is whether this is age based or needs based. Arguably, residents are more likely to want to be surrounded by those who are as able/healthy/sociable as them as opposed to those the same age. In a sector where lifestyle, the avoidance of social isolation and wellbeing are buzzwords the maintenance of "community spirit" is likely to be essential to keeping residents happy and so to retaining them, bearing in mind the low barriers to entry in retirement for rent also create low barriers for exit.

The care pathway offer

Will operators include care homes within their offer to enable the proposition of a simple transition from independent retirement living to a care home? The market seems divided on the point though it was noted that this could for example attract couples where one needs or is more likely to need in future a care home setting allowing them to remain in the same location.

Delivery cost

We see in for sale models in other jurisdictions and increasingly here business models reliant on event fee income to offset the significant cost of delivering and maintaining the essential and substantial communal facilities offer availably in typical new build retirement villages. A different solution is needed for funding a rented offer.

Not an exclusively urban solution

It was noted as part of the discussion on delivery costs that the model might be more urban and as such provide access to some amenities locally which might not then need to be provided as part of the development-specific offer. However, location is of course a key part of the offer.

The model should not be limited to urban settings - where people choose to live is a personal preference that the market should seek to meet. Operators will need to meet locational demands from customers which may result in a mix of rural locations, as opposed to the predominantly urban/sub-urban development already in operation.

Rural developments will influence what other amenities are available locally and consequently what should be offered alongside the units, which could mean rural retirement villages needing to provide a greater range of amenities such as shops, a gym or restaurants on-site rather than relying on the local area to provide these services. While many for-sale villages developed in recent times do this, a retirement for rent product is financed differently and would need to be developed on a different business model.

The ability to locate build-to-rent developments in rural or semi-rural areas has potential to spark a heightened interest in the rented model. Most rural areas are only catered for by residential care homes, leaving very few options for those not looking to move further afield. The opportunity arises to capitalise on a demographic very much in need of alternative solutions to more independent retirement living.

> “Retirement PRS is an attractive alternative to the sales model and once there is more certainty in respect of security of tenure, it should gather pace.”
>
> —— Samantha Rowland, Director, Savills

Roundtable

List of participants

Savills	Stuart Garnett - Director (Chair)
Aviva Investors	Andrew Appleyard - Head of Specialist Real Estate Funds
Towers & Hamlins	Andy Barnard - Partner
Auriens	Sarah Bradley - Sales Director
LaSalle Investment Management	Louise Evans - Associate Director
Richmond Villages	Philippa Fieldhouse - Managing Director
Towers & Hamlins	Kyle Holling - Partner
Greystar	James Pargeter - Projects Director
ARCO	Shandi Petersen - Head of Operations
Savills	Samantha Rowland - Director
Birchgrove	Matt Steere – Operations Manager
Savills	Victoria Wallace - Associate Director


Andrew Barnard

The wider financial offer – an actuarial model?

Annuities are a concept carrying some negative connotations in the UK, with take-up considerably reduced following Government's introduction of alternative flexibilities on the management of pension income in recent years.

A key issue identified in discussions around a rented sector product is providing some kind of safety net which answers the "what if I run out of money" question many expect consumers will ask when considering a rented retirement option. This might be a question asked by an individual but often couples will be concerned about the consequences on pension income and consequently on affordability of one outliving the other.

At present no such safety net exists but participants agreed that it should be possible for this to develop. Insurance-based solutions could be offered by the insurance industry, or a bespoke form of retirement for rent annuity might be possible where instead of traditional rented structure capital is exchanged for guarantees around a home for life offer. Participants noted that rents are typically higher than the market average because of the range of services and amenities on offer and that as such the evolution of these kinds of products will only help. It was also noted that products which offer a degree of investment return to an occupier, or their estate, are likely to be seen as more attractive.

While such novel approaches are evolving, participants noted a need to be practical and work with the tools available. For operators this is likely to include running financial checks on potential tenants. While such checks don't necessarily exist in the mainstream build to rent market, retirement for rent differs materially by the home for life nature of the offer operators will seek to make to attract customers. A delicate balance will be needed to avoid possible entrants viewing such checks negatively. One participant noted that they referred all potential customers to an independent financial adviser so that both the customer and the operator have some certainty on affordability in the longer term.

The US solution of renting a family home to fund the rental in a retirement setting may work for some, as it would allow entry to a possibly more beneficial setting for older people and retain many of the low barriers to entry which help sell this sector.

