New How:
Perspectives

Investing in living

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Living

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Introduction

Our homes have evolved in the last 18 months. They have become a bit more "mixed use" – school, office, gym, doctors' surgery and even kitchen disco.

The enforced focus on the use of our homes during the pandemic – particularly their inadequacies, together with the flexibility that working from anywhere has brought – has created unprecedented demand to move house and / or relocate. There was also the small matter of a £530m government SDLT giveaway that may have had some effect.

In times of uncertainty, our homes become places of sanctuary and security. This is true for both individual homeowners and institutional investors who have flocked to bricks and mortar. After an incredible year off the back of the pandemic, the intense focus on the sector continues, creating any number of interesting trends, challenges and opportunities. Examples include private equity investors hovering to take advantage of the low share prices of listed housebuilders; diversification between living sector assets; Lloyds and John Lewis the surprise new entrants to the investor landlord cohort; and 'build to rent' (BTR) coming of age.

Amidst the clamour to invest in living products and assets, there are challenges too, both immediate and medium term. Land prices are increasing along with build costs. With margins doubly squeezed, can developers ensure that supply keeps up with demand? Housebuilders are struggling with supply chain issues, anecdotally swapping bricks for render and stockpiling timber and plaster. There are also labour constraints post-Brexit, and not to mention the impact of the "pingdemic" in the summer.

Ground rents are confined to history, taking with them a profitable income stream for developers and investors alike. Particularly surprising was the news that the outlawing of ground rents will also apply to retirement housing. The fall-out from the Grenfell tragedy continues to create unique obstacles for owners, developers and lenders in the sector, particularly high-rise BTR blocks and residential apartments. Gateway 1 has come into force, building regs are changing and the EWS1 form scandal remains unresolved.

Investors are searching for yield in the living sector, hunting out the best performing assets. The leasing market – relevant to the BTR, student and later living subsectors – will have issues to contend with too, including the fact that the abolition of RPI in 2030 will require a replacement index. There is talk of an inevitable return to inflation, which will worry individual homeowners but conversely boost commercial investment returns in the longer term.

2021 heralded a collective light bulb moment regarding climate change (and rightly so) and investor and funder anxiety regarding ESG compliance is palpable. Much of the product available to be funded now will have been based on schemes developed two or three years ago, prior to the sea change in corporate attitudes to the climate crisis. All of our living specialists are advising clients on the impact of ESG requirements on their schemes.

In the following pages, we probe the highs, lows and future trends of the living sector in more depth. Enjoy.

“

Home is the nicest word there is.”

Laura Ingalls Wilder

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The search for yield

The annual inflation rate in the UK jumped to 3% in August 2021, the highest since March 2012, with the Office of National Statistics predicting it to hit 4% by the end of the quarter. As we re-emerge blinking into the sun in a post pandemic world which has suffered sustained economic and wider market volatility, we ask the question: where should the UK investor turn in their search for yield?

One of the core principles of investment strategy, which is drummed into us from a young age, is that high yield equals high risk. Yield is relative, it transcends markets and sectors and is understood globally as a like-for-like measure of the risk / return equation. It is at the heart of understanding the measure of investment returns.

With 10-year and 30-year UK government bonds ("gilts") offering 1.01% and 1.38% respectively at the time of writing and the current dividend yield on the FTSE 100 index at around 3.51%, should investors who normally shy away from the perceived "high risk" of the property market look to the long term income returns that can be achieved in UK real estate, and in particular the living sector?

Perhaps surprisingly, long-income UK commercial real estate can offer attractive yields when compared with more traditional low risk alternatives like gilts, without necessarily heightening the risk curve exponentially, whilst also outperforming the expected dividend yield from FTSE 100 investments of a similar risk profile. The living sector in particular can offer some surprisingly stable long term returns and with the added benefit of capital growth.

Generally, in the UK real estate market, long term income is defined as anything with a 15-30 year life span, so it is comparable with the investment return profile of the long term bond market. Unlike bonds, investing in real estate does put both capital and income at risk, however with a proper understanding of sectors and strict investment criteria, those risks can be mitigated with proper assessment and due diligence on the asset itself and the covenant of the entity underpinning the income.

The desired outcome is to ensure a genuine risk matrix that compares favourably with low risk investment but is underpinned by an appreciating property asset. In today's market, it is also key that the target property asset is a newly built ESG exemplar property to ensure long term capital value resilience.

