ISSUE ONE

thinking Real Estate

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Trowers & Hamlins is an international law firm helping businesses and governments change the way we live and work for the better by providing commercial advice geared towards tackling tomorrow's challenges in industry.

Fascinated by the future of our towns and cities, the firm delivers valuable opinion, beyond just interpreting the law, by balancing the needs of commerce, culture and communities in the built environment.

With a genuine edge in inward investment and a growing reputation in the private sector, Trowers & Hamlins provides a bridge between the public and private sectors, and is the firm best equipped to connect business and the wider infrastructure of society to ultimately create more sustainable communities.

Extensive experience in municipality has driven behaviours that set the firm apart from other private practices with a team of open-minded, unstuffy and refreshingly collaborative people.

Also refreshingly different is our approach to sharing our experience and insight. That's why we've commissioned "thinking..." – this first issue focuses on the real estate sector. We hope you find it interesting as well as useful; we'd love to find out.

OCTOBER 2015

LAND OF OPPORTUNITY

If developers and investors are to make the most of the continuing growth in demand for UK residential property and meet the country's growing housing crisis, then creativity and collaboration is what's needed, according to market analysis by Trowers & Hamlins.

It's no secret that as UK population growth has accelerated over the last decade, housebuilding has not kept up in volume terms, never mind adapted to the changing needs of the country's ageing population or the requirement to adapt UK cities to underpin economic growth. But, despite the complex challenges facing the sector, the opportunities in the UK are out there for investors who are prepared to tackle the challenges head on, say partners at the firm.

"Ultimately, people have to have somewhere to live,"

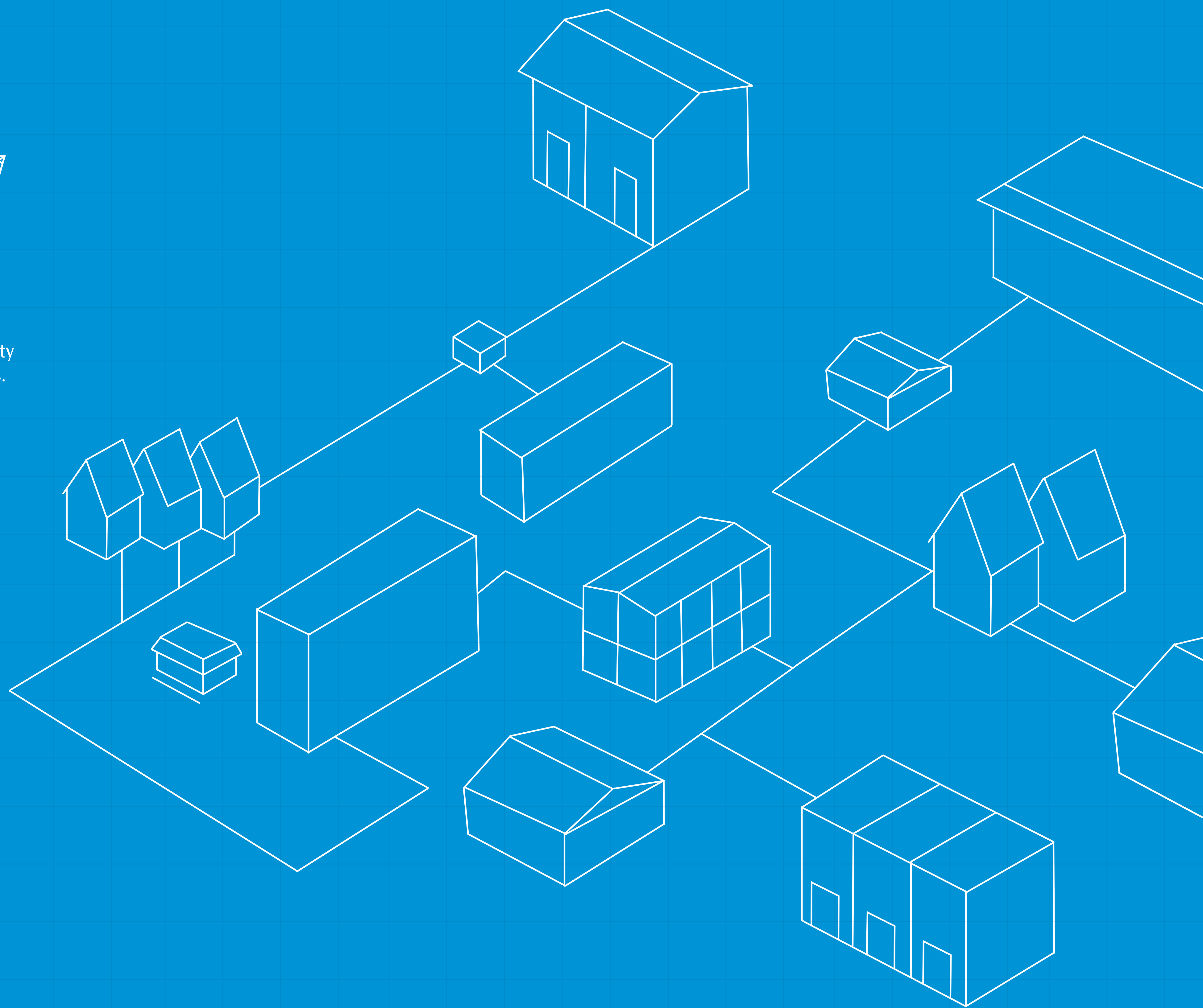
says Rebecca Wardle, residential development partner, "and the market is going to have to find solutions. At the moment, the money is out there but other factors such as land availability, planning, and a desperate skills shortage mean there just aren't enough schemes coming on site at the rate they need to."

