Co-Living is here to stay

A review and outlook of the Co-Living sector in the United Kingdom

February 2023

Introduction to the sector, supply & demand market dynamics, investment trends and ESG considerations

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Introduction

What is Co-Living?

Co-Living is a form of housing where, typically, private studios are combined with extensive communal amenities, such as gyms, co-working spaces, resident lounges and cinemas, set in large-scale purpose-built properties.

Under the Co-Living model, high quality private living space is supplemented by large amounts of communal amenity space and social events, all of which is included in a single fee (for all utilities and services) on a flexible length contract. Co-Living seeks to create a sense of community and promote sharing of experiences and skills through organised social events and spaces for co-working. Figure 1 compares Co-Living to other residential models.

What is Co-Living?	Traditional multi-family	Hostels	Serviced apartments	Seniors housing	Student housing	Co-Living
Flexibility on lease term but with minimum commitment	✗	✗	✓	✗	✗	✓
Management-sponsored community programming emphasis	✗	✗	✗	✓	✓	✓
Open to any age/demographic	✓	✓	✓	✗	✗	✓
Hassle-free living solution including furnishing and all-inclusive billing	✗	✓	✓	✓	✓	✓
Shared living space	✗	✓	✗	✓	✓	✓

Figure 1: Comparison of residential housing models

Why Co-Living?

The Co-Living sector has an expanding pipeline across the UK and Europe, with operators, developers and investors all seeking diversification away from the more 'traditional' real estate classes and into this 'living' sector.

Co-Living is a relatively nascent sector, which has developed out of a combination of changing real estate and social trends such as urbanisation, rental inflation, socio-demographic changes, housing shortages and the need for social engagement. Co-Living is a response to the increasingly flexible ways that people live and work today. The model offers high-quality, purpose-built accommodation, usually in city centre locations at a discounted price to traditional renting. This particularly appeals to the demographic who have often become accustomed to purpose-built student accommodation (PBSA).

This paper makes the case for investing in Co-Living assets and outlines reasons why the sector is here to stay for the long term.

Market Dynamics - Demand

The investment case for Co-Living is underpinned by a number of macro factors, including increasing population, urbanisation, decreasing household size, a greater proportion of renters and rental inflation as well as shifting consumer attitudes. In turn, each of these factors reinforces the case for Co-Living.

Population growth and urbanisation

Population growth combined with urbanisation has created a lack of affordable housing in urban centres; Co-Living allows for denser occupancy in high quality accommodation.

From 2000 to 2020, the UK's urban population grew by over 10 million, and by 2020 84% of the UK's population were living in an urban environment, as illustrated in Figure 2. This trend is present across Europe with 75% of the EU population currently living in urban areas and this figure is predicted to rise to 84% by 2050[1].

More people are struggling to find affordable housing, with cities becoming more crowded and space becoming scarcer because of urbanisation.

Co-Living delivers higher density housing compared to traditional living accommodation. It allocates space efficiently, allowing for greater occupancy whilst supplying high quality accommodation.

