HOUSE PLANNING HELP

Episode 253

Would property investors buy sustainable homes? – with Rob Bence

The show notes: www.houseplanninghelp.com/253

Rob: So, the Property Hub began five-ish years ago when I met Rob Dix.

We had a podcast first and the podcast went really well. It was called The Property Podcast. We learnt that we had a community out there, so to engage the community, we built a website and a forum where they could interact with each other rather than be isolated as an audience.

That audience then started to tell us, 'we want this, we want that.' And off the back of that, we started to create businesses: a sourcing business, a tax business, but the one that's probably most relevant for today is the development business.

We started to develop properties now with investors in mind. So, we make decisions on the type of products and specification that we've used to suit properties that will be let out over the long-term and see more people going through those homes than a traditional home probably would.

Ben: It's quite interesting because this is early days for that section of the business, isn't it? Although you've been through a cycle of this. Why did you want to create that?

Rob: It's really solving our own problems or our own challenges. So, the sourcing business was first. We used to source properties and work with developers like Taylor Wimpey or Renaker and do deals with them.

We then wanted a letting agent because we used to hand out stock to other letting agents and found that we couldn't control the service levels. So, by creating our own letting agent, we could control that.

We then created a tax business to then make sure that people's tax affairs were covered because people again told us, 'we can't get good tax advice.' And then more recently we've started a mortgage service because again, people want the mortgages looked after.

And we could recommend some people but we wanted to bring it in-house and make sure again, we were controlling the whole process.

And I think because we're control freaks, we thought, we're doing all of the other stuff. If we can build the product and then have it exactly as we want it and build it as we would choose, then we can control the whole process and the whole service journey from start to end.

Ben: I'm looking to tackle a development. I want it to be small to begin with. So, I think it's going to be nice to get your take on some of this. Specifically, I don't know what route I'm going down, who this spec development will be for, who it will be aimed at.

But today, I guess the question I'm really asking is, will property investors have any interest in a very high performance home that could be a passivhaus, that could be built with sustainable materials, that might also have some level of renewables?

Let's just start with that point. If you were just answering it straightaway, what would you answer?

Rob: It's certainly possible. It's more important to people nowadays. Not everybody just wants a yield. People will say, 'I want this type of home' or 'I want to provide this type of experience for my tenant.'

So, it's not going to appeal to all property investors, but no property does. Some people feel very different about the experience of owning a house or an apartment. And again, people will feel different about the type of properties they own and will feel that, 'yes, I want to own that type of property that's built that way, that means that the tenant will enjoy that experience.'

I think more and more investors, particularly as there are so many changes in the buy-to-let market now, more and more investors are serious about what they do and they have beliefs on how they should provide to the market and offer a better service and a better product to tenants.

So, while it may not be seen as a mainstream product for a tenant, I certainly do think there'll be a demand for investors and therefore tenants.

Ben: I will say at this point that I am a property investor and I'd like to be able to switch my own portfolio across at some point. But that's another discussion.

What are investors interested in? Is there a common thread that even though this might be more of an ethical investor, what do they want?

Rob: Well, ultimately they want their property to be let quickly and they want as few issues to occur. So, a well-built home will mean that hopefully the issues or challenges as a landlord and as an investor are reduced. And they also then want their home to be desirable so that the void periods are at a minimum.

That's kind of the basic requirements. Not a lot of hassle and by being let out quickly, again that reduces hassle. Beyond that, it's going to be capital growth, being a long-term investment.

Of course, whatever type of property it is, it is going to be dictated to by the market cycles, the local area and how that's performing. But what's quite interesting about what you're trying to do, is I do think that the capital growth element will very much work well with what you're trying to do. Because I think unique homes and properties that are built to a higher standard are certainly going to perform better from a capital growth point of view than a cheaply built terraced or apartment that after ten years looks like it's been there for a hundred, when it really shouldn't.

Ben: It's been quite interesting. I've gone through my own self-build and I've been noting down the snagging list, the little things that are going on. And there's virtually nothing on there. And I have my fingers in certain pies, forums and what have you, and the amount of things on these buildings from so-called big, professional developers – so, if I could definitely have that high performance where people are just pleased with their homes at the end, that would be a major thing.

How might I validate this?

Rob: Great question. I think it's by speaking to local letting agents in the areas that you're looking to develop in, and having conversations with them and saying, 'what are your best performing properties?'

They may give you a quick answer, but really push them. 'Which properties just go straightaway and why? Why is it? What is making a difference? Do you have any properties that are built this way?' If they don't, 'do you find that properties that are unique or are built to a higher specification, do they perform better on the lettings market?'

You've got to be careful how you frame the question because if you lead them, they might just give you the answer you want. But if you are clever about how you approach the questioning and don't lead them to an answer you want to get, then they're the people who are going to give you that validation because they're on the front line. They're dealing with investors and tenants on a day-to-day basis.

Ben: My gut feeling from what I found out before is that it would be the normal things like location. That's number one, isn't it? Availability of stock. That's probably why the major developers keep selling their products because people are just desperate to get hold of them. So, it would be things like that, near to good schools.