Another option might be to adapt the model utilised in the student rental sector where guarantees are not uncommon – could working age family members provide some underwriting of the income risk to operators, and the consequent security of a home for life risk to customers.

Structuring the offer: what's in the rent?

The group considered what should make up a retirement rent – what would be core and what would fall outside of the rent to be funded on an "as used" basis.

The initial answer is that this should be flexible, based on the anticipated preferences of customers and capable of adapting to meet market demand. However, several of our participants are actively working on retirement for rent solutions and each had developed their own approaches to the offer. For example, some offered a rent inclusive of council tax, while others did not. There were different approaches to the amount of support (which could range from anything between housekeeping and domiciliary care) included in the offer, and different approaches to the fixing and indexing of rent were taken. Operators will offer a range of add-on services for tenants to choose from in order to create a more bespoke package and acknowledged that they should have the ability periodically to review and alter the scope of services being purchased.

As noted already the approach to deposits may differ compared to the mainstream build to rent market. Another key part of the financial offer is any joining fee payable by residents on entry. Some operators are considering or intend to make provision for these to meet the costs of financial and healthcare assessments and also to cover unit refurbishment costs. As the sector grows the approach to these may evolve with it. From a regulatory perspective there are some overlaps with charging structures in the care home sector, something the CMA has taken a close look at recently which operators in this sector may wish to consider being aligned to where applicable.

"

The level of investor interest in the retirement sector remains high, which is hardly surprising given the demographics - both age and wealth - that underpin current and future demand. Retirement for rent forms part of the solution and it's important for the sector to recognise, debate and overcome the potential barriers to such a market becoming mainstream, some of which affect the whole sector while others are specific to rented products."

—— Kyle Holling, Partner, Trowers & Hamlins

Concluding thoughts from Trowers & Hamlins and Savills

Tenure forms a key part of the "saleability" of retirement for rent as a product. It will take time for the sector to communicate its messages to the markets it is targeting. This is very much in keeping with the wider retirement market which is in its infancy and must communicate what it is, who it serves, and the advantages it brings.

In the same way as build to rent products meet the demands of market segments across other age demographics there will be scope for products either aimed at older people specifically, or catering for a range of ages but able to offer a more bespoke tenure, financial and support package to older people.

Existing short-term occupation structures are based on tenancies - a licence is not compatible with security of tenure which a retirement product should offer via a person having their own front door. Assured shorthold tenancies (even using fixed initial terms) potentially lack the level of security customers are looking for. Lifetime (assured) tenancies come with succession rights which could lead to unexpected consequences and so may create the wrong balance between operator control and customer certainty. It should also be noted that the stamp duty land tax regime is not entirely inapplicable to tenancies, particularly those which run for longer periods and/or at higher rents. As such the existing legal structures, while workable, carry some downsides.

In one sense, the longer term view would be to remove the importance of tenure altogether by adopting structures which are consumer rights focussed and give the customer the security of knowing that as long as they pay what they have agreed to and comply with the rules of a village around respect for property and other residents and staff, they will have a home for life. Exceptions to this should be extremely limited, though operators would need to have the ability to move a person on if their needs became such that it was unsafe for them or for others for that person to remain in a specific retirement setting. A form of tenure of this kind could be "wrapped" around the person, coming to an end when they died, or chose to leave. This should dovetail with existing consumer rights and equality law.

Similarly, a financial offer could be wrapped around the person. Each person coming to a retirement setting will have a different mix of available capital and regular pension or other income to spend. These ought to be able to be fed into a model which generates a suitable outcome for that person. A wholly rented offer might be the right one, as may a part-rented part-capital offer. Modelled correctly, the transactional outcome for the operator should be able to work within a wide range of flexibilities. Alternatively, operators may choose to offer specific capital or revenue-based facilities in different (or indeed in similar) locations so as to match customers and their financial positions to products.

At present there is no perfect form of tenure to apply to these principles – in a rented or a for-sale setting. The market will continue to work with what it has available to it, and will no doubt do so very well. However, perhaps the longer term approach, which would be linked to the wider sector specific regulation we believe is coming to this sector and will be a key part of its evolution, is to is to move to something akin to the New Zealand Occupation Right Agreement model which comes with a wrapper of consumer protections but seeks to create (very effectively, based on the size of that market in per-capita terms) the right balance between consumers and operators.

Further information

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