‘Generation Rent’ – changing the housing landscape

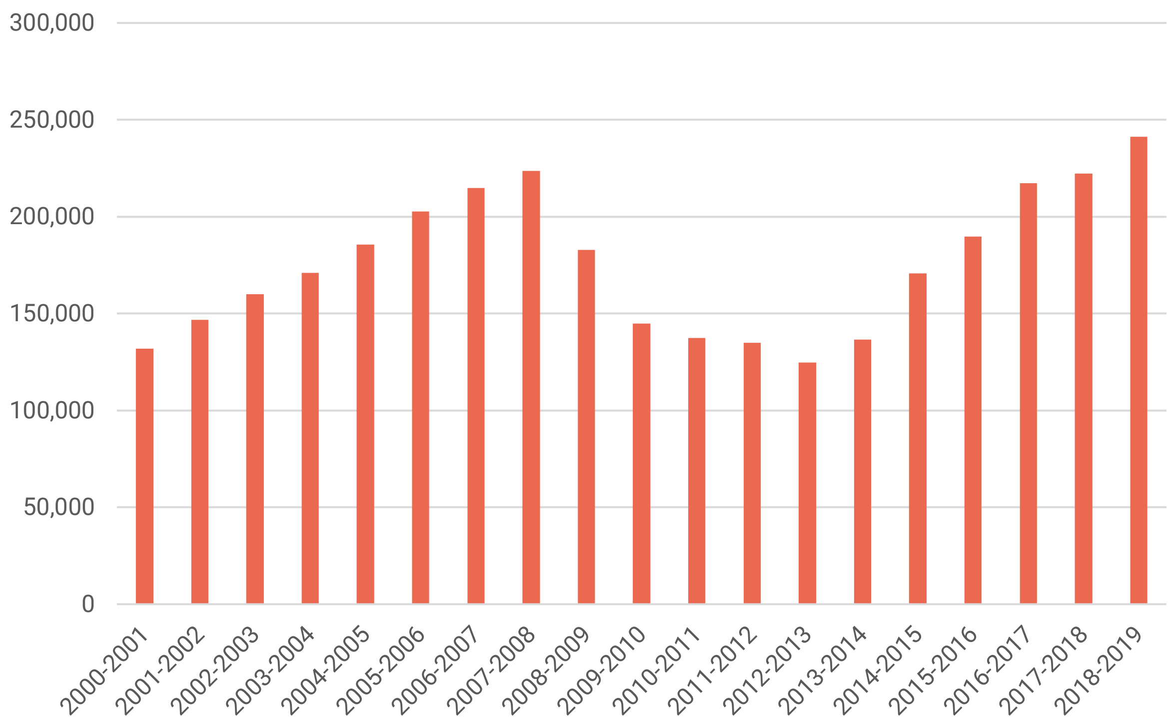
“Quality is never an accident. It is always the result of intelligent effort” – John Ruskin

Home ownership is an aspiration that has stood unchallenged for decades, signalling for many people a marker of success and security. Yet it is a relatively recent phenomenon. In the early 20th century, most of the UK’s population lived in rented accommodation with three-quarters of households classed as private renters in 1918. This number fell to just under a tenth of households by 1991.

The trend has reversed somewhat since the early 2000s. A failure to increase the quantity of housing in order to keep up with rising demand has led to house prices spiralling higher which has pushed the opportunity of owning a home further out of reach for many, particularly younger people.

The UK population is projected to rise from the 66.4 million recorded in 2018, to 70.1 million by 2029 and 72.9 million by 2041, while the size of households continues to shrink. Taken together, the number of UK households battling for a roof over their heads is expected to increase by an average of 180,000 a year up to 2039 (ONS). It is estimated that 300,000 new homes are needed each year in order for supply to meet this growing demand, however the UK has consistently fallen short of the target, resulting in an estimated housing supply gap of around 1.2 million homes.

The number of net additional dwellings 2000-2019 consistently falls short of the 300,000 required per year (2017 Budget)