Maybe this is a point then to talk about fundamentals and when I go about a land search, I can do this anywhere. What advice would you give to me?

Rob: Of course, you want the fundamentals that you've touched on. You need the rent amounts, the schools, the transport links et cetera. Of course, people instantly think of city centres, but absolutely it's not the case. You can do good work and build properties that are built for the investment market outside of city centres.

I think what's quite interesting is, I think there's a real opportunity there. When you look at the rental market in more suburban areas where people do want to rent, it's often people's homes that they've moved out of. They're not professional landlords, it's just they've moved on. They've decided to let their property for whatever reason. And often those properties are tired and dated, and I think there's an opportunity for high quality new builds to really stand out.

It's like a car. If you're offered a new car or a second-hand car that's ten years old, that's got a few rips in the seats and so on, you're always going to choose the new car if they're the same price. And if it's the rental market, if you bring in a new, high quality product to the rental market, and you can make it look like that for as long as possible, then your product, your home, is going to stand out.

Now, it's a bit harder to do in a city centre and you have to take it a step further in a city centre and you have to then find a unique angle, a different way. But actually, just building a good quality home in a suburban area makes it stand out. You've got to have the fundamentals but that's the basics. Once you've done that, I actually think because of the lack of competition for these types of properties, the rental demand will be strong. You've just got to make sure that your yield is there.

Ben: How am I going to go about financing this? What different types of finance have you used in your business or would you consider?

Rob: So when we started, we actually used a peer-to-peer lender. There are a few out there who will lend to property investors. The fact that you've built your own home will be a big tick in the box for them. They like to see some track record.

If you don't have a track record, so if you're listening to this and you're thinking about doing it yourself, then you need to have a team of people to build it for you to have a track record. And let's face it. Why would you work with someone who's going to do a development for the first time on your project? So, you can get your track record that way.

Once you have that, peer-to-peer lenders will entertain you. If it's your first project, the rates might be a little bit higher. But they are flexible, they are willing to lend, and they have pots of cash that they have to allocate and distribute as quickly as possible because their investors get upset if their money that they put in isn't being used.

So, for the first development, if you don't go that route, at least consider peer-to-peer lending.

Beyond that, then you have development finance options. And I would recommend that you work with a broker. You can try to do it yourself, but it's a nightmare. Although we have been doing this for a short while and have got a bit of experience now, we wouldn't consider trying to do this without a finance broker.

They're different to a mortgage broker. A little bit of Googling or LinkedIn searching and you'll find them. Always go for recommendations if you can. And that route again is something to consider.

There are more and more lenders coming to the market which is really pleasing and you may be able to get finance going down that route.

So, peer-to-peer, or if not, try a broker. You want to avoid the banks. They may tell you they want to lend but they don't want to. They have to be seen to be showing encouragement and will to lend to developers and businesses, but actually they try to do all they can not to. And if they do lend to you, they'll want so much security against the development that you may as well fund it yourself.

Ben: You have sometimes sold developments upfront. Has that worked well?

Rob: It has. It's worked well for us because we know what our exit is, that part of the equation has gone. So, that's quite nice to know, that once we've finished a development then we can pretty much walk off-site after all the snagging is done.

It doesn't actually impress lenders as much as you'd think it would. We thought that lenders would be impressed. Yes, they tick a box, but it doesn't hold too much weight for them.

What it does do though, is it means that you're locking in your price today. And if you do have capital growth – which we've seen on a development recently; we've got twenty-four apartments in Greater Manchester – if we resold them today, even though we've only just started developing on it, we could possibly add ten-thousand pounds per unit because that's where the market has gone. Against twenty-four units, that's two-hundred-and-forty-thousand pounds which is a huge swing.

Now, it can go against you the other way. So, it's pros and cons. But the other thing that we've noticed is, if build costs have gone up in that period as well, then you've got to pay for them. You've locked in your price.

So, it's great and it's nice from a security point of view, but there are some downsides. And you make a choice. You can sell them at the end and not have that security but then possibly get more of an uplift, or you can just lock-in today and know what you're dealing with. And for us, we prefer that security, just to know where we stand. Particularly if we plan to do a few of these. It just gives us that comfort and peace of mind.

Ben: Any other forms of finance that might be worth considering, finance that you've used or maybe have thought of using? Crowdfunding? I don't know.

Rob: You could consider a JV, basically private money. If you have a network, you can approach them with a plan to say, 'I intend to do this' and you may attract investors who would be willing to get involved. Particularly with the banks giving out so little in the form of interest these days, a lot of people are keen to do projects like this.

The downside for me and the reason why we've stayed away from it is the amount you have to offer to make it attractive to these investors can be quite high. Some people want very high returns, double digit in terms of percentages, or a profit split.

So, for us, in the beginning we've gone down peer-to-peer, and then since then, development finance.

Ben: This all sounds second nature to you but if I'm totally honest, it scares me a bit. Have you ever had those moments during your business, even if it is back to the early days? And how have you dealt with it?

Rob: It still scares me now. Because the numbers that you're dealing with, no matter what size development, are always pretty intimidating.

From a business point of view, we're dealing now with much bigger numbers than we've ever dealt with before. And it's not hard with a development for that to happen because these are properties at the end of the day, and properties are expensive.