Creative ideas from developers are only part of the puzzle, according to the firm's analysis. Government policy not only needs to create the right business climate, but must take proper account of planning, environmental and community considerations which might prevent, delay or discourage development.

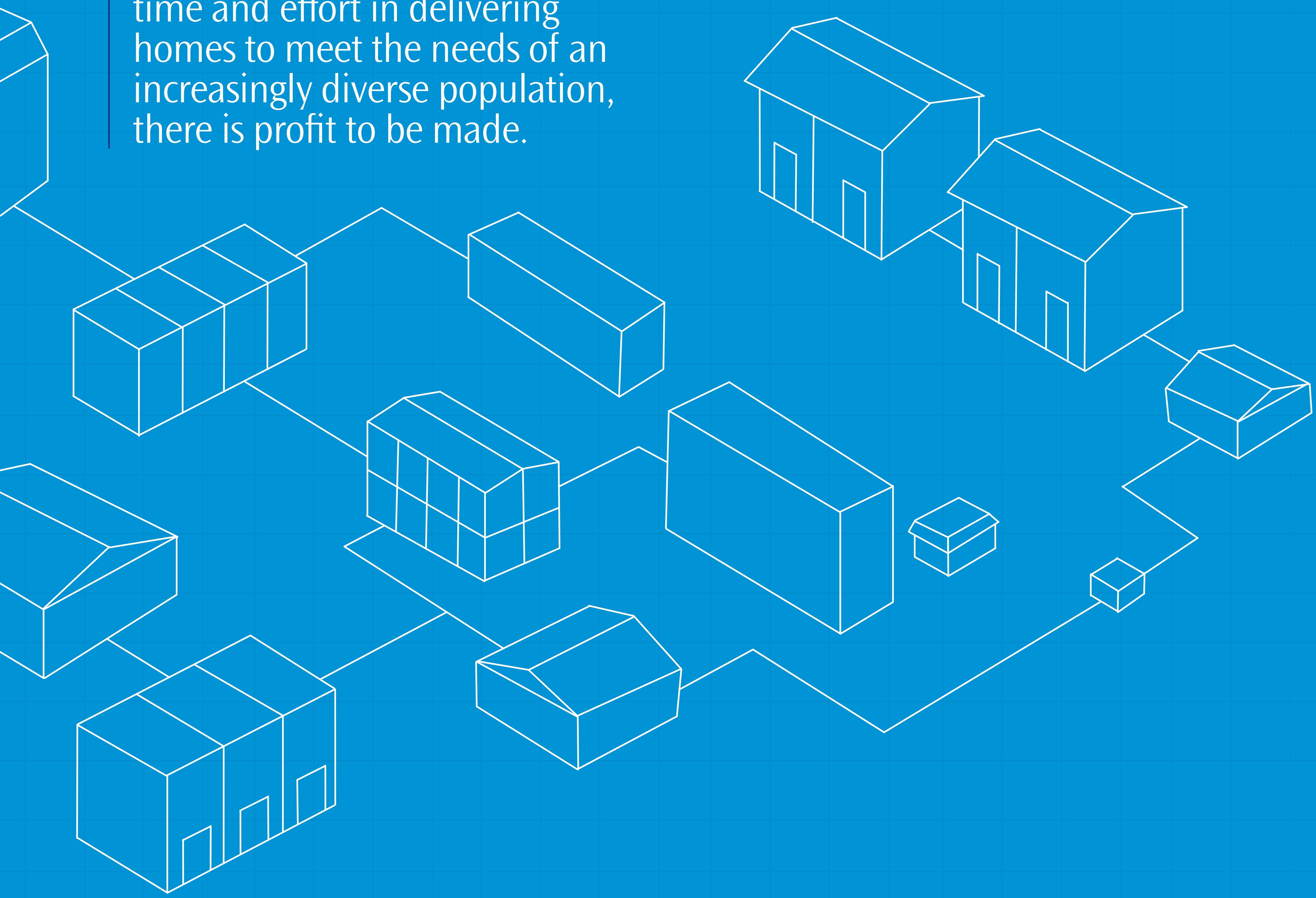
The current crusade to 'get homes built' has focused on building to buy, rather than building to rent, despite many commentators trumpeting the growth of the Private Rented Sector (PRS). "Whilst culturally the UK is a country of homeowners, and the government's focus is undoubtedly on home ownership, the numbers just don't add up in all parts of the country. I think there is still room for professionally managed built-to-rent homes," says Andy Barnard, partner and housing specialist.