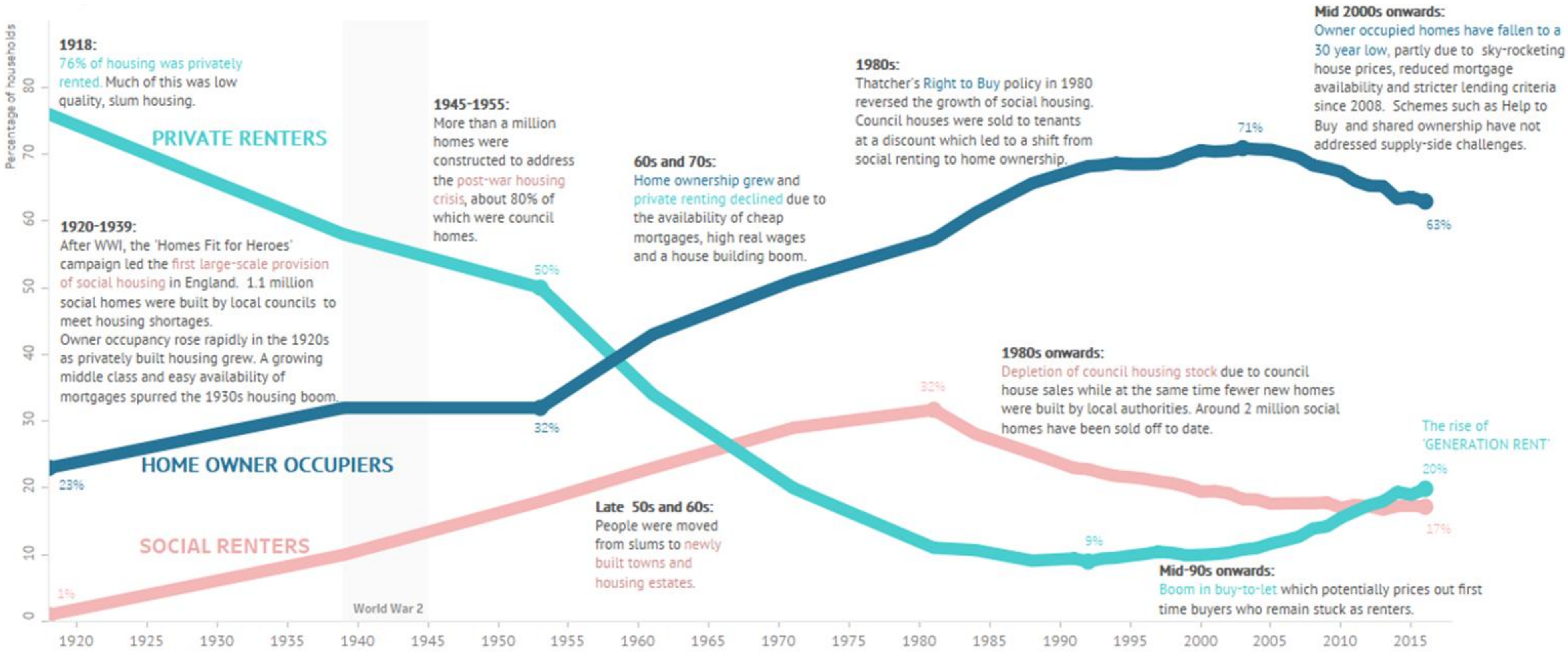
Source: Ministry of Housing, Communities and Local Government; UK House of Commons Library

The shortage of homes and the inaccessibility of home ownership have pushed the proportion of private renters up, with the English Housing Survey finding that the number of people living in the private rented sector has increased by 124% since 2000.

For greater detail please see overleaf.

Gravis

Home ownership versus renting: the past 100 years in England



Source: English Housing Survey

As demand from renters increased, so the investment opportunity for private 'buy-to-let' landlords expanded accordingly, and their influence and ownership increased significantly, controlling swathes of the private rented sector. However, in recent years, tax changes have made the sector less attractive, resulting in over 200,000 buy-to-let landlords abandoning the sector. The percentage of homes being sold to buy-to-let landlords in the first nine months of 2020 fell to 9%, down from 17% recorded in 2015 (Hamptons International).

Pension funds, institutional investors and property companies have stepped in to fill the supply gap left behind. The result is the emergence of the 'Build to Rent' (BTR) model - a growing and exciting sector within the private rental sector that contrasts significantly with the traditional buy-to-let model.

Instead of a single landlord letting and managing a handful of houses and apartments, the BTR sector is backed by property companies and institutional investors that develop, and often manage, large blocks of housing. They benefit from the economies of scale offered by bulk ownership of modern, quality assets and the increasing number of renters in need of somewhere to live, as the supply from buy-to-let landlords dwindles. The tenants themselves have also driven growth by demanding better quality homes. Far from an old Victorian house converted into rooms or flats, these developments are modern, purpose built, and affordable. Often offering gyms, concierge facilities, communal lounges and bike storage areas, apartments in these type of buildings are increasingly in demand from the younger 'Generation Rent' who are mobile, have busy and active lifestyles, and want a home that supports them. These buildings are designed to be 'homes, not houses', offering tenants a community hub, with amenities and high-quality shared facilities, as much as somewhere to live.

The outbreak of Covid-19 and national lockdowns has accelerated the demand for such developments, with more people aware of the advantages of having a comfortable and spacious living area that must double as an office when told to 'stay at home'.

