

OCTOBER 2013

NEW APPROACHES

TO MARKET RENTED HOUSING

Supporting organisations to pioneer
new ways of working and review
current and emerging practice

WHY NOW?
WHAT ARE
OTHERS DOING?
GETTING IT RIGHT



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Introduction

Louise Leaver, Head of Social Housing Finance, Winckworth Sherwood

Market rent is seen by many as a solution to the growing problem of the lack of decent housing within the reach of average income households who are not eligible for social or affordable housing, but whose incomes make the prospect of homeownership remote. Market rent is viewed as an expanding, but as yet an undeveloped, sector in the UK. It is generating much discussion and interest with institutional investors, government and across the whole housing sector. The Resolution Foundation has suggested nearly four in 10 households will be living in market rented housing by 2025.

Among the advantages to social landlords of having a portfolio of properties let at a market rent is the ability to re-invest any return into their social housing activities. In the present economic climate, a commercial portfolio can provide more certainty in the timing and value of future cash flows than open market sales. Social landlords are experienced in large scale property management and have the infrastructure and personnel to manage large numbers of properties, unlike other interested players in the new world of market rent, such as institutional investors and house builders.

However it would be foolhardy to see market rent as a panacea for social landlords. It is important to have a clear understanding of the market and the risks involved. Market rented housing is a more volatile and less stable sector than social housing. The management issues will be different and specific to private renters, and you will need specialist staff experienced in the market rented sector.

This briefing will guide you through the world of market rent and hopefully provide you with an understanding of what you need to consider before entering the sector. It examines the wider policy influences on social landlords and the specific outcomes that can be achieved by them in the market rented sector. It focuses on specific examples and case studies by organisations that are either managing properties for existing private landlords or establishing a market rented portfolio of their own, by either development or acquisition. Finally it sets out the key considerations and questions that must be examined and considered before deciding whether market rent is for your organisation and if so, what approach to take.

Winckworth Sherwood is delighted to sponsor and contribute to this report, which forms part of CIH's programme to support and advise organisations in new methods of working, and how to adapt working practices and adopt new approaches in a changing economic climate. Specifically, this document examines the opportunities which market rent can offer to your organisation and also the challenges you will be confronted with. We hope it will assist you in deciding whether market rent could be an option for you to consider.

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Acknowledgements

Richard Donnell, Hometrack, provided expert advice on the content of this briefing.



Steve Stride, Vice President, CIH

This is the first in a new series of CIH briefings that aim to support organisations to pioneer new ways of working, to review current and emerging practice and to support those who might be thinking of adopting new approaches.

CIH has always played an important role in driving change in the housing industry, by identifying innovative ways of working and by challenging organisations to think differently. However, this is especially pertinent at a time when the whole industry is facing huge challenges and we are all being asked to do more with less to help solve the country's housing crisis.

This briefing looks at the potential opportunities and challenges involved in letting homes at a market rent, an area of work which is gaining greater prominence in the wake of the Montague report and with the establishment of the government's build to rent fund. It aims to help those who are considering providing accommodation at market rents for the first time, or those who have already had some involvement but are now thinking of extending or revising their approach, to do it more effectively.

Over the coming months CIH will be producing more briefings like this, focusing on other areas of emerging practice. Look out for details on www.cih.org in due course.

About CIH

The Chartered Institute of Housing (CIH) is the independent voice for housing and the home of professional standards. Our goal is simple – to provide housing professionals with the advice, support and knowledge they need to be brilliant.

CIH is a registered charity and not-for-profit organisation. This means that the money we make is put back into the organisation and funds the activities we carry out to support the housing industry. We have a diverse and growing membership of more than 22,000 people who work in both the public and private sectors, in 20 countries on five continents across the world.

Find out more at: www.cih.org

What is this all about?

This briefing looks at the potential opportunities and challenges involved in letting homes at a market rent.

It looks at the options for both:

- managing properties on behalf of existing private landlords, for example by establishing either a social lettings agency or a private sector leasing scheme
- establishing a portfolio of properties for let at market rents by purchasing and/or developing properties for this purpose, either alone or in partnership with an institutional investor.

It is divided into three main sections:

- the first asks “why should you be thinking about this now?” It looks at both the wider policy influences and the specific objectives that you might achieve by letting homes in this way
- the second asks “what are others doing?” It includes a number of case studies showcasing the work of other organisations
- the third asks “how do you make sure you get it right?” It sets out the things that you really need to consider before you can begin moving into providing homes for let at market rents.

It is intended primarily for organisations who are considering providing accommodation at market rents for the first time, or those who have already had some involvement but are now thinking of extending or revising their approach. However it may also be of interest to individuals working in local authority housing strategy or planning departments, who may need to work in partnership with organisations that are pursuing this area of work.

How have we developed this briefing?

We consulted existing literature and hosted a range of discussions at our Housing 2013 conference and at other CIH events. We also conducted a series of interviews with organisations that have already expanded their areas of activity to include either purchasing, developing or managing homes for market rent. We asked them about their motivations, their current and planned activities and the lessons that they have learnt so far.