With recent reports outlining that investment yields in three of the core living sectors – housebuilding, student accommodation and hotels – are achieving yield spreads averaging between 3.35%-5.5%; 3.5%-8% and 3.75%-8% (Source: CBRE UK Beds Sector Report, September 2021). It is therefore no surprise that many traditionally low risk investors are turning to the real estate market and the living sector in particular.

Living assets are incredibly sought after at the moment. Later living, particularly the long income from 35-year care home leases, is having a real moment. The BTR market has seen a massive inflow of capital over the last 18 months, with many commentators predicting this will continue to rise exponentially. While a year of lockdowns saw transactions in most areas of commercial real estate put on ice, investment in BTR is expected to top £5bn in 2021, up from around £1bn in 2015. With normally risk averse pension funds such as L&G and Lloyds Banking Group entering the BTR market, it is safe to say that the search for yield has very much come "home".

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> "Long-income UK commercial real estate can offer attractive yields when compared with more traditional low risk alternatives."

Tall stories – forms, laws and retribution

Whether you are a property professional or otherwise, you would have had to have lived in a hole to have missed the EWS1 saga. In the four years following the tragic Grenfell disaster, the industry and the government have been grappling with how to deal with a generation of potentially defective tall buildings.

The response has been multi-faceted, with government and professional bodies (including RICS) providing detailed advice and guidance to building owners as to what steps they should take to examine the make-up of their external wall systems, and the circumstances in which remedial works will be necessary.

For many tenants, purchasers and funders, a key document in understanding the risks associated with the façade of a building is the EWS1 form ("EWS1").

EWS1 – looking back

EWS1 forms are certificates produced by a qualified professional certifying whether there are fire risks associated with the external wall systems of residential buildings. They are not required as a matter of law but have been created as an industry response to the problems associated with some building cladding systems, building insulation, fire-break systems and vertically stacked balconies made from or connected by combustible materials – together referred to as external wall systems.

They were introduced by RICS in December 2019 primarily as a result of concerns that lenders did not have sufficient information about the fire safety risks of tall buildings when providing funding for flats being bought and sold. Since then, they have become a widely used tool for buyers, investors and lenders wanting to see a completed EWS1 for a building before buying, investing in or lending on. The EWS1 form provides information as to whether the building could require potentially high future replacement and maintenance costs if the external wall systems presented a fire risk. Fire risks will, of course, have an impact on the value of the building.

From the outset, RICS issued guidance on when an EWS1 form is required, confirming that they were primarily for tall buildings (over 18 metres) or where specific concerns existed. However, almost immediately, buyers, investors and lenders started to request EWS1 in more situations than RICS originally intended, often leading to arguments between buyers and sellers as to whether the form was necessary for any particular transaction.

On 21 July 2021, the government issued further guidance stressing that an EWS1 should only be required for buildings over 18 metres high. HSBC, Barclays, Lloyds and others have said that the expert advice and the government's clear response paves the way for EWS1 to no longer be required for buildings below 18 metres. It is hoped that other lenders, together with buyers and investors, will accept the latest guidance from the government.

However, this has still not resolved the issues we are facing on the ground as RICS is yet to change its guidance to its members. It has said that: "In light of this announcement from government, RICS will work with all stakeholders (fire safety bodies, lenders, insurers, valuers, leaseholders and others), to consider the impact on our guidance to valuers. If amendments are needed to RICS' guidance they would be developed through a consultative process and decided on by the independently led RICS Standards and Regulation Board which is responsible for ensuring our regulation is undertaken in the public interest. In the meantime, our existing guidance remains in place and RICS valuers should continue to fulfil their professional obligations to advise lenders and purchasers, accurately on a property's market value."

As such, the clarity the government hoped to provide has not universally occurred. The guidance will, we suspect, assist sellers and lenders of residential flats and stop some unnecessary impediments to the issue of residential mortgages. However, issues of fire safety are not limited to buildings over 18 metres and, for some buildings at least, purchasers will still wish to know the extent of the risks they are buying into when acquiring property.

When is an EWS1 required?