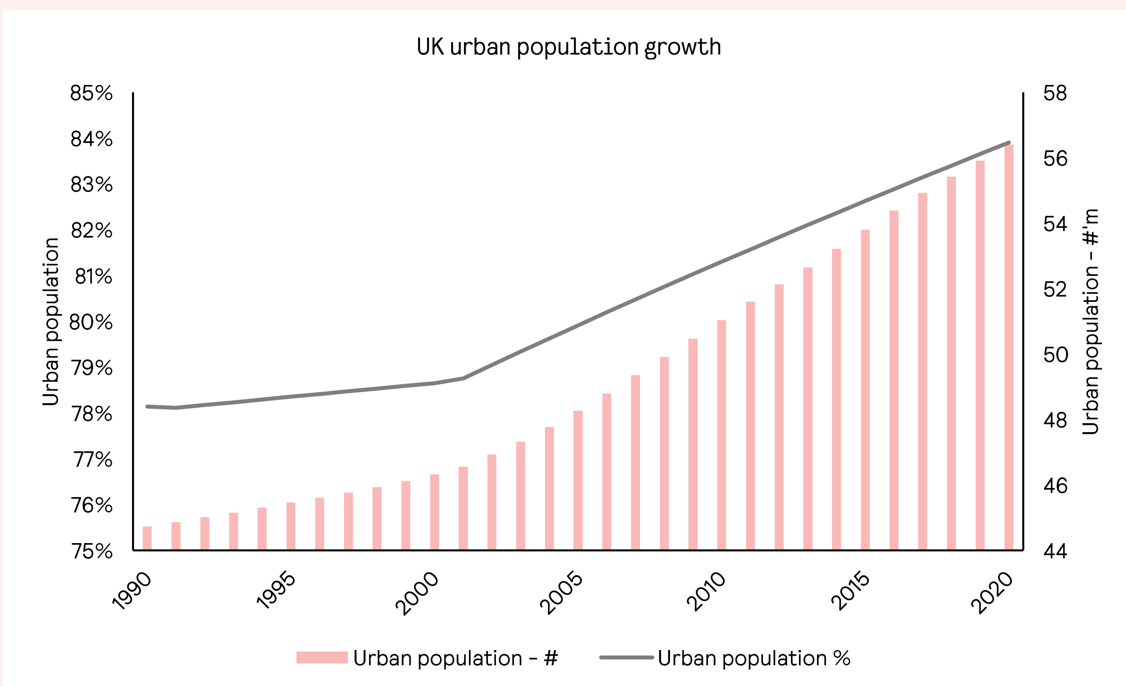


Figure 2: UK urban population growth. Source: World Bank

[1] United Nations

Proportion of renters and home ownership

Homeownership is becoming increasingly unaffordable, driving a greater proportion of renters; the Co-Living model provides on-demand, affordable, high-quality accommodation which appeals to 'Generation Rent'.

Over the past decade, UK residential property prices have increased by 47% whilst real wages have grown at only 6% over the same period, as can be seen in Figure 3. As buying a property becomes more unaffordable, the proportion of the population in the private rented accommodation sector has more than doubled from 11% in 2000 to 24% in 2020, illustrated by Figure 4.

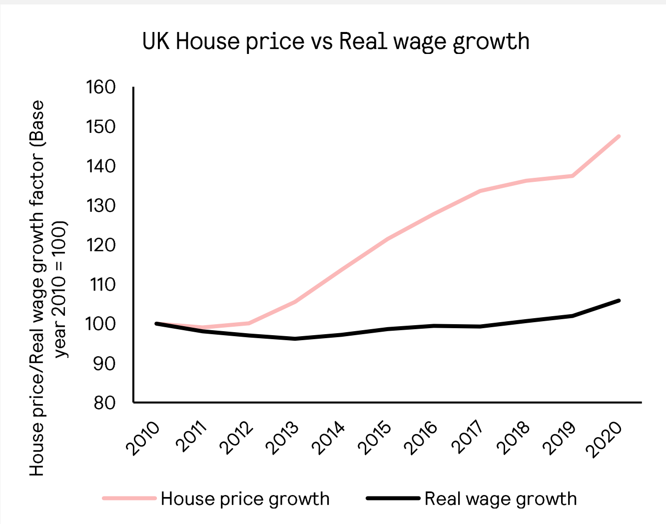


Figure 3: House price growth vs. real wage growth.
Source: Office for National Statistics