While home ownership remains a goal for many, there are increasing numbers of people making an active choice to rent rather than buy, even if only over the shorter term, and those that are renting expect to live in better quality accommodation. While buying a home is unattainable for some, it is less of a concern for younger people who are not ready to settle down and appreciate the freedom to move for new opportunities around the country. This 'iGen' group, those in their twenties and early thirties, are most likely to be happy renting, with 30% of this demographic responding to a Knight Frank survey stating that they prefer the flexibility offered by renting rather than home ownership.

CLIPPERS QUAY, MANCHESTER

Build to Rent asset owned by Grainger plc

Location: Salford, Manchester

Acquired H12016, completed H12019

Size: 444,178 sq. ft

614 apartments with 178 studio one-bed, 370 two-bed and 66 three-bed

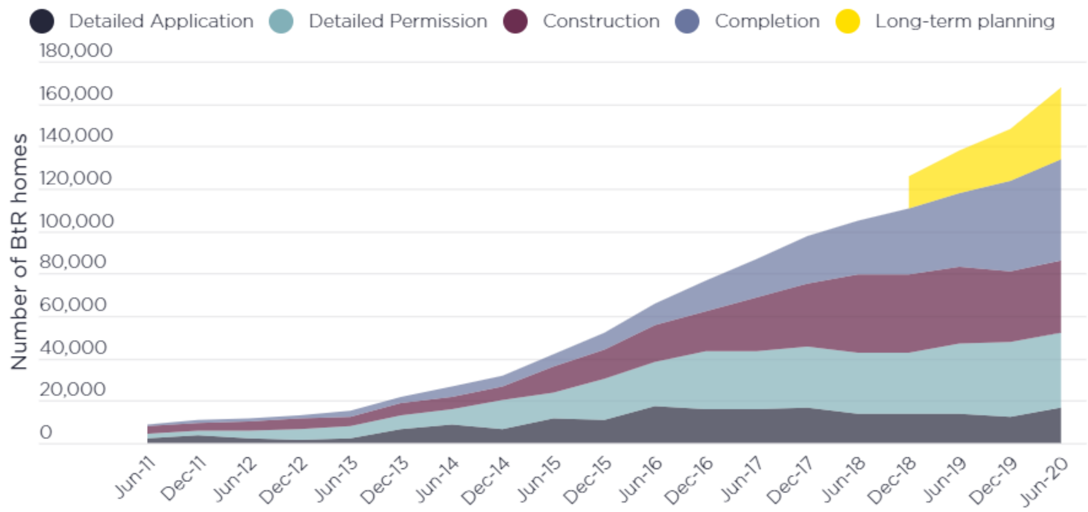
7 retail businesses

Average occupancy: 95%

Facilities

- 24-hour gym
- Free superfast Wi-Fi
- Parcel collection & storage
- Private & public gardens
- Shops and cafes
- 24-hour concierge
- Residents lounge & co-working space
- Secure parking available
- Cinema room
- Private hire dining room
- Bookable handyman

Build to Rent is a specialist product that is still relatively new to the UK, currently accounting for just 1% of all private rented homes, a figure far surpassed in the US and Germany where 45% and 35% of all private homes are classed as BTR respectively (Savills). It has, however, shown consistent growth in recent years. Figures from Savills and the British Property Federation show that the number of complete BTR homes in the UK, as well as those at the application, planning and construction stage, had risen from less than 20,000 in mid-2013, to around 130,000 by mid-2020, with a significant additional amount in the long-term planning stage.



Source: Savills, British Property Federation, Molior

Purpose built student accommodation ("PBSA") is another growing opportunity within the private rented accommodation sector. As with BTR, the new generation of student 'digs' are large, high-quality, modern, blocks with high-speed internet and an element of communal space such as gyms and lounges. Often, access to support staff offering pastoral care in the form of career guidance and mental health support is provided. Purpose built, and licensed specifically for student tenants, rather than converted homes, these blocks are now a staple of the student accommodation market offering high-quality accommodation. The trend towards better quality accommodation is one that has been underway for many years, in line with the introduction of tuition fees and the growing number of international and postgraduate students, all of whom recognise they are paying customers and should be treated accordingly. The Covid-19 pandemic has helped accelerate this trend as students, and their parents, are likely to seek accommodation, for example, with private ensuite bathroom facilities and the space to self-isolate comfortably if a similar situation occurs again.