An EWS1 applies to the building as a whole and should be obtained by the building owner. It lasts for a period of five years. In theory, it is required in the following circumstances:

Type of building	EWS1 required	But consider...
Tall residential building over 18m. Constructed pursuant to the Building (Amendment) Regulations 2018 in England or the Building (Amendment) (Wales) Regulations 2019 (in Wales) (the 'New Regulations') i.e., no combustible material used in the external wall systems.	✗	It should not be necessary to require the production of an EWS1. However, a purchaser of the building will want to undertake due diligence to ensure the building complies with the new regulations. For the present, there is no consistent approach (although the position may improve once the Building Safety Bill is passed).
Tall residential building over 18m. Not constructed pursuant to the New Regulations.	✓	This category is the only one which appears to be categorical.
Tall residential building under 18m.	✗	Following recent government guidance, it no longer seems appropriate to require an EWS1 where a building is less than 18 metres high, even where it is currently classified by RICS as an 'at risk' building. However, many purchasers will still expect evidence of the condition of the external wall system.
Hotel over 18m.	✗	No EWS1 should be required on the development of a hotel of any height. However, purchasers will still likely expect evidence of the condition of the external wall system.
Hotel under 18m.	✗	No EWS1 should be required on the development of a hotel of any height.

Nevertheless, tall building developers and owners will still have to watch this space as we are in a period of adjustment where lenders are reviewing their policies. However, it is worth noting the following points:

- As the market begins to understand the risks associated, more lenders will understand the information they need before lending. It is positive that many lenders appear to be willing to adhere to the government advice.
- EWS1 forms are simply pieces of evidence. There is nothing to stop a buyer or lender asking for one, even if the government guidance says it is not needed. If an EWS1 certificate isn't provided, some buyers will want alternative evidence.
- The fact that a building doesn't need an EWS1 is separate from a building owner's obligations to ensure it is compliant with fire safety regulations. Proper fire risk assessments will be needed even if an ESW1 isn't.

Gateway one – looking forward

Following Dame Judith Hackitt's review into the Grenfell disaster, the so called "Planning Gateway One" is now in force. This is one of three gateways – or checks and balances – to regulate the life of a new higher risk building. The new planning obligations apply to higher risk buildings (being those higher than 18 metres or over seven storeys) and have two components:

- A requirement to submit a fire statement with a planning application for relevant developments; and
- To establish the Health and Safety Executive as a statutory consultee for relevant planning applications.

This change in law will affect many living sector stakeholders (although not care homes and hotels currently).

> Property developers operating in the housing sphere need to have this potential levy in bold, red and italics on their risk registers."

RPDT – so who pays?

Understandably, there is a lot of rhetoric about who should pay for the cladding crisis, particularly in light of tragic stories in the press of those individuals affected. Retribution needs to be seen to have been done for the shocking mess we find ourselves in with respect to flammable high-rise buildings. We have looked back at the "quick fix" EWS1 form and the future of buildings regulations, but that leaves the question for the government of who pays for this? Their answer is a tax on residential property developers.

Developers are easy pickings, criticised for everything at the best of times, from land banking and causing the housing shortage to playing fast and loose with tenant safety post-Grenfell. A popular scapegoat with deep pockets and, of course, preferable to unwitting flat buyers who cannot be left to bear the cost of remediation via sky high service charges.

The Residential Property Developer's Tax is proposed as one solution, but what do we know currently about the tax? We recently wrote a piece on our website on the draft legislation which probes the plans in more detail, but in short we know this:

- The tax will be imposed from 1 April 2022.
- Companies will be subject to the tax as residential property developers ("RPDs") if they are within the UK corporation tax net, carry on 'RPD activities' relating to residential property development and have – or had – any interest in the land on which the activities are carried out (excluding a licence or security interest).
- Care homes and student accommodation will not be included, provided the students live there for at least 165 days a year.

The Autumn budget has confirmed that the rate of taxation is going to be 4% on profits over £25m. It is clear is that property developers operating in the housing sphere need to have this potential levy in bold, red and italics on their risk registers."

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Build to rent boom

Although it is well documented that the BTR sector is continuing to go from strength to strength, with new entrants such as John Lewis leading to rising investment volumes, what is interesting are the trends that are beginning to be played out.

We are seeing a real shift in young professionals looking for rental properties outside of London and the sector is responding to this with an increase in the number of development opportunities being brought forward in the regions. Activity outside of London accounted for 84% of all planned BTR developments (as of October 2021). It is clear that the pandemic has accelerated the demand for space outside of London and made everyone re-evaluate their priorities, including how and where they want to live.