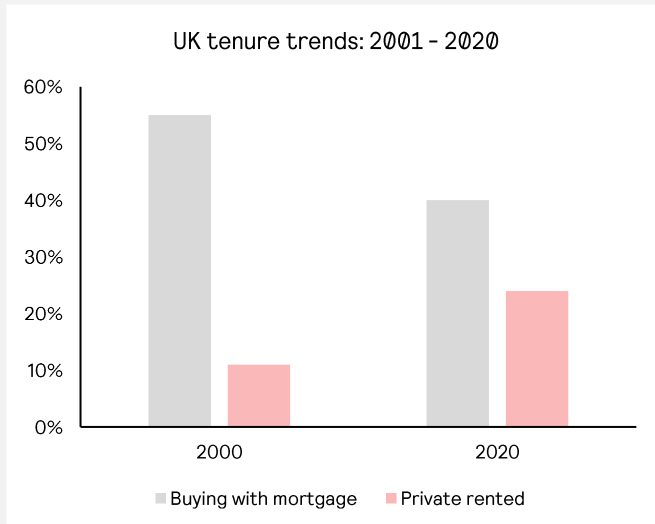


Figure 4: UK tenure trends 2001 – 2020
Source: MHCLG, Office of National Statistics

As the proportion of private renters has increased, the level of home ownership has gone down (Figure 5). This is particularly pronounced among certain age groups with 64% of 16–34 year-olds in the UK not owning their own home[2].

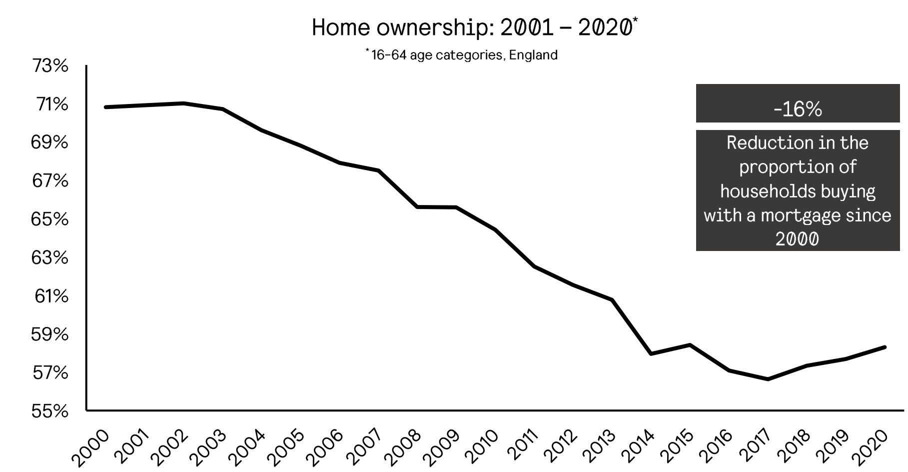


Figure 5: Home ownership 2001 to 2020. Source: MHCLG, Office for National Statistics

[2] Office for National Statistics

The decline in home ownership has been driven by unaffordability and a shift in market trends with a greater emphasis being placed on experiences and flexibility rather than long-term ownership.

The Co-Living model appeals to the 'on-demand' generation by offering high quality private living space, supplemented by an extensive amenity offering which is all included within a single fee on a flexible length term. Social interaction is a key attraction for residents; for example, on-site management teams create a sense of community through regular organised social events.

Key stats	London	UK
Average first-time buyer deposit	£158,196	£60,718
Affordability ratio (median income to house price)	13.7	8.9*
% increase in number of PRS households (2019 vs 2011)	38%	50%*

*England and Wales

Figure 6: Key statistics on home ownership Source: UK Finance, ONS, Census, Experian, Savills

Rental inflation

UK rents have increased by more than 20% over the last decade, Co-Living provides the resident with a 20-30% saving in total housing costs.

Increasing demand in the private rented sector has pushed up rental inflation and increased the unaffordability of the rental market. The UK has seen rents rise by over 20% over the past decade, with inflation highest in London where rents have increased by 31% since 2008[3]. This inflation is expected to continue over the period to 2025 with rents across the UK expected to increase by over 17% and London rents forecast to increase by nearly 20%[3].