The pandemic has of course impacted student accommodation numbers this year, with providers such as Unite Group and GCP Student Living, two of the REITs in which the VT Gravis UK Listed Property (PAIF) Fund ("GULP") is invested, reporting lower booking levels for the current academic year. GCP Student Living recently reported occupancy levels at 69% versus full occupancy pre-pandemic and Unite Group reported 88% booking levels versus 98% in the prior academic year. However, this bears all the hallmarks of a temporary setback, with student numbers expected to rebound once the current crisis abates, and with exposure solely to top tier universities, the likes of Unite and GCP Student are likely to recover lost ground. Unite's own research has found 93% of first year students intend to continue their university courses, despite the turbulent experience they may have had during their first autumn term. In the UK, the structural trend of continued growth in student numbers, both domestic and international, seems set to continue, and with it we expect the trend towards higher quality accommodation to persist.

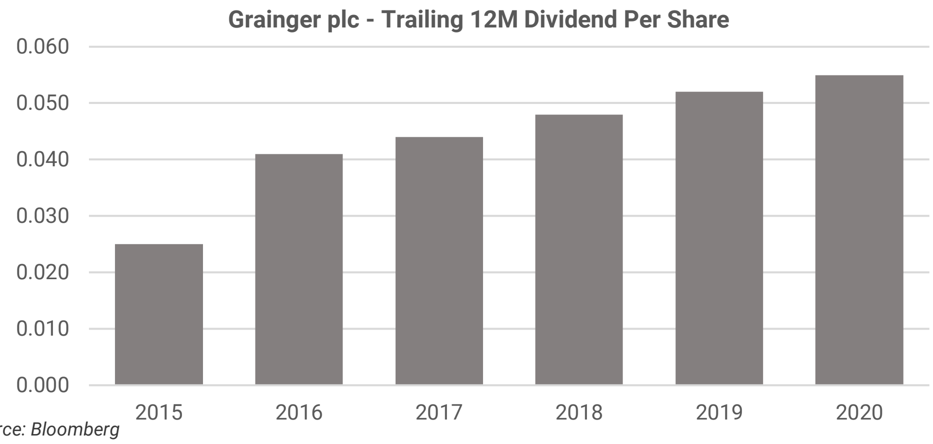
For real estate investors stock selection is key when looking for exposure to the BTR and PBSA sectors. The most successful real estate companies within these sub-sectors, such as Grainger, Unite Group and GCP Student Living, own assets in big, bustling cities. Grainger develops assets in large towns and cities benefiting from the factors discussed in last week's chapter on urbanisation, while

Unite and GCP Student own PBSA in cities home to top tier, predominantly Russell Group, universities, where demand will always exceed supply. Local demographics are hugely important to ensure demand exceeds supply for these assets, providing strong, stable rent collection.

Importantly, Unite and Grainger both own and operate their assets. They have the scale and branding that will ultimately benefit end investors. As owner-operators both companies have invested significant capital developing online operating platforms with the dual aim of enhancing customer service and increasing operating efficiency. These digital platforms ease the process of turning prospective customers into rent paying tenants. Integrated with proprietary revenue management models they provide each company with the capability to optimise occupancy levels to maximise rental income. These bespoke platforms also facilitate high levels of customer service with tenants able to report maintenance issues and schedule repairs online and in real-time.

Despite the uncertainty caused by the pandemic, equity markets have been very supportive of specialist REITs, in both the BTR and PBSA sectors, in 2020. Unite was able to raise £300m via a share placing with the proceeds funding the development of three new schemes and enabling new partnership opportunities with universities. Grainger issued £185m of new equity to accelerate its next phase of growth and to bring forward its investment pipeline.

It has been a difficult year for income investors and that looks set to continue for some time to come, whereas the specialist REITs sector managed far better. Unite chose to cancel its final dividend for 2019 in the wake of Covid-19 uncertainty, however, as potential vaccines herald increasing in person tuition, it is fair to assume that the REIT will look to reinstate dividends. GCP Student Living, on the other hand, did not cut its dividend entirely but reduced the amount and outlined hopes to increase the payout in coming months. Grainger, with its increasing exposure to the BTR sector, has proven particularly resilient. It announced a 5% increase in its total dividend at its annual results this year following “strong rental growth and solid overall performance”.



Source: Bloomberg

The growing UK population and move to renting, coupled with the continued housing shortage, all contribute to this key megatrend, ‘generation rent’. The **VT Gravis UK Listed Property (PAIF) Fund** benefits from this trend which offers a strong and enduring source of alternative income in the REIT space. With increasing underlying demand from a growing number of tenants in the private rented sector, investment in the space offers the chance to tap into lucrative potential returns, whilst supporting efforts to provide modern, high-quality, affordable, and sorely needed housing solutions across the UK.

Matthew Norris, CFA
Director of Real Estate Securities
Fund Adviser, VT Gravis UK Listed Property (PAIF) Fund
25th November 2020