However, the sector is not just the preserve of young professionals seeking purpose-built high rise apartment blocks; there are now an increasing number of developers seeking to deliver single family housing within suburban or rural locations. This is an area that is experiencing rapid growth, attracting investment from the likes of L&G, Goldman Sachs and Packaged Living, and now constitutes around 12% of the BTR market. With an increase in the proportion of households with children in the private rented sector over the past ten years, the demand for high-quality family-friendly rental properties in well-connected locations will continue to rise. 2021 was the year we started to hear about single family housing and, in the next twelve months, watch out for multi-family housing being the latest north American trend to hit the UK shores.

Interestingly, we are seeing a growing number of older homeowners choosing to sell up and rent in their retirement too, being attracted to high-quality accommodation, locations close to local amenities with good transport links, onsite management services with a care aspect and being part of community living. It is a model that is piquing the interest of a few investors who see the BTR sector as providing a solution to this growing demand and offering a new choice in the later living sector. There is also a trend for this later living BTR product to be located centrally to take advantage of the "grey pound" in our town centres.

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The pandemic has accelerated the demand for space outside of London and made everyone re-evaluate their priorities, including how and where they want to live."

Finally, we are seeing a focus on the way homes are being designed and constructed to create more energy efficient spaces. Modern methods of construction mean that homes will be built more efficiently, sustainably and quickly, with customers looking at developments that have a good energy performance rating, track energy consumption and promote wellbeing.

Moving away from the buzz around new build stock the UK's existing private rental portfolio has also been attracting investor interest. Bricklane's deal with Moorfield Group is notable in that, by using a tech platform called Compass, it aims to open up the UK's existing stock of single-family housing to institutional investors. A vision to instutionalise the private rented sector is exciting for the sector as a whole. The intention is to buy 2,000 houses and flats over the next two years in London, Bristol and the South East from the existing 2.5m buy-to-let landlords.

Purposeful investment in the BTR sector has also been evident in the last twelve months. Home REIT became the first UK real estate investment trust to focus on reducing homelessness (and creating investor profits). They invest in areas with the highest rates of statutory homelessness. This has the twin effect of reducing the local authority's costs of accommodation and providing security and stability for residents.

What is clear from the above is that the private rental sector is a dynamic one, ever evolving to expand and diversify both to meet the living needs of the customer and, due to the significant growth opportunities, attract ongoing and innovative institutional investment.

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RIP RPI

Rumours of the Retail Price Index's ("RPI") death have been vastly exaggerated in the past. We were told back in 2013 that the Office for National Statistics was going to stop formally recognising the index as a national statistic, but it took a while for the industry to take note. We have all carried on using it in our indexed linked rent reviews since then. Now it looks as though the final nail in the coffin will be 2030.

It has long been recognised that there are issues with the way that RPI reflects the rate of inflation, resulting in times when it overestimates inflation and other occasions when it underestimates it. The government therefore recently called for a review and consultation on the adoption of an alternative methodology to align it more closely with CPIH (Consumer Price Index including owner occupier housing costs).

RPI is calculated and published by the Office for National Statistics and used to calculate the cost of living and wage increases, as well as government gilts and securities. Were a change to CPIH to be implemented, it could have an adverse impact on those gilts and securities in particular, which is something the Chancellor felt unable to sanction until the relevant index-linked gilts have matured in 2030. Accordingly, any change to RPI is likely to be postponed until February 2030 at the earliest.

What does all of this mean for the living sector? RPI is a common measure for increases in lease payments, such as rent and service charge, and so any shift to the use of CPIH is likely to mean that increases in such payments will be lower. CPI measures the average change in a "shopping basket" of goods and services over a period of time in a typical household. Consumer behaviour has obviously been affected by the lockdowns arising out of the pandemic as people have been unable to spend as much of their earnings on eating out or going on holidays, and so query what impact this will have on CPI in the coming months.

CPI generally results in a lower measure of inflation than RPI, at around 0.75%-1% less annually since 2011, and so this will mean that lease payments linked to the new measure will result in lower increases than has traditionally been the case. This is something that landlords in particular will be considering in any lease renewals and new leases going forward. We are certainly making sure in our deals, to the extent it was not the case already, that lease clauses are flexible enough to deal with a change in the way RPI is measured. Some clients are also considering building in a "top up" to CPIH rates to address any reduction that is anticipated, for example making the rate CPIH plus 1% to address the traditional discount to RPI.