It's not all been plain sailing. It still isn't, and we are learning as we go on. Our first development, we made a loss. We're very lucky that we had other businesses that were doing well that could absorb that loss. But that was a painful experience. We learnt a lot from that experience.

Ben: What did you learn?

Rob: We learnt that the team is key. Ultimately what cost us was having the wrong people looking after the project. There were lots of mistakes, but that one was the biggest.

Having the right team and the right people is critical. What we found is that if we'd had the people that we have now in place, even though they cost a bit more, they would have paid for themselves several times over.

So, pay for good people because they can be the difference between profit and loss. And even if it eats into your profit a bit by employing or having a team that is just that little bit better, it's worth it. Because if you put a poor performer in charge of the project or a poor team in charge of the project, not only can they reduce your profit, but you could end up at a loss.

That's the risk that you take with development. The upsides are attractive but the downsides are quite scary.

Ben: This is obviously a position that I don't want to get myself into. And I suppose that's one reason why I'm so keen. I've got ideas of a potential architecture firm to use, builders and so-forth; a pool of those sorts of people. But that, as you mentioned, comes at a cost.

So, how are you levelling out your budget and making sure that you are quite confident in all those numbers?

Rob: It's really interesting because the finance companies will have a monitoring surveyor and check your numbers. So, if you work with a peer-to-peer lender or a development financier, they will have their own QS review the numbers and decide whether your plan and project is viable and whether your numbers stack up.

Because you can present numbers to them but you could be wrong or optimistic because you want the deal to work. They will critique your numbers and give you a second opinion.

You can also pay independently for a third opinion, if you like, to give you more comfort particularly on the first few projects, that your numbers are right and you should come in where you want to be. But the surveyors don't cost a lot of money, even really good ones. You're talking a couple of grand here. A mistake or something priced wrong can cost you a lot more than a couple of grand.

So, having your numbers checked at the beginning I think is critical, and asking people to be really critical, point out what's wrong with your plans, what's wrong with your ideas, what's wrong with your timeframes, really invite criticism early on, critiquing of what you plan to do. Because even if they're being a bit overzealous in their opinion and feel that, 'this is really bad' or 'you should really avoid this,' while that may dishearten you, you want to really encourage that. Because you can then go and investigate it. And it's a lot cheaper to investigate it before you start than after you've started.

Ben: Who have you got in your team? You're obviously saying that the team is such an important part. So, for a developer, who are the key people?

Rob: It depends on what level you're going at. For us, because of the projects we have and what we want to do, we're building our team bigger than we probably actually need right now.

So we are bringing in, some of these hires are with us and some of them are being hired for, but a construction director, a senior QS, a procurement/estimator, a site manager, we've already got our land buyer.

Actually, for the size of projects we're dealing with, that is probably overkill. But it's where we're going to next and we want to be ready in advance for those bigger projects. But as I've already said, the cost of getting it wrong can be so big that the investment for us is absolutely worthwhile.

For developers starting out who just want to do a few projects, having a good estimator, someone good at procurement who's going to find the materials, get the right teams in at the right prices, and a really good QS – there are lots of them out there, but as we know in any field, they're not all created equal.

Ben: Are there any important questions that I should be asking myself at this stage, where it is really all in the air and I could go in any direction? What sort of things do I need to be thinking about? I've obviously got the background of a self-build which I know doesn't take me everywhere.

It's interesting; it's almost the flip situation of you coming from the property development side and then jumping into construction.

Rob: For me, I'd get very clear of what you want your outcome to be. Because you can go into this and you could build some nice homes and make a nice profit. But you can't judge whether it's been a success or not without getting very clear at the beginning.

Like, 'why am I doing this? What is my outcome? What does that look like in twelve, twenty-four months?' Whatever your timeframe.

By getting very clear on what you want as an outcome will help you make better decisions at the beginning. You have so many decisions in front of you right now, it's hard to make them. But by getting clear about what you want in the future will make the decision process a lot easier.

Ben: Let's just throw some of this at you. Let's say that I would like to do more development. I feel that it's a crying shame that so many poor quality houses get built. So, I'd like to be able to scale up. Does that inform this smaller development?

This is just a test really to see whether it would work well. I don't want to come out of this thinking I never want to do it again. That's quite important for the first one. Three to five units. I really don't want to be slipping up the slope if I can help that.

Rob: I think by doing your first one, you're going to learn a lot about what you like and what you don't like as a developer, the type of projects you may or may not be willing to take on after that.

The first one you're going to learn the most. It certainly was the case with us. And I think it's wise not to go too crazy on that first one. I think the experience of that will help inform you, 'have I got the right people around me? Have I got the right business angle, the right model? Am I going after the right markets?'

All those things you can have in theory the answers, but by being a practitioner, by actually doing it on whatever scale will help inform you and then guide you to make better choices moving on from there.

Ben: Rob, I've really enjoyed my chat today. Thank you very much. It is very much the beginning. So, you're in at the beginning. If you think of anything, you know where I am.

Rob: I will. Thank you, Ben. I look forward to following the journey.