Traditional housebuilders and developers have tended to steer clear of PRS in favour of a more immediate return from selling homes, but Wardle thinks they should take heart from the success of the student accommodation sector, which has attracted significant amounts of capital since the late 1990s, with £3.1bn of investment in the first quarter of 2015 alone.

Student accommodation largely defied the 2008 market crash, and has shown a consistent rise in investment, development demand and yields since, but as Wardle points out, concerns over visas for foreign students and changes aimed at making the student market more competitive could create volatility for investors, causing them to start to look for new places to put their money, particularly in London, where there have been so many projects. An established build-to-rent sector would bring new money in for housing delivery, as well as meeting a demand and creating a better product and better choice for the market.



One size does not fit all, whether looking at homes for sale or rent, and for those who invest time and effort in delivering homes to meet the needs of an increasingly diverse population, there is profit to be made.



“Indeed, the market is already showing an inward flow of significant investment to fund the purchase of development sites and the construction of quality homes for build-to-rent. A number of large-scale PRS schemes will be completed within the next two years. 2016 and 2017 will be defining years for PRS,” adds Andy Barnard.

There are also opportunities between housing associations and hospital trusts, given the government’s wish to encourage the hard-pressed health sector to get more out of its real estate assets. “There are interesting questions around how these public authorities – and NGOs – interact to keep up with budget cuts,” points out Kyle Holling, partner and co-head of health and social care at the firm. “The NHS, along with other public bodies with land assets, need to consider the best use of those assets – is it a quick sale to generate short-term funds or something more strategic which fits their wider objectives?” Key worker accommodation is likely to become a political priority, especially in the South East of England, and has to be on the radar of the canny investor.

Another area where developers could tap into rising demand is in the senior living sector, which in the UK is inextricably linked with Care – a largely underfunded sector with a poor reputation, albeit one that is set to quadruple in size over the next 25 years.

“In stark contrast to the US, Australia and New Zealand, people in the UK associate senior living with a loss of control and with end-of-life care,” says Holling. “So many older people are struggling to maintain houses which are simply impractical for them, effectively locking up their assets.