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Another unexpected consequence of any change in the measure of increase, by say a switch to CPIH, would be the way it is treated for SDLT purposes. Any uplift linked to RPI during the first five years of a lease is generally ignored, but this would not be the case for an increase linked to CPIH or for any adjusted measure such as CPIH plus 1%. It is hoped this will be addressed by the government to update the SDLT rules to ensure a consistent approach, but it is something for tenants be aware of when entering into such leases in the future.

Another potential impact is the way service charge costs are assessed. As CPIH is likely to result in a lower increase than has traditionally been the case, are there services which should be excluded from any cap in order to protect a landlord against a shortfall? For example, insurance or utility costs, where those costs increase at a rate higher than inflation. Again, this is something to be discussed and agreed at the outset of a transaction in order to mitigate any potential shortfall costs, which are always an issue for investors and lenders.

Other things for property owners to consider as a result of any convergence of RPI and CPIH would be the impact on any existing hedging and funding arrangements caused by a portfolio of assets which have CPI-linked long-term income.

One to watch, although a report in February 2021 by Aviva Investors pointed to the fact that there had been no noticeable change in the valuation of RPI-linked assets as a result of the government's reform proposals, although it was also acknowledged that there had been limited transactional activity at that time.

"It has long been recognised that there are issues with the way that RPI reflects the rate of inflation, resulting in times when it overestimates inflation and other occasions when it underestimates it."

Ground rent reform – fixing one problem and creating another?

The draft bill to implement the government's ground rent changes finally reached the House of Lords in May 2021. This legislation had been long awaited and, largely, the provisions were as expected following the earlier consultations and government announcements and discussions.

Despite the fact that legislation is still only in draft, the living sector is already pivoting in many respects to comply with the legislation. For example, it has now become the norm that all new residential apartment leases are being granted without a ground rent and with the intention that the freeholder of pure residential blocks will be transferred to the residents' management company.

Back in January 2021, there was a surprise announcement that later living housing would be included within the terms of the legislation and would no longer be an exempt product. This part of the market is being given until April 2023 to change their form of leases, an announcement which took the industry somewhat by surprise and has meant that the standard form of retirement lease used in the past has had to be reviewed and amended to ensure the ongoing financial viability of these types of developments. The decision is one which is rather baffling considering the social care crisis and general acceptance that the UK needs more accommodation for older people, and that obstacles to growth should be removed where they can be.

The lack of a ground rent is, on the face of it, good for residential owners but, from an investment perspective, is an income generation stream that is now missing and needs to be recouped in other ways. This has meant the restructuring of our clients' standard forms of lease and may give rise to increases in unit costs to cover the missed income generation stream.

Legacy ground rent deals are still being agreed on previously completed apartment blocks, although the changing legislative landscape has had an impact on the price these assets can command as buyers move away from this market.

How the structuring of mixed-use residential and commercial blocks will be impacted by the changes is less clear. Careful thought needs to be given on each and every mixed-use development now in order to ascertain who will be the best long-term owner of the freehold and long leasehold interests in the block, given that there is now no income stream on a yearly basis from the residential apartments. This may mean that mixed-use buildings become more complex from a legal structuring perspective so as to future proof their ongoing maintenance and service charge recovery. These changes, coupled with the changing regulatory landscape post-Grenfell, will put an extra administrative and legal burden on residents' management companies, who will in turn require more professional help from managing agents to relieve this burden. Is this a case of fixing one problem and creating another? Time will tell.

“Careful thought needs to be given on each and every mixed-use development now in order to ascertain who will be the best long-term owner of the freehold and long leasehold interests.”

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Private equity – laughing all the way to the land bank

The double hangover from the pandemic and Brexit is proving hard to shift for FTSE 100 property companies.

In theory, housebuilders' share prices should reflect the incredible growth in house prices seen over the last 18 months which have risen, in part buoyed by rising consumer confidence, but also due to low mortgage interest rates, low mortgage deposit schemes and the government's stamp duty holiday. Yet instead, housebuilder stocks remain stubbornly lower than their early 2020 levels. Acquiring companies at a bargain price when they hold considerable freehold estates (the value of which is only going up in the current market) is making investing in UK propcos (or supermarkets!) a "no brainer".

