UK Build to Rent

Performance in a Pandemic| **August 2020**

Introduction

The Coronavirus Pandemic that has caused such tragic loss of life and an immense economic dislocation has also caused all of us to reappraise what we thought we knew about investment, and certainly about Real Estate. We manage assets in a range of different sectors at Gatehouse Bank, but we have been struck by just how well our two Build to Rent (BTR) Funds have performed during, and immediately following, the lockdown period.

In these challenging times, both Private Rental Sector (PRS) Funds have performed strongly in rental collection, occupancy, new lettings, dealing with arrears and Gatehouse has managed to complete a new investment BTR transaction. We have set out below some key features that make UK BTR a defensive asset class in uncertain times.

The damaging impact of the Pandemic on the commercial property sector has been well documented. In our view and experience, BTR assets have conversely performed relatively well. Residential accommodation is a necessity, not a luxury expense item, and there are significant credit risk diversification benefits exhibited due to the granularity of BTR schemes, which is a unique characteristic of the sector.

Looking across the sector there have been short-term effects related to delays and defaults in rental payments from workers suffering economic hardship, however, the experience from our existing funds is that this has been largely mitigated by government support.

Gatehouse's Private Rental Sector Pandemic Highlights

98% rental collection rates across both Funds

Occupancy rates **continued to rise** – close to **100%** in Q2 2020

Arrears remained low across both funds, peaking at **8%** in April and reducing to **2%** in July

New lettings achieved even during lockdown

£10m acquisition of a new site completed on behalf of Private Rental Sector Fund II during lockdown

Pre-Pandemic vs Peri-Pandemic Performance

Gatehouse Bank was among the first movers in UK BTR and currently manages two portfolios comprising roughly 1,600 units, distributed across 23 sites, largely in the major urban centres of the Midlands and North England such as Birmingham, Manchester, and Liverpool with over £200m invested to date across two funds — PRS Fund 1 (FI) & PRS Fund 2 (FII).

Throughout 2019, PRSFI showed both a low gross-to-net-leakage and the portfolio was almost fully let throughout the year, with the overall portfolio recording an occupancy rate of 97% for the year. Overall, rent grew above inflation Year on Year (YoY) from 2018 to 2019 (comparing annual rents). PRSFII, as a slightly newer portfolio, saw larger rental increases close to double the rate of inflation YoY, albeit with slightly higher vacancy rates during the stabilisation phase.

So far in 2020, both portfolios have proven remarkably resilient with occupancy levels increasing to the end of April and remaining relatively stable through the lockdown period. In addition, even in the current challenging environment, the Property Manager, Ascend Properties, is managing to secure rental uplifts, largely as a result of the formation of more rental households increasing overall demand, although we are currently limiting rental increases to new tenancies until economic conditions stabilise.

Impact of Government Intervention

The Government's furlough scheme, which affected approximately 25%[1] of the UK's workforce and originally paid 80% of a qualifying employee's wages (up to a £2.5k monthly limit), has certainly helped underpin some of our tenants' income. Initially we saw a greater impact on the self-employed where Government payments were delayed. As the scheme was extended until the end

1 https://www.resolutionfoundation.org/publications/the-economic-effects-of-coronavirus-in-the-uk/

of October, it remains to be seen how the withdrawal of this support and potential rising unemployment levels will impact on the occupational performance of PRS funds.

With careful management, most struggling tenants have remained engaged throughout the crisis so far by signing up to a payment plan. Rental arrears remain in line now with long run averages, with only a fraction having to be written-off currently as bad debt (generally less than 0.5% of total income).

The Government temporarily stopped allowing landlords to evict tenants for non-payment of rent, while court hearings for non-payment of rent only look set to re-commence in September. As a potential output of this, arrears did spike across both portfolios during April and May at the height of lockdown to around 8%, with some tenants moving on to repayment plans, but by July this figure was back down to pre-pandemic levels of 2%. We will await Q4 2020 performance stats with interest and monitor closely the impact of the cessation of furlough on our tenant base.

With both portfolios continuing to exhibit rental growth and occupancy in May and June, at times occupancy nudged very close to 100%, particularly on the newer PRSII fund, which is remarkable against other real estate sectors in terms of maximising income during an historically difficult economic period.

Resilience of Income

Real estate returns are ultimately driven by occupancy and, fundamentally in the current environment, rent collection. The benefits of alternative real estate asset classes such as BTR are that they are operational in nature, enabling the owners to proactively manage the Profit & Loss like a live business.

In a recent tenant survey;[2] we found the average income to rent coverage ratio to be around 5x. Furthermore, in the majority (60%) of these households, there were two or more people responsible for paying the rent, which meant that even if one person were to unfortunately lose their job, disregarding income support, the other tenant would often be able to cover the rent until income support came through or the unemployed tenant found fresh work.

Moreover, our tenant base comprises of a diverse range of employment types, which results in a low credit risk. For example, assets like offices are exposed to significant concentration risk.

Whilst self-employed tenants have been the group most likely suffering arrears during lockdown, the high household income to rental obligation has reduced the likelihood of tenants defaulting on rents. There have been reports that rental collection rates across the UK Commercial Real Estate asset classes have been at only circa. 70% since lockdown.[3] By comparison, Gatehouse's PRS funds have significantly outperformed with 98% rental collection rates.

Letting demand across our Funds and elsewhere continues to be maintained, as letting agents in the UK report an increase in rental queries. Almost six months on from the first lockdown and during the sharpest, most precipitous, economic shock in recent memory, we have found BTR has come into its own as a defensive asset class, underpinned by resilience in income generation.

At its heart, BTR remains a management intensive, operationally led, real estate asset class. If you can perfect the art of remaining in control of the management of your income stream by acting flexibly and working hard on operational detail, while using expertise and judgement, our experience suggests you can collect near-total rates of income due, even during a pandemic.

2 based on a sample of 631 households across both PRS I & PRS II
3 https://www.propertyweek.com/news/rent-collection-rates-edge-up/5107689.article

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