Meanwhile, there are too few developers building lifestyle-based aspirational schemes and there is a (slowly improving) hesitancy among institutional funders to invest in an unproven sector, so it’s a bit ‘chicken-and-egg’.

“But when you consider that the number of people aged 65 in the UK is forecast to grow from the current 10 million to 17 million by 2040, developers prepared to be a little bolder and more creative will unlock pent-up demand that is only going to grow,” he adds.

The affordable housing sector is under considerable pressure from the government’s decision to allow tenants to buy their properties at a discount in an extension of the ‘Right To Buy’ policy, the four-year rent reduction, as well as the recent announcement that the affordable housing planning commitment will be extended to allow developers to deliver Starter Homes, instead of traditional affordable housing.

“This highlights a need for housing associations to explore new sources of funding as well as joint ventures with private sector developers in order to meet housing need,” says Suzanne Benson, partner in the firm’s Manchester office.

One size does not fit all, whether looking at homes for sale or rent, and for those who invest time and effort in delivering homes to meet the needs of an increasingly diverse population, there is profit to be made.

“The sector is becoming very fluid,” says Benson. “As with much of the economy, we’re seeing unprecedented changes, and so the old ways of doing things just don’t apply any longer. Developers relying on tried-and-trusted techniques may find their ideas no longer appeal to local authorities, or might be outflanked by other stakeholders with a more creative approach.”

THE COLD, HARD REALITY OF PLACEMAKING

Placemaking may be the buzzword of the moment – giving ‘destination retail’ and ‘urban grain’ a run for their money – but the complexity of putting together large mixed schemes is understandably concerning for investors in the UK’s increasingly fluid real estate market.

“Lawyers are often seen as a necessary evil,” says Adrian Leavey, real estate partner at Trowers & Hamlins, “and bluntly, we are. But it’s important that we don’t get in the way of the deal. There are enough complications there already without lawyers saying something ‘can’t be done’ or ‘this regulation says…’.”

“Every real estate asset needs to deliver for investors,” he adds, “but getting the best returns out of the UK market these days requires more than just chucking a heap of cash at an attractive investment and waiting for the money to roll in.”

The idea of placemaking – a term first coined in the 1960s – has gained new impetus of late in UK real estate as online retailing has hammered traditional High Street shopping and the dull, functional shopping centres constructed in the 1970s and 1980s.

Recently, some developers have turned to prestige architects to design attractive landmark buildings in an attempt to create an instant sense of ‘place’, but this has been met with scepticism among many market observers, such as James S Russell, US architecture critic and author of ‘The Agile City’, who calls it a “rhetorical gimmick”.

> **“Great architecture is very important but it isn’t enough on its own,”**

agrees Sara Bailey, Trowers & Hamlins’ head of residential real estate. “Placemaking is not just about assets, it’s about people, and if you haven’t considered the people aspect you’re not going to get the best long-term returns.”

“Achieving that has become more difficult,” she explains. “Local communities in the UK – who have final say on planning and hold much of the land needed – want more than just retail parks, they want housing, they want infrastructure, they want leisure activities. They want big new developments to be more than just collections of nice buildings.”

Adrian Leavey says that means investors have to think differently in order to engage the people who will be accessing the scheme in question. “For instance, we might suggest a developer puts a cinema into a large mixed-use development as the anchor on a limited rent-free, turnkey deal,” he says. “That creates immediate community engagement, and will onboard five or six quality bars or restaurants because of the guaranteed additional footfall. An investor might be against that initially because they’ll think a cinema can bring good, quick returns, but our experience can reassure them that this kind of front-end loading results in a better long-term play.”

Further consideration might need to be given to ‘no rent now’ deals for start-ups, for instance, which, with a more exciting and innovative approach than larger competitors, can prove to be attractive recruitment destinations, which in turn will attract big companies who will be good long-term tenants for developments with a major office component. The regeneration of South London’s famous Brixton Market was one major scheme where smaller local businesses were offered attractive deals to kickstart the project and better engage the community.