Vistry's chairman, Greg Fitzgerald, was reported in the FT recently as saying that no private equity firms had spoken to him about Vistry, but he "wouldn't be too surprised if that didn't come in due course". Other living sector clients have also been snapped up: think St Modwen, Sigma Capital and McCarthy Stone to name a few. No doubt there will be more – The Times reported in September that Bridgepoint is gearing up to exit Miller Homes, for example.

Many commentators will therefore be reflecting on whether the influx of private equity into the world of housing is necessarily a good thing for the sector. In respect of the recent Morrisons acquisition by Clayton Dubilier & Rice, Yorkshire MP Kevin Hollinrake asked Sir Terry Leahy for assurances, telling The Yorkshire Post: "I am not against private equity investment, but we have to make sure they do not benefit from any in-built tax advantage. We must do more to establish and maintain a fair and level playing field for all businesses that operate in the UK."

In the current low interest borrowing environment, acquisitive (overseas) private equity houses will not turn their noses up at the potential that exists in the UK. Add to that the relative weakness of sterling and this appears to be a trend that will not be going away soon.

"In the current low interest borrowing environment, acquisitive (overseas) private equity houses will not turn their noses up at the potential that exists in the UK."

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Current trends – a contrarian view

Economically, we have looming challenges to the living sector, but we have almost 15 years' market movement under our collective belt since the last great unpleasantness and perhaps things are different now. Ultimately, it is all about supply and demand (and hopefully a profit element in there somewhere), but let's look at some of the elements that contribute to that in the housebuilder sector.

On the supply side, land and material costs are challenging. Land prices are probably too hot – both for strategic and immediate sites, where landowners have minimum price expectations guided by their land agents, and everyone is looking over their shoulders at what is being agreed on other schemes. In the same way that London office rents were driven upwards through the nineties to vanity levels that, some would say, did not reflect the real value of the underlying assets, land prices are heating up for desirable sites and that has to filter through to house buyers further down the line. Couple that with significant upward pressure on construction costs, and it makes for an uncomfortable margin squeeze for developers.

Pips are getting squeezed, and the recent SDLT holiday was great for driving sales activity and house prices up, but bad for medium term house pricing.

On the demand side, potential shocks include affordability and affordable housing supply. If it costs more to buy land and build housing stock, that has to be reflected in an increase in house prices (or chipped margins, and no investor is going to welcome that with open arms). House prices are at a historic high multiple of average earnings, and that's with a recent history of low interest rates. All it needs is a minor creep in the cost of borrowing, and there has to be a worry that overstretched buyers will fall out of bed. Not only is that bad for private borrowers, but it could correct house prices and then attack developers' margins and borrowing costs. It may never happen, but it's the elephant in the room as we row our own boat more post-Brexit.

"Pips are getting squeezed, and the recent SDLT holiday was great for driving sales activity and house prices up, but bad for medium term house pricing."

This also has an impact on affordable housing provision and recent planning policy developments focusing on "First Homes" as a discounted market tenure product are not very helpful – the real need with affordable housing is in rented stock, not sub-market priced sale stock, and we probably don't need to salami slice the sales end of the market. For those registered providers with the relevant skills, it is driving them to bring forward their own developments instead of relying upon developers' section 106 obligations, and it has certainly introduced choice and added impetus to the housebuilding sector. The regulator has longstanding views on segmenting core affordable stock from other trading activities, but it is certainly likely that the affordable housing sector will continue to pursue housebuilding aggressively to strip out a layer of profit from commercial housebuilding and to continue to fulfil a role in satisfying affordable housing demand in the widest sense.

Are we looking at 2008 all over again? Probably not – the money has been through a massive learning curve since then. There are systemic challenges to the sector with land and build price challenges, and operational funding and asset management challenges as stock is repositioned to a sustainable lower carbon way of working. But the sector and our sector stakeholders are alive to the issues, and work is well in hand to manage those shocks proactively rather than reactively. Will it be easy – no. Will it be cheap – no. But is it achievable – yes, it has to be.