The organisations that we spoke to were chosen to include a mix of local authorities and housing associations and of organisations operating in different parts of the country. They are organisations whose work in this area has a high profile - most have been featured in the trade press and some have won awards for their work on market rent. They are:

- A2 Dominion
- Cadwyn Housing Association
- Derwent Living
- Exeter City Council
- Genesis Housing Association
- Gentoo
- London Borough of Havering
- London & Quadrant
- Notting Hill Housing Group
- Sovereign Housing Association
- Thames Valley Housing Association/Fizzy Living
- Worcester Citizens Advice Bureau/Worcester Housing and Benefits Advice Centre



Why should you be thinking about this now?

Why now? The broader policy influences

This is not an entirely new area of work. Some organisations have already been running social lettings agencies/private sector leasing schemes, or have held small portfolios of market rented accommodation, for many years. However we are now seeing a rapid and substantial increase in both the number of organisations who are interested in this area of work and in the scale of their ambitions. There are a number of factors driving this change, including:

The growing importance of market rent in the housing market

A combination of high house prices and tighter constraints on mortgage lending, coupled with a shortage of social housing, has led to a rapid increase in the number of households living in market rented accommodation. Figures published in the [UK Housing Review 2013](#) show that this now accounts for 18 per cent of the population of England, the same proportion as live in social housing. Projections, produced by organisations such as [Savills](#), suggest that this will continue to increase in the future. However there are also a number of widely held concerns about the way some parts of the traditional private rented sector currently operate, leading many organisations that have historically focused on affordable housing to think about the contribution that they can make to meeting the needs of this group.

Reductions in public spending on affordable housing

As part of its policy of reducing public spending across most areas, the government has significantly reduced the funding that is available to support the development of new affordable housing. Instead there is a clear expectation that government grant must be supplemented with a combination of increased borrowing and income from other sources. As a result many organisations are now looking at different ways of generating a surplus, to reinvest in building affordable homes.

The need to increase the overall supply of housing

Detailed information about levels of housing need and current rates of house building are available in our [UK Housing Review 2013](#). However in summary, estimates suggest that, across all

tenures, around 240,000 – 250,000 new properties are needed each year. Current rates of house building are still some way short of this, with just 115,000 new homes being completed in England in 2011. To address this some organisations are seeking to explore more ways of funding development that are not dependent on government grant, and supporting this is a key aim of government policy in this area. For example via the 'build to rent' fund the government will provide £1bn of loans to support the development of new homes specifically for market rent. In the first instance the scheme is intended to deliver up to 10,000 new homes, however its longer term goal is to kickstart a new market which could ultimately be self-sustaining - with more development of this type being supported by institutional investors on a commercial basis, rather than by government grant.

The development of a more diverse social housing sector

Since the last general election the social housing sector has experienced a period of rapid policy change, with fixed term tenancies and affordable rent being introduced, regulation being significantly reformed and self-financing for local authority landlords taking effect. Coupled with the constraints on government spending, the changes are leading many organisations to consider some fundamental questions about who they house and what their social purpose is. Not all organisations will come up with the same answers to these questions, but some are now seeking to operate more commercially and to expand their involvement in profit-making activities such as market rent, while still retaining a social purpose. This is considered in more detail in the recent Smith Institute report [Social hearted, commercially minded: A report on tomorrow's housing associations](#).



For what purpose? Possible outcomes

There are both incentives and drivers for providers to diversify into market rented housing. It is important to understand why you might want to get involved and what outcomes you are trying to achieve. Broadly, organisations who are already involved in the provision of homes for market rent state that some of the outcomes that they are aiming to achieve include:

- generating revenue that can be reinvested in social activities
- improving access to market rented accommodation among groups who are sometimes unable to access the traditional private rented sector
- making an improved offer to traditional private renters, such as 'young professionals'
- providing a viable, long term alternative to homeownership for families.

These outcomes are not necessarily mutually exclusive and it may well be possible to achieve more than one of them. However some degree of 'trade-off' between objectives is inevitable, so it is vital to have a clear idea of the priorities for your organisation before you start. Understanding exactly what you are hoping to achieve and what success would look like is an essential first step to moving in to market rent.

Generating revenue

Government support for the development of new affordable housing has reduced, during both the current and upcoming spending review periods, and uncertainty remains over future funding arrangements in the longer term. To compensate for this, you may wish to consider increasing or expanding your commercial activities to include market rent, alongside other activities such as providing homes for shared and outright homeownership. Surpluses from these can then be 'ploughed back' into the social arm of your business, ultimately enabling you to build more properties for social or affordable rent, or to fund other activities for the benefit of the local community.

This idea, of greater 'cross-subsidy' between social and commercial activities, is consistent with the government's often stated desire to see social landlords making the most of their assets and maximising the contribution that these can make, particularly to increasing housing supply.

However, the likely returns from investment in market rent vary significantly from one area to another, with London and the South offering the greatest potential to generate a surplus as a result of the higher rents and rising property values. Depending on your location, the biggest returns are also likely to come from acquiring or developing properties for market rent. However it is also possible to generate revenue by managing properties that are owned by existing private landlords.

Improving access to market rented accommodation

At present some groups can have difficulty gaining access to the private rented sector, particularly in high demand areas where there may be considerable competition for available properties. Specific groups that sometimes have difficulty securing accommodation include:

- households in receipt of housing benefit
- households who are homeless but are not in priority need
- single people under 35 who are in need of shared accommodation

- households who are not able to provide an up front deposit or a guarantor to cover their rent.

Direct involvement in market rented housing could be an effective way to address this and to ensure that you are able to meet the housing needs of these groups. Additionally, where local authorities are making use of new powers to restrict access to their housing register and to more easily discharge their homelessness duties into the private sector, it may also enable you to make an alternative offer to some of the households affected by those changes.

Making an improved offer to traditional private renters

Historically private renting has been popular among 'young professionals' - single people and couples who are in employment and typically without children, and who may move on to other tenures in the longer term. High house prices, increasing rents and restrictions on mortgage availability now mean that this group is growing and that in many cases they are also renting for longer, as it has become harder for them to access homeownership. This is explored further in our recent work to [uncover the true cost of housing](#).

In contrast to the social sector, most private landlords operate on a very small scale, with [figures published in 2010](#) showing that more than three quarters only own a single property. Many are 'accidental landlords', who may have acquired properties through inheritance or a change in personal circumstances, or are part time or amateur landlords. Only a small minority are 'professional' landlords, for whom their portfolio of properties represents their only, or main, source of income. Given your greater resources and experience of housing management, there is therefore considerable potential to develop an improved offer aimed at young professionals.

In doing this you may be able to address some of the concerns first raised by the [Rugg report](#) about the ability of the traditional private rented sector to fully meet the needs of private renters. Specific improvements that you may be able to offer, compared to at least

some traditional private landlords, include:

- a greater guarantee of quality, in terms of property standards
- a greater guarantee of professionalism in your approach to housing management
- more stability, either in the form of longer tenancy agreements or simply by virtue of your size, which may offer an assurance that you are unlikely to need to sell the property at short notice
- less restrictive tenancy conditions, for example by giving tenants more freedom to redecorate
- fewer, or fairer, charges and administration fees for things like credit checks.

Providing a viable alternative to homeownership

Recent [research published by Shelter](#) shows that as the number of households living in market rented accommodation is increasing, the profile of renters is also changing. The number of families with children renting from private landlords is growing and Shelter's research suggests that there is a strong appetite for greater stability among this group in particular. Further [research conducted by Halifax](#) also shows that a majority of younger people now believe that long term renting will become the norm within

the next generation and that a significant minority have no plans to get on the housing ladder themselves.

In response to these trends it may be possible to promote market rent as a 'tenure of choice' by offering properties that are attractive to families, together with guarantees of relative stability for tenants. This could constitute an attractive and more affordable alternative to homeownership for many households.

However the majority of organisations that we spoke to are continuing to target more traditional private renters, such as young professionals, who may not remain in the sector for the long term. This suggests that there is currently only limited appetite among early adopters of market rent to move towards a more European system, where it is presented as a viable, long term alternative to homeownership.

This may be because rental yields (the income derived from letting a property divided by the cost of developing or purchasing it) are typically more attractive on smaller properties, compared to family sized homes. Even so, this could still represent a legitimate aim for your organisation.



What are others doing?

This section sets out some of the approaches being taken by the organisations we spoke to. It includes both organisations who are managing properties on behalf of existing private landlords and those who are establishing a portfolio by developing and/or purchasing homes for let at market rent.

Managing properties on behalf of private landlords

There are some advantages to simply managing, as opposed to directly owning, properties for let at market rents. Firstly it can enable you to contribute towards improving the quality of, and access to, market rented housing, while taking on comparatively little financial risk (as any fall in property values will mainly affect the owner of the homes, rather than the managing agent). Also, because of the lower level of risk involved, it is less 'location dependent' than developing or purchasing properties. It is an approach that can be adopted in most parts of the country – provided there is a pre-existing market for private rented accommodation.

However the potential to generate a surplus in this way is relatively limited, and you may find that it is more effective as a means of improving access to accommodation and driving up property standards than as a revenue generator. Opinions on the profitability of schemes vary, however some organisations, such as Cadwyn Housing Association in Wales (see page 9), do generate a healthy surplus by operating social lettings agencies.

Private sector leasing schemes and social lettings agencies

Schemes for managing properties that are owned by a third party take two main forms:

Private sector leasing (PSL) schemes

Under a PSL scheme you lease the property from its owner for a pre-determined period of time. You pay a monthly rent to them, regardless of whether or not the property is occupied, and act as the landlord to any tenants who are housed in the property.

The benefits of adopting this approach are that you gain complete control of the property and who it is let to, and that you know it will remain in your control for the duration of your agreement - which will usually be for several years at a time.

PSL schemes are often used to secure properties which can be used as temporary accommodation. However the viability of many of these schemes has been affected by the introduction of the overall benefit cap, and this may pose a challenge if you are intending to establish a PSL scheme for this purpose.

Social lettings agencies

A social lettings agency operates like a commercial lettings agent, but with a social purpose. Lettings are usually targeted at households who might have difficulty securing accommodation through a commercial agent and many schemes require landlords to cap their rents at local housing allowance levels to ensure that properties remain affordable.

The owner of the property remains the landlord but you carry out most day-to-day housing management activities on their behalf. In return you retain a proportion of the rental income as a fee for your services.

The main advantage of adopting this approach, as opposed to a PSL scheme, is that you are not liable to continue paying rent to the owner if there is a long period where the property is empty. However many organisations do guarantee rent for an initial period of time as this ensures the scheme will be attractive to landlords, even if rent levels are less than could be achieved through a commercial agent.

Learning from others

The **London Borough of Havering** operates a social lettings agency in their area. For a fee of between eight and 12 per cent, they take on all of the key housing management functions for the landlord including identifying suitable tenants, collecting the rent, and carrying out repairs and annual gas safety checks.

Properties are not advertised on the open market, instead lettings are targeted specifically at groups who would have difficulty accessing the traditional private rented sector. This includes households who have been accepted as statutorily homeless and households who are unable to provide a guarantor or a deposit. Shared accommodation is also available, which is aimed at single people under the age of 35 who are homeless but not in priority need or who are affected by welfare reform.

Tenants are mostly people who have been in contact with the Council's housing advice service. To qualify they must:

- have a local connection
- fall into the lower quartile for the borough in terms of their household income
- have no major rent arrears or history of anti-social behaviour
- be currently living with family or friends, or in unsettled accommodation.

Rents are currently set at local housing allowance rates, although the Council are considering taking on some properties at a slightly higher rent as data suggests that some of their tenants could afford this. To ensure the scheme is attractive to landlords, they guarantee to pay rent in advance, even where the tenant is in arrears and during void periods and offer a one-off incentive payment to compensate for the lower rent levels.

Contact: *Martin Pereira*, martin.pereira@havering.gov.uk

Cadwyn Housing Association offers a full lettings and management service to private landlords called CanDo Lettings. They currently manage around 450 properties across two local authority areas – Cardiff and Vale of Glamorgan.

Their service is similar to that offered by a high street letting agent but with the benefit of the association's experience of working with low income tenants and supporting them to sustain a tenancy. They are able to assist tenants with benefit applications and to also offer support and financial advice during their tenancy, where necessary.

Applicants must qualify to receive housing benefit and are mostly referred to the association by support workers. Rents are all within local housing allowance limits.

Establishing the initiative required significant financial investment from Cadwyn but it now generates a surplus, which is reinvested in the association's other activities.

Contact: *Francesca Coles*, francesca.coles@candolettings.co.uk

Exeter City Council (ECC) operate both a PSL scheme and a social lettings agency, called ExtraLets. Properties in the PSL scheme are used as temporary accommodation, while ExtraLets seeks to address the demand for properties at local housing allowance rates in the city.

ExtraLets tenants are mostly referred by the Council's housing options team and are mainly households who are already homeless or at risk of homelessness, but who may not be in priority need or who may have been classed as intentionally homeless. The Council are also keen to begin using ExtraLets to discharge their homelessness duties to households that are in priority need, however they would need a significant increase in the number of properties covered by the scheme to make this possible.

Rents are set at local housing allowance levels and the Council takes a 10 per cent fee to cover the cost of managing and letting the properties. Typically this is a slightly lower level of rent than the landlord might be able to achieve if they were to let their property through a commercial letting agent, however ECC guarantee to cover the rent for the first six months of any void period and they have found that this is attractive to many landlords.

Contact: *Chris Hancock*, chris.hancock@exeter.gcsx.gov.uk

Establishing a portfolio of properties

You can build up a portfolio of properties by either purchasing or developing, or a mixture of the two. Either way, significant initial investment will be required and you will probably need to secure the necessary finance either through borrowing or by entering into a partnership with an institution investor. There will also be a greater financial risk to the organisation, compared to managing properties on behalf of a third party (these issues are discussed in more detail in the section of this briefing on “how do you make sure you get it right?”).

However, if you are going to retain ownership of the properties yourself, there is also more potential for significant financial rewards as, in addition to gaining a new revenue stream in the form of additional rental income, you may also benefit from increasing property values over the longer term.

Learning from others

Notting Hill Housing Trust (NHHT) currently has a portfolio of around 500 properties for market rent and intends to significantly increase this to around 2,000 over the next five years. It is their intention to carry on building new developments that are mixed tenure, containing some permutation of properties for affordable rent, shared ownership, market rent and outright sale.

As well as traditional bank lending, they have been able to raise funding for all their activities at favourable rates through the capital markets and they do not currently have any plans to raise separate funding for market rent. NHHT is one of the organisations that successfully bid for funding through the government’s build to rent scheme and they have also partnered with the Homes and Communities Agency (HCA) to use Get Britain Building investment to add to their market rent portfolio. Profits from their commercial activities are ploughed back into the organisation’s core activities of developing new homes and reinvesting in existing homes and communities.

Their market rent portfolio is mainly comprised of one and two bedroom flats and houses which mostly fall within local housing allowance limits, although lettings are not particularly targeted at welfare recipients.

Contact: Andy Belton, lclafton@nhhg.org.uk

Fizzy Living is a company initially funded by Thames Valley Housing Association (TVHA) and Macquaire Bank. They currently own around 180 new build properties in Canning Town, Epsom and Poplar, which they have acquired through bulk purchasing.

They advertise their properties through commercial websites such as RightMove and Zoopla and their tenants are typically young professionals who are ineligible for social housing and currently unable to afford to move into homeownership. Many have previously had poor experiences of private renting and are

For this reason building up a portfolio of properties may be a significantly more attractive option in affluent, high demand areas. Most of the organisations that we identified who are already pursuing this option are based in London or the South and many also said that the considerable difference between social and market rents in these areas, combined with relative certainty over future property values, is essential to their business model. However there are a small number of organisations, such as Derwent Living (below), who have been able to establish a portfolio of properties in other parts of the country.

attracted by the opportunity to rent from a professional landlord who won’t sell the properties at short notice and who offers high standards of property management.

Properties are let on rolling tenancies with a break clause at the end of the first six months for both the landlord and the tenant. Rent levels are dictated by the local market and the standard of housing management services provided is typically higher than would be the case for TVHH’s social housing stock (for example repairs are usually carried out within quicker turnaround times), to reflect the higher rent and tenants’ higher expectations.

Contact: Dan Read, dan@fizzyliving.com

Derwent Living currently own 427 properties for market rent, predominantly in Derby and Nottingham, with a further 180 that they manage on behalf of private landlords. Most of their portfolio was developed in the late 1990s and early 2000s. The organisation stopped building specifically for market rent when the buy to let market really took off but is now planning to begin again and is currently looking to attract institutional investors for this purpose.

They are now looking at developing more two and three bedroom houses, which will be attractive to families or to couples who want to start a family. They expect that their target market for these properties will be people who are in employment but whose incomes are not high enough to enable them to access shared or outright homeownership, or who are nervous about making such a large financial commitment and would prefer to be able to rent for the longer term.

Their market rent properties are currently let using assured shorthold tenancies of six months, which are then allowed to roll on. However as part of their move towards providing more family housing, they are now investigating whether they should start offering longer tenancies.

Contact: Samantha Veal, samanthav@derwentliving.com

Learning from others

Stratford Halo is an award winning mixed tenure development delivered by **Genesis Housing Association** in Newham, East London. There are over 700 homes in the development, of which more than 400 were developed specifically for let at market rent. Genesis secured investment in these units from an institutional investor. Their sale to M&G on a 160 year lease has released Genesis' original investment, maintaining their capacity to continue to develop more new homes.

The properties have now been leased back to Genesis for a 35 year period. The advantages of the leaseback agreement for Genesis are that:

- it made the sale more attractive to the investor
- they are developing a new community at Stratford, so retaining management control of the market units is important to the achievement of this objective
- they expect to make a surplus from managing the properties they have leased back, which will be used to fund their core business.

The properties are let on more favourable terms than most traditional private sector landlords would offer. For example:

- Genesis offer longer tenancies of up to five years, with annual rent increases pegged at RPI + 1%
- tenants are free to decorate their homes as long as the unit is returned to Genesis in the same state as when the tenancy was agreed
- there is a 24 hour concierge service and onsite manager covered by the rent, providing assurance that repairs and other issues will be dealt with promptly
- there are no hidden fees. Genesis do not charge an admin fee if a tenant wants to renew a tenancy, or to move to another of their properties, and they don't take any commission on credit checks.

Genesis employed **Winckworth Sherwood** Solicitors to draft a suite of fixed term assured shorthold tenancy agreements that would be in line with their current precedents and comply with their existing policies and procedures, whilst taking account of all commercial aspects of this development.

Several factors made the drafting of these agreements complex:

- the fixed terms were to vary from one to five years
- Genesis' leaseback agreement required that they get approval from M&G before any tenancies could be granted
- promotion of the scheme was already in full swing, with prospective tenants needing to see a copy of their tenancy agreement
- the 24 hour concierge and built in services such as WIFI, an onsite car club and underground car park all required separate licenses.

Winckworth Sherwood delivered the suite of tenancy agreements, parking licenses and completion guidance on time, so that all the apartments have now been let and one of them has resulted in the tenancy agreement being enforced successfully.

Contact: *Feargal Ward*, feargal.ward@genesisha.org.uk or *Nikki Lynds-Xavier*, nlynds-xavier@wslaw.co.uk

Essential Living is a specialist market rented housing business which will develop and operate 5,000 homes for rent in London and the South East over the next ten years. Like many organisations developing market rented housing, they face many challenges including navigating the complexities of our planning system.

However **Winckworth Sherwood** has just helped Essential Living secure approval for a scheme at Archway in North London, which will involve the converting of an existing office building for residential use, using a new planning mechanism. 'Permitted development rights' enable the conversion of office buildings via a simplified planning process. Developers who can demonstrate that their conversion will not have flooding or contamination risks (or an adverse effect on highways or traffic) can obtain prior approval in as little as 56 days, with much less bureaucracy and expense.

Essential Living submitted independent professional reports to provide evidence to the local Council that these conditions were satisfied and the 'prior approval' process under these permitted development rights does not attract statutory s106 obligations, e.g. for the provision of affordable homes.

Contact: *Martin Bellingier*, martinb@essentialliving.uk.com or *Karen Cooksley*, kcooksley@wslaw.co.uk

How do you make sure you get it right?

This section sets out the key considerations and things that you need to take some time to research and understand before you can diversify into market rented accommodation. It is based around seven key questions that formed key points of discussion during our interviews:

- do you understand the local housing market?
- do you understand your target market?
- how will you secure the necessary finance?
- do you understand the risks and are you equipped to manage them?
- how will you structure your business?
- do you have the right skills?
- can you respond to the differing expectations of tenants?

Some of these questions will be particularly pertinent if you decide to establish your own portfolio of properties, however many will still be relevant to some extent should you decide to manage properties on behalf of others.

Do you understand the local housing market?

One of the most significant challenges in diversifying into market rent is the need to first develop a robust understanding of your local housing market.

There are huge regional variations in the demand for market rented accommodation. For example, data produced by Hometrack shows that currently 50 per cent of homes that are let at market rents are concentrated in just 6 per cent of the UK's area, so before you do anything you will first need to establish that there is a market for this in your area.

Even in areas where there is already an active private rented sector, both property values and rent levels can vary considerably, so if you are thinking of establishing your own portfolio of properties you will also need to establish that this is financially viable. It is likely to be a more attractive investment in some localities than in others and in some cases you may find that establishing a social lettings agency or a private sector leasing scheme is a more viable way of achieving your objectives.

To determine this you will need to carry out an extensive mapping exercise to develop a robust understanding of:

- levels of demand for market rented accommodation in the area, including the most desirable property types and locations (see section "do you understand your target market?")
- the difference in affordability between buying and renting. Despite the increasing number of households who are renting, surveys continue to show that most people still aspire to own their own home and facilitating this remains a key aim of current government policy. Arguably investing in market

rented accommodation carries less risk in areas where the affordability gap is greatest, as demand is less likely to be diminished if, for example, mortgage availability continues to improve in the future

- void rates, rental values (the current level of rent which you could charge) and trends in rental growth (how rapidly rent has increased over time) in the area
- likely rental yields from different property types and in different locations (this is calculated by dividing your expected rental income, as calculated above, by the cost of developing/acquiring the property)
- the potential for capital appreciation (ie: the likelihood that your properties will increase in value over the longer term).

Organisations such as [Hometrack](#) can provide data to enable you to carry out this analysis. You should also bear in mind that returns can vary significantly even over a short distance, as rent levels can vary on a street-by-street basis. You will therefore need to develop a sufficiently detailed picture of the local housing market to ensure that you understand these variations.

Do you understand your target market?

As well as the scale of demand, it is also important to understand the types of people that you intend to let to and the things that are likely to be attractive to them in a property. If the properties you are able to offer do not match the requirements of your target market, there is a danger that some of these may become difficult to let.

In considering this you will need to think about:

- property type - for example, many of the organisations we spoke to said that their properties are mainly one and two

bedroom homes, often flats, intended for young professionals. However if you are targeting families you will need to be able to offer a different kind of property (ie: houses, rather than flats, with a greater number of bedrooms and ideally some outdoor space)

- location - most organisations who already own properties for let at market rent are concentrating their activities on the more desirable, high demand areas of their locality. Many who are letting mainly to young professionals say that they always consider proximity to city centres, transport links and amenities when developing or acquiring properties, as they know that this is particularly important to their target market
- affordability - there is a clear need to balance desirability with affordability, as there is a danger that properties in particularly exclusive areas may be too expensive to let easily. If you are intending to let to households who are likely to be in receipt of benefits you will also need to think about how your rents compare to local housing allowance rates and whether tenants will be affected by the overall benefit cap.

Of course you may not need to settle on a single property type, location or price point and it may be viable to offer a variety of different properties to cater for different needs. However, ultimately, whatever approach is taken will need to be informed by an understanding of demand in your local area.

How will you secure the necessary finance?

Depending on which approach you decide to take, it is likely that considerable up-front investment may be required, particularly if you intend to build new homes specifically for market rent. Consequently, the need to secure the necessary finance may be one of the main barriers to you being able to pursue this.

Once you have developed a clear understanding of the expected returns, there are a couple of potential sources of funding which you could pursue:

Using your social assets to lever in affordable borrowing - you may be well placed to develop for market rent if the relative financial security of your social activities enables you to access credit at an affordable rate. Although the challenges posed by welfare reform may present a threat to this, several organisations report that lenders still consider their core social activities to be relatively financially secure and are continuing to offer them relatively favourable rates. If this continues, it could enable you to access capital with which to grow your portfolio of properties. Surpluses generated by these – initially from rental income and, in the longer term, possibly also from an increase in their value – can then be ‘ploughed back’ into the social arm of your business.

However it is important to understand the ‘trade-offs’ involved in this approach. Although you may be able to generate revenue and ultimately build more affordable homes in the long term, borrowing to pursue commercial opportunities will ‘tie up’ some of your financial capacity over the shorter term.

The HCA are also currently in the process of consulting on potential changes to the regulatory framework which are intended to ensure that, as many organisations are taking on greater levels of debt, social assets are not put at risk. Depending on the outcome of the consultation, the changes could introduce greater restrictions on this form of cross-subsidy.

Entering into a partnership with an institutional investor – another option is to enter into a deal with an institutional investor, such as a pension or insurance provider, whereby you develop a number of properties and then immediately sell them to the investor. You might then also enter into a further agreement to manage the properties on their behalf, in return for a percentage of the rental income.

Finding an institutional investor does not negate the need to secure capital up front to fund the development, it just means that there is a more immediate ‘pay out’ once the properties are completed. However the government’s [build to rent fund](#) is intended to help organisations to bridge this gap. Under the scheme the government will provide £1bn of loans to support the development of new homes, with any borrowing being repaid at the point that the properties are sold on to the investor. The first 45 projects which are being supported by the scheme were announced in April 2013, and the HCA are currently inviting expressions of interest for its next phase.

Do you understand the risks and are you equipped to manage them?

If you decide to establish your own portfolio of properties, this will involve a significant financial investment and could therefore present a significant risk to your organisation. It is absolutely vital that you have a clear understanding of the level of risk involved and clear plans in place to manage it.

It is essential that you develop an ‘exit strategy’ in case financial returns do not live up to your projections, or in case there is an unexpected change in the housing market. To do this you should think about how else you might be able to use the properties that you intend to let at market rents. Could you convert them to other tenures, such as affordable rent? Could you sell them on the open market? If you had to do so, what would be the cost to your organisation and is that a ‘hit’ that you could afford to take?

It is not yet clear exactly what approach the regulator will take to ensure that any borrowing which is taken on to support commercial activities does not expose social assets to unacceptable levels of risk. However they will certainly expect you to be able to demonstrate that you have the skills to assess and manage risk effectively. If you are already engaged in other commercial activities, such as developing homes for shared and outright homeownership, you may already have considerable experience of this. However if you have historically focused solely on social rent, this may be a more significant challenge.

How will you structure your business?

Some organisations have established commercial subsidiaries to develop and manage their portfolio of market rented accommodation, clearly separating out their social and commercial functions. Alternatively, others are continuing to operate as one business where market rent is one of a number of different workstreams which they pursue.

How you structure your business requires careful consideration, and there are pros and cons to both approaches. There are a number of factors to take into account, including:

- your approach to risk management and the extent to which you can create financial 'buffers' between your core social assets and any, more risky, commercial activities while still retaining the ability to borrow at an affordable rate
- the need to retain charitable status, which may make it necessary to clearly separate your charitable functions from any commercial activity
- the need for different skills among front line staff managing social and market rented accommodation (see section "do you have the right skills?"), and how this would best be reflected in your organisation's structure
- how your market rented properties will be promoted. Is it an advantage to have them clearly associated with your organisation? Or, if your market rented accommodation is aimed at a different client group, do you want to establish a separate brand which will appeal to your target market?

Do you have the right skills?

You will need different skills among your workforce at a front line level to enable you to effectively manage properties on a more commercial basis. For example, you will need staff who are able to set rents and negotiate with potential tenants in a way that generates the best financial returns for the organisation. This requires a very different skill set to letting social housing, where allocations are based on need and rents are determined by a formula and are non-negotiable.

If you are already providing homes for a variety of tenures, including shared and outright homeownership, you may already have many of the commercial skills that are required. However if you have historically focused solely on social rent, this may again be a more significant challenge.

Where they don't already have these skills in-house, some organisations are buying them in by using online or high street lettings agents during the lettings process. Others are looking to actively recruit new members of staff with a commercial background.

Can you respond to the differing expectations of tenants?

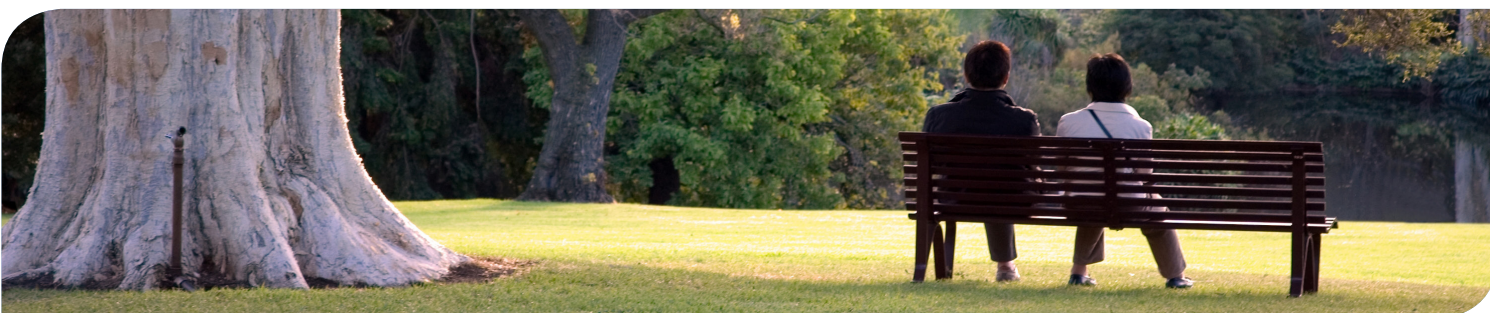
Prospective tenants for market rented accommodation are typically able to exercise a greater degree of choice over their housing options, compared to those applying for social housing, and their expectations often reflect the higher level of rent that is being charged for the property.

Consequently many organisations report that tenants often expect, for example, kitchen and bathroom units of a higher specification and that they are often inclined to negotiate a lower rent if they do not feel that the property is up to a sufficient standard. This means that your ability to let properties quickly and to maximise rental income may depend on you delivering a high specification property.

Tenants' expectations may also vary in relation to the housing management services that you provide. To address this some organisations operate shorter turn-around times for routine repairs to their market rent properties, and many who are letting mainly to young professionals also say that this group tend to expect a greater degree of choice over when repairs are carried out, and to be able to report them via different channels (for example online, via text message and via social media). Where units are concentrated in a single block, some landlords are also employing onsite managers or concierges for this purpose.

Ultimately tenants' expectations are likely to reflect the level of rent that is being charged for the property, meaning that this is likely to be a particular challenge if you are planning on maximising your revenue by charging rents at the higher end of the market. If this is the case, you will need to think about ways of delivering greater value to tenants in terms of:

- the way in which properties are decorated and presented, and the specification of utilities and fixtures provided
- the facilities that are provided with it, for example some landlords are ensuring that properties are already connected to a broadband provider
- the housing management service, including the methods by which issues can be reported and how they are dealt with.





Final thoughts

From our research we have identified five key conclusions to help you consider and shape your approach to providing market rented accommodation:

- **there is considerable potential to achieve positive outcomes by diversifying into market rent, but you must be clear about your priorities.** In the first section of this briefing we identified a range of positive outcomes that can be achieved by diversifying into market rent. These are not entirely mutually exclusive but some degree of 'trade-off' between them is inevitable. To be able to make an informed decision on not just 'whether' to diversify into market rented accommodation but 'how' to do so, you first need to be clear about why you are doing this and what your objectives are
- **a robust understanding of the market you are operating in is essential and should inform any decisions you make.** Before you can make any decisions, you need to build up a clear picture of the local housing market and of demand for market rented housing in your area. This should inform all of the key decisions you need to make, including whether to develop and/or purchase properties or to simply manage them on behalf of others, as well as the profile and location of properties that you should offer
- **developing or acquiring a portfolio of properties for market rent won't be for everyone.** This briefing features case studies from a number of organisations who have successfully established a portfolio of properties for let at market rent. You may be able to replicate their approach in your own organisation, however this is not likely to be possible or desirable for everyone. For example, you might decide that your local housing market does not lend itself to this approach or that you do not want, or are not equipped, to take on the required level of financial risk. For some, operating as a managing agent for existing private landlords may represent a better way of achieving your objectives – or you may simply decide that diversifying in this way doesn't fit with your core business objectives
- **managing market rented housing may pose different challenges to social rent.** If your background is firmly in managing properties for social rent, you may find that managing market rented accommodation is a very different activity and that you are dealing with a different client group, with different expectations. You should think about the services that you intend to provide to these tenants, and ensure that they have been designed with their needs in mind. Additionally you should think about the skills that you have in your organisation, at both senior and front-line levels, to make sure that you are well equipped to carry out lettings, housing management and asset management activities on a commercial basis
- **you need to have a clear understanding of the risks and how to manage them.** If you do decide to develop or purchase a portfolio of properties for market rent, this is likely to require a considerable financial investment and could therefore represent a significant financial risk. To a certain extent, risks can be minimised by ensuring that you are making informed, evidence based decisions about the properties that you are investing in. However it is also crucial that you are realistic about the level of risk involved in any commercial activity, that you have plans in place to monitor and manage it and that you have developed an 'exit plan' in the event that you need to reconsider your approach.



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