“With that kind of thinking,” adds Sara Bailey, “you’re starting to create a real destination. That’s attractive for local authorities, but they face a huge volume of ever-changing regulation and guidance. We see our role as helping them to see the wood for the trees. We can look at their response to a proposal and let them know how it’s going to land with the bidders, and equally advise bidders they may not get finance with this or that particular scheme.

> **“It’s quite a long way from what people usually think lawyers are for, but these days we see ourselves as facilitators. At Trowers we think we’re more in tune with the way the market is going because of our history and our involvement with so many of the major housing and regeneration projects undertaken in the UK in the last 30 years.**

“There are any number of lawyers out there who can do a big investment or put together a development project, but you need to be asking yourself how many have in-depth knowledge of every aspect of one of these complex placemaking schemes.

“Being able to understand what the local authority will want to focus on ahead of putting in the final proposal could be the difference between getting the go-ahead or being sent back to the drawing board,” adds Bailey.

“It’s often said that ‘cold money don’t care’,” says Adrian Leavey, “and to an extent that’s true. If you can’t get the finance, you can’t build. But depending on your investment priorities, what you want to achieve out of a particular scheme, the new landscape means that the cold money that thinks a bit more carefully at the outset is going to get better returns, certainly in the medium to long-term. And that’s what we’re here for.”

UK INVESTMENT: THE KITCHEN JUST GETS HOTTER...

It's often said "if you can't stand the heat…", but for investors in the UK property market, it's a question of not just being able to stand the temperature, but to read where the heat is coming from and how hot it will be when it gets to you. For those who fail to find the returns they are looking for in London, the UK's regional cities are of increasing interest to both domestic and international investors.

"We're continuing to see UK property perform phenomenally," says Stephen Marks, an investment specialist partner at Trowers & Hamlins, noting record rents of £185 per sq ft in 'safe haven' London recently, "but investors are needing to track an increasing number of variables at extremes we've never seen before."

Marks points not just to UK deal volumes hitting a 20-year high, but active money closing deals on a very different basis to the traditional UK investor. "We're seeing yields in the West End as low as 2.5%," he says, "which a lot of people said could and would never happen. But if you look at investors out of Asia, they're quite happy to deal at that level, and that's making things very interesting for more traditional Western investors who are accustomed to much higher yields."

> **If you add in other new phenomena, such as 'money-boxes-in-the-sky' – foreign investors buying central London flats and just leaving them empty – there are a lot of distorting effects on UK property right now."**

With the focus on devolution and increasing investment in cities such as Manchester and Birmingham, there are opportunities for developers and investors across commercial, residential as well industrial, logistics and infrastructure.

Partner and residential specialist Jeremy Hunt observes that "institutional investment is flowing through into new and varied areas of real estate – for example, we have helped Aviva Investors REaLM Social Housing Fund to invest over £150m into affordable housing over the last few years – showing the strong trend we are seeing of large pension funds looking to different kinds of residential property to diversify their portfolios and provide a good match for investors income requirements."

Rebecca Wardle, one of Trowers & Hamlins' development specialist partners, with a particular focus on residential, explains that the growth of the UK's private rented sector (PRS) – which is now worth five times the country's commercial property estate – is broadening investment choices, but complicating the picture.

"Student accommodation is a good example of an alternative investment which has for some time been considered a safe bet, delivering good yields and a pretty guaranteed income," she says, "but right now, the government is relaxing the rules for residential developers to try to ease the housing crisis, so relatively affluent young people in work who choose to rent are providing investors a very attractive alternative: higher-spec units with better rental yields, often in mixed-use developments with exciting commercial possibilities."

Tim Nye, corporate and private equity specialist, comments that "Investors looking for high yields are increasingly attracted to perceived riskier sectors such as healthcare, including senior living. It used to be a niche sector but increasing competition for the best assets, as well as new entrants into the market, has seen prices steadily rising and overseas investors, particularly US REITS, very active.