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ESG – distinguishing between sustainability and greenwash

Two recent articles in The Times and The Sunday Times highlighted the attractiveness of the affordable housing sector to investors keen to promote their ESG credentials. During the pandemic, ESG has gone from being a niche term used mainly by private equity funds and their investors to being a mainstream term used across a range of sectors and industries. It is now rivalling "sustainability" as the term of choice for businesses seeking to minimise their impact on the environment, have a positive social impact and demonstrate that they are responsibly managed. The COP26 climate change conference taking place in Glasgow in November 2021, provides a platform for UK businesses to demonstrate their ESG credentials.

On the face of it, social housing is an obvious choice for ESG investors. After all, the "S" in ESG is "social". But is that social purpose the real reason to invest in it? As the Sunday Times article points out, social housing is attractive as an investment because the rent is relatively secure and landlords who provide specialist supported housing are permitted by the government to charge higher rents. While there is nothing wrong with investing in sectors which can deliver good returns, does the growing interest in ESG provide no more than a convenient PR tool for investors? In reality, there may be little difference between funds that invest in social housing and funds that invest in other parts of the living sector, such as 'built to rent', in that they both have a common goal of maximising returns for their investors, but the former can claim to have better ESG credentials than the latter.

The environment is also an increasingly important factor for investors in the living sector, as the government seeks to mitigate the impact of buildings on climate change and ensure that the UK is made more resilient to the inevitable impacts of climate change. According to BEIS, in 2020 the living sector accounted for 20.8% of the UK's CO_2 emissions (some 67.7 $MtCO_2$). That represents a 13.5% reduction since 1990, which is no mean achievement given that the number of households has increased in that period, but other sectors have delivered much greater reductions over the same period – for example, the public sector has delivered a 42.2% reduction and the power generation sector an impressive 75.3%.

There has been no shortage of regulation to try to improve the environmental performance of the living sector, from Energy Performance Certificates to Part L of the building regulations. In the near future, the sector is also going to have to deal with the government's proposed ban on the installation of gas-fired and oil-fired boilers from 2025. Under proposals contained in the Environment Bill – which is expected to become law later this autumn – developers will also be faced with a condition in every planning permission requiring them to deliver a minimum 10% increase in the biodiversity value of development sites. In many cases, that "biodiversity net gain" will need to be delivered off-site, which in itself creates an investment opportunity for acquiring sites that can be used to generate biodiversity "credits" for sale to developers needing to comply with their biodiversity net gain planning conditions. It seems likely that such investments will also be marketed to investors on the basis of their ESG credentials.

The appropriation of land and resources for environmental purposes is also a factor in the concept of net zero carbon, the achievement of which by the UK economy before 2050 is now enshrined in the Climate Change Act 2008, following an amendment to it in 2019. A net zero carbon economy does not actually emit zero carbon, but offsets what it does emit through measures such as carbon offsetting, which may involve activities such as the acquisition of land outside the UK for afforestation. This so-called "green grabbing" poses a whole new set of challenges for investors seeking ESG-compliant investments.

A lack of regulation in the ESG investment space has not made it easy for investors to distinguish between investments with robust ESG credentials and those which are “greenwashing” – making misleading claims about their environmental practices, performance or products. While the EU has adopted the Sustainable Finance Disclosure Regulation (which imposes duties on investors and financial advisers to make disclosures about their approach to sustainable investment) and the related Taxonomy Regulation (which establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable), the UK government has proposed a different approach. In November 2020, HM Treasury published “A Roadmap towards mandatory climate-related disclosures”, which proposed mandating climate-related disclosures across the UK economy aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). As their name suggests, the TCFD disclosures are focused on climate risks, rather than on ESG risks generally, so their scope is much narrower than that of the disclosures required by the EU Sustainable Finance Disclosure Regulation[1].

Organisations operating in the living sector should also be aware of making claims about their environmental credentials following the Competition & Markets Authority’s recent publication of its guidance on “making environmental claims on goods and services”. Housebuilders marketing “eco-homes” or “zero carbon” homes should pay close attention to the guidance’s principles to avoid accusations of mis-selling.

ESG investing in the living sector is here to stay. Interest in ESG investing is likely to increase as the UK moves towards its net zero carbon target in 2050 and the government’s Roadmap towards mandatory climate-related disclosures is implemented. While the delivery of good investment returns will undoubtedly remain a primary aim for investors in the sector, new and emerging regulation will require them to be more transparent about their ESG policies for selecting investments and the ESG credentials of individual investments.