Co-Living provides the resident with a 20-30% saving* in total housing costs on a per unit basis relative to a comparable studio product, thereby providing an attractive value proposition for residents. For those unable to afford to buy a property but wanting to live in cities close to jobs and amenities, Co-Living offers a comparable alternative to traditional renting. Figure 7 illustrates an example hypothetical value proposition for Co-Living.

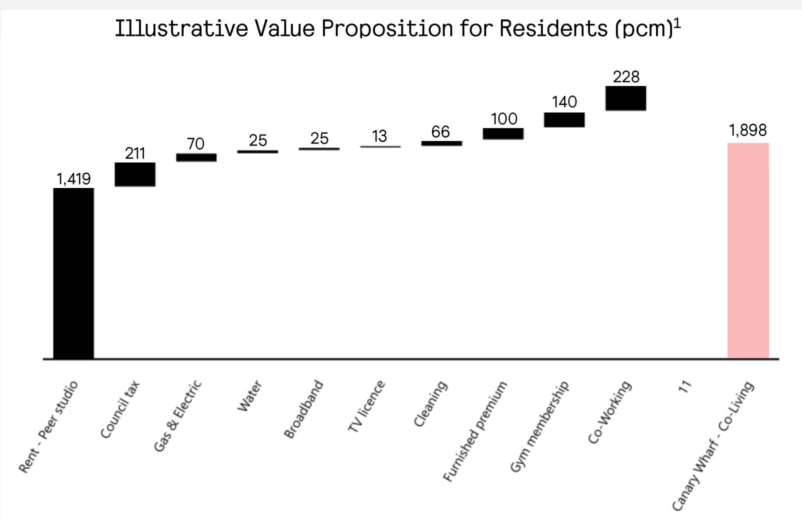


Figure 7: Illustrative value proposition for residents

Source: Office for National Statistics, Tower Hamlets Council, UK Power, Thames Water, Uswitch, TidyChoice, Virgin Active, WeWork, SpaceWorks, ServCorp, The Collective

[1] Rent is the average mean rent for a studio and 1bd in E14 taken from the London Rents Map published by the Mayor of London | Council tax £211 for a band G property in Tower Hamlets 31/01/22 | Average monthly coworking membership at WeWork, SpaceWorks and ServCorp 31/01/22 | Virgin Active gym membership £135pcm 31/01/22 | Monthly rental premium for furnished apartment | Thames Water bill £25 for a studio, gas and electric based on the best dual fuel tariff for a studio in E14 on ukpower.co.uk as at 03/11/21 (unable to compare at date of publication due to energy price caps) | Broadband based on the best fibre tariff in E14 on Uswitch.com as at 31/01/22 | Average cleaning for 2 hours bi weekly on Tidychoice.com

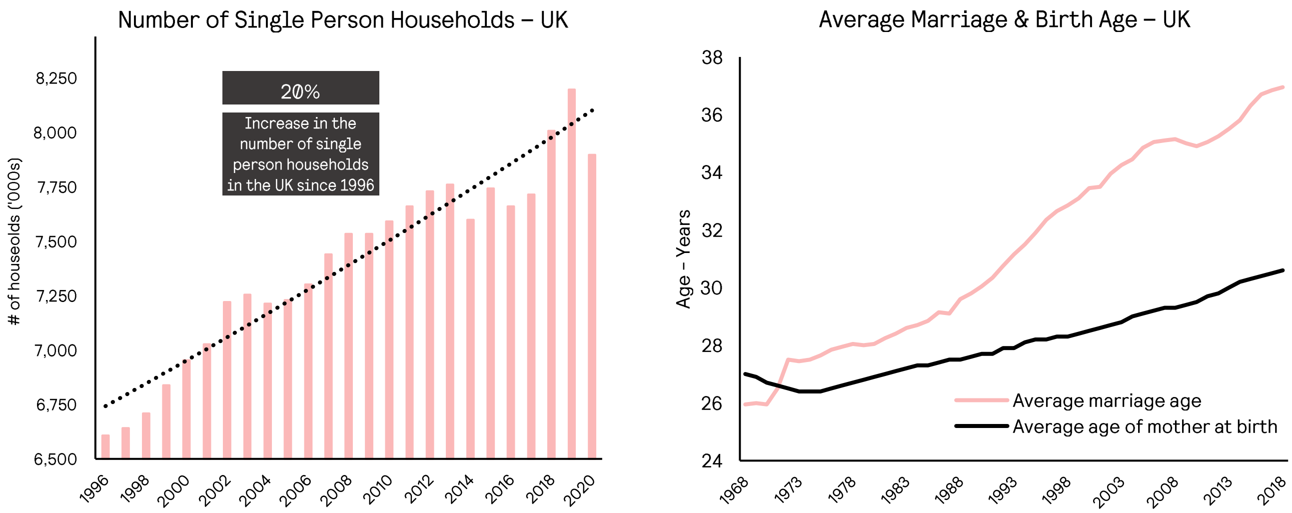
[2] Advertised Standard Studio monthly rate for a 12-month membership at The Collective Canary Wharf (rate during Q1 2023). Rates vary based on room type, floor level and length of stay

[3] Office for National Statistics, Savills, Trust for London

Socio-demographic changes

An increasing number of single person households lends itself to the Co-Living model.

Over the past 25 years there has been a 20% increase in the number of single person households in the UK (Figure 8). This can be partly attributed to a higher proportion of young people attaining a tertiary education, which is creating a more career-focused generation, who are opting to defer family formation, including delaying marriage and having children. For example, the average age at which mothers first give birth in the UK has increased from 27 in 2008 to 29 in 2018 (Figure 9). In turn this is contributing to individuals spending a greater proportion of their time living alone.



Figures 8 & 9: Number of single person households in the UK and average marriage & birth age in the UK.
Source: Office for National Statistics

It can also be considered that, combined with the narrowing gender pay gap, a wealthier cohort of younger people who are much more independent than previous generations are opting to live alone – contributing to the demand for Co-Living accommodation. The Co-Living model caters for this career-focused demographic with co-working and time-saving amenities often available, along with the promotion of sharing of skills.

Attracts young professionals

Co-Living provides the natural progression for recent graduates and young professionals who have grown accustomed to high-quality purpose-built student accommodation.

Much of the demand for Co-Living comes from recent graduates and young professionals. Post-university, this demographic seeks high quality, often professionally managed, housing and aims to live close to job opportunities often found in cities. Co-Living fits this bill. It encourages social exchange and promotes the sharing of skills and experiences by offering amenities and the sense of community that is often pursued by this cohort. The Co-Living model prioritises the flexibility required by the 'on-demand' generation and the needs of an increasingly global and mobile workforce, but also one that feels increasingly isolated and craves community. Residents are attracted to the prospect of connecting with a like-minded community.

Market Dynamics – Supply

In combination with the demand factors, several supply factors strengthen the investment case for Co-Living, including lack of housing stock, low rental market supply and the fragmented residential investment market.

<u>Housing stock</u>

The continued undersupply of homes will maintain pressure on the existing stock of residential property for the medium term.

The UK suffers from a long-term chronic undersupply of housing due to high land costs, restrictive planning for private, independent, residential assets, limited resources for publicly funded initiatives, and a highly fragmented investment market, combined with population growth.

Recent delivery of new residential property stock has fallen short of the additional 300,000 dwellings per year required to meet Government targets, with a current annual shortfall of over 54,000 homes (Figure 10).

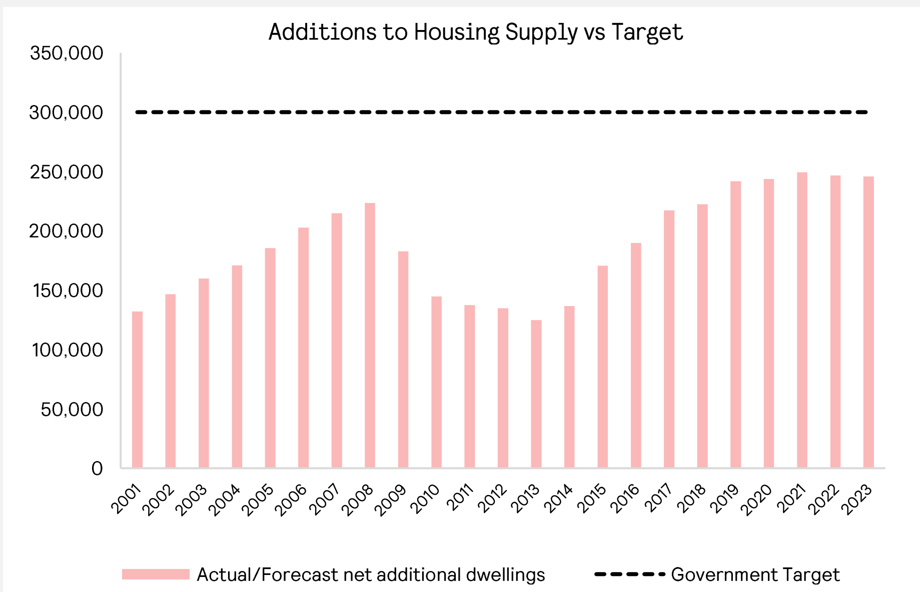


Figure 10: Additions to housing supply compared to the target additions. Source: MHCLG, HM Treasury

<u>Rental and investment markets</u>

The supply issue is further compounded by the fragmented UK private rental market, lack of institutional quality housing and the increasingly onerous administrative burden making it unappealing to be a private landlord.

The UK private rental market suffers from fragmented ownership with only 3% of the UK private rental market estimated to be owned by institutional investors[4]. The limited supply of existing private rental stock is of poor quality, with 27% of homes in the UK private rented sector not currently meeting the Government's Decent

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[4] Investment Property Forum

Homes Standards. Similarly, the stock is lacking in management, with 97% of private rented homes not professionally managed[5].

Intensifying this supply issue are headwinds in the buy-to-let and house in multiple occupation (HMO) markets for private landlords. Several factors have aligned to reduce the attractiveness of the sector:

- Reduction in mortgage interest tax relief
- SDLT – Second home stamp duty surcharge
- Increased capital gains tax rates for residential property
- HMO licensing burden
- Energy performance certificate (EPC), electrical safety and fire safety requirements

This combination of factors has reduced the attractiveness of the residential investment market, further compounding the existing supply shortage.

Planning landscape

Co-Living is now a recognised asset class and included in planning policy.

Initially the emergence of Co-Living in the UK was focused in and around London. However, the regions are catching up, with 60% of units submitted for planning over the past 3 years being outside of London[6].

There was a turning point in March 2021 when Co-Living was formally included in the Mayor of London's 'The London Plan'. This is the first time the concept of Co-Living has been officially recognised in a planning policy document and in this plan, Co-Living is defined as 'Large-scale purpose-built shared living' along with a broad framework of criteria. Consequently, local authorities across the UK are increasingly acknowledging the benefits of Co-Living and actively planning for it.

More recently, the Greater London Authority (GLA) published further, more detailed, guidance on Co-Living, which will be a material consideration within the London Plan. A wide variety of industry stakeholders, including Gravis, collaborated to put forward representations on this guidance with the aim of enhancing the variety of Co-Living options for consumers.

ESG

The concept of Co-Living is based on the idea of sharing – space and lifestyle. With this comes a sustainable means of living and thus Co-Living accomplishes the ESG goals.

'E' Environmental: Co-