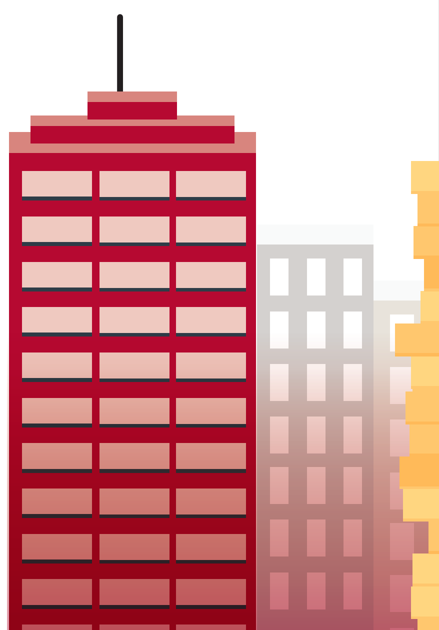
"In London and the South East particularly, there is an increase in self-pay customers seeking luxury properties, where five-star hotel type amenities are available. Investors looking to invest in and build such properties and then enter into long-term operating contracts to outsource the provision of care and support are able to position themselves to take advantage of the ageing population and a shift towards a model of retirement care more like that seen in the US. These long lease type arrangements for investors offer greater certainty against other commercial properties where leases can be shorter," he adds.

Stephen Marks agrees investors need to keep a close eye on what government is doing.

"We've seen a number of government interventions in the UK housing market in recent years," he says, "which in turn has a major impact on local authorities, especially where mixed-use development is concerned. Investors need to keep an eye in every direction at the same time to make sure they're not just getting the best yields, but that they are in investments they can get out of when they need to."

Lawyers need to be equally agile. "Investors want to know what can be done and how it can be done," says Marks. "And that means we need to understand what is possible, what is likely and what is going to work best – and quickly."

> **The landscape is definitely more complex for investors," adds Rebecca Wardle. "In some ways it's never been more important to know how, when and where to deploy your capital to best effect."**



POP-UP LAW? DREAM ON...

Pop-up retail parks, restaurants and even a bar selling bowls of breakfast cereal have proved that using vacant retail spaces or temporary structures to attract consumers is far from a passing phenomenon.

The second annual report into Pop-Up Retail by the Centre for Economic and Business Research estimates pop-ups now employ 26,000 people in the UK and generate revenues of £2.3bn, accounting for 0.76% of the UK retail sector.

Pop-up promises start-ups and larger companies looking to experiment with off-the-wall brand extensions easy, flexible and cheap solutions, and can offer landlords stop-gap revenue or exciting new destinations which attract more permanent tenants.

But legal is the one part of the equation which doesn't 'pop up' quite so easily.

"Tenants naturally expect a high degree of flexibility with pop-ups," says Julien Allen, head of Towers & Hamlins' hotels and leisure group, "but in reality, many of the legal issues are exactly the same regardless of whether the tenant is there for a few weeks or many years."

For the landlord, meanwhile, co-ordinating the varying needs and wishes of multiple tenants of very different business types can quickly become quite complex.

"If you're looking to use pop-up to create retail destinations, rather than just to deal with idle real estate, you'll achieve better returns and greater sustainability if you think about pop-up in strategic terms from the outset," Allen adds.