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[1]By way of comparison, the EU Sustainable Finance Disclosure Regulation defines a “sustainable investment” as: “an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance”.

Focus on Northern Ireland

As with other parts of the UK, the last 18 months have seen a period of exceptional market activity in the living sector in Northern Ireland, despite the economic challenges of Covid. Much of that activity has in fact been driven by the societal challenges and behavioural shifts brought about by the pandemic. Northern Irish "ex pats" (particularly those in London and the South East) have been returning to Northern Ireland in unprecedented numbers with their "deep pockets" and are snapping up large, detached properties in some of Northern Ireland's most desirable and expensive locations. As such, supply for quality stock continues to out strip demand and the market continues to run "hot".

This is due in part to a demand and supply imbalance, which already existed prior to the pandemic but which has now been intensified by our collective prioritisation of the need for more space and greater flexibility from our living environment.

The delivery of new homes in Northern Ireland continues to be subject to various development constraints, including chronic delays with the planning system and under-capacity in the sewerage network, which has halted new developments in some parts of Northern Ireland. At present, around £55m worth of infrastructure projects, including upgraded wastewater treatment works and new water mains, are not being delivered due to public expenditure cuts.

> The "brain drain" that once characterised the career choices of many of Northern Ireland's most talented young people is already being stemmed by the emergence of Belfast as a cosmopolitan and exciting city for people to live and work."

The global shortage of skills and materials is also being felt by the construction industry in Northern Ireland. This has led to spiralling costs and prices which, in turn, has fuelled the BTR market as an alternative residential supply. The lifestyle and economic considerations driving the BTR boom elsewhere in the UK apply equally in Northern Ireland, but there are also some local factors at play. Due to historical reasons, the residential market in Belfast city centre is under-developed but is an issue that Belfast City Council is determined to change. The requirement for 6,000 homes in the city centre has been identified as part of its emerging local development plan and it is acknowledged that the private rented sector will be integral to achieving this objective. Local market research indicates that young professional renters – generally graduates accustomed to purpose-built student accommodation – will drive demand for new purpose-built rental properties. The "brain drain" that once characterised the career choices of many of Northern Ireland's most talented young people is already being stemmed by the emergence of Belfast as a cosmopolitan and exciting city for people to live and work. The provision of high-quality accommodation for these young professionals will only help retain this talent in Northern Ireland which, in turn, will help incentivise institutional investors to invest in this sector.

A further UK trend that is being mirrored in Northern Ireland is the move towards "smart homes" which include "green" features such as onsite electric vehicle charging points. There are only a couple of such private housing developments in Northern Ireland at present, but this looks set to change with the government -backed drive towards carbon net zero and a vested interest from stakeholders across the board. The trend in funding affordable housing in Northern Ireland is also evidenced by the recent announcement by bLEND, a subsidiary of The Housing Finance Corporation, of its first social bond for a Northern Irish housing association in line with bLEND's recently established Social Bond Framework, which aligns with the Sustainability Reporting Standard for social housing.

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A plan for living

'A whole new planning system for England' is what Boris Johnson was promising in his introduction to the Planning White Paper. He also took a sideswipe at the current system for providing "nowhere near enough homes in the right places". However, the proposed radical reforms to shift planning away from discretionary decision making to a zonal system have now been paused, following the outcome of the Chesham and Amersham by-election and the appointment of Michael Gove as Secretary of State.

Whilst the government ponders the future of planning, there are other measures that might be used to help deliver the government's 300,000 annual homes target. Expansion of permitted development rights has offered a quick fix to housing delivery in recent years and is a trend that may well continue. The latest and perhaps most controversial change is the introduction of permitted development Class MA in August 2021, allowing the conversion of buildings in Use Class E to residential use. Class E was introduced as recently as September 2020 and incorporates a wide range of commercial uses, including offices, shops, restaurants, cafés, health services, nurseries, gyms and leisure uses.

In sharp contrast to many schemes that have resulted from the exercise of permitted development rights, the recently revised National Planning Policy Framework now emphasises the virtues of "fostering well-designed, beautiful and safe places". So, the challenge Michael Gove faces is to devise a system that accelerates housing delivery whilst maintaining public engagement and supporting the placemaking agenda by providing well-designed homes in the right places. Watch this space!

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