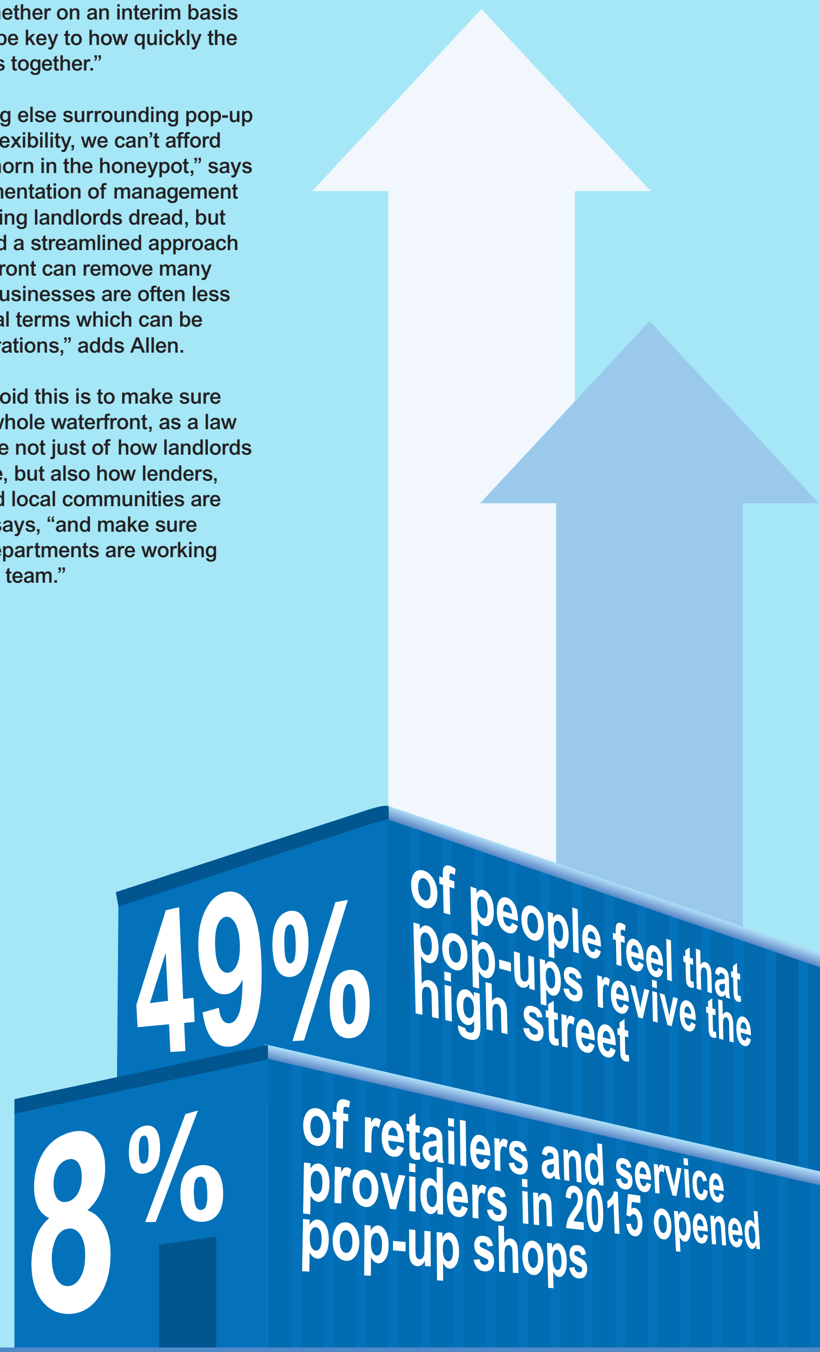
The lease – length, type, conditions – is the obvious place to start, but landlords need to think carefully about how to convert temporary income streams to more permanent ones, and how to achieve the best balance of occupancy while meeting their legal obligations and creating the best possible conditions for satisfactory yields.

"Pop-up represents the most creative thinking in terms of how to achieve best returns from your retail asset," says Allen, "but can present challenges to other stakeholders in a mixed-use development."

"The residential component of mixed-use development will often drive the commercial imperatives of the rest of the scheme," explains Sara Bailey, head of residential real estate. "Residential developers, including social landlords, need to understand how the rest of the scheme will affect their calculations, and so the approach of a commercial landlord keen to use some kind of pop-up solution, whether on an interim basis or longer term, will be key to how quickly the development comes together."

"Because everything else surrounding pop-up is about ease and flexibility, we can't afford for legal to be the thorn in the honeypot," says Julien Allen. "Fragmentation of management is generally something landlords dread, but careful planning and a streamlined approach with legal input up front can remove many concerns. Pop-up businesses are often less concerned with legal terms which can be tailored to short durations," adds Allen.

"The best way to avoid this is to make sure that you cover the whole waterfront, as a law firm, with knowledge not just of how landlords and tenants operate, but also how lenders, local authorities and local communities are going to think," he says, "and make sure that your various departments are working together as a single team."



Source: Britain's Pop-Up Retail Economy 2015 – Blurring the lines between pop-up and traditional retail
A report by the Centre for Economics and Business Research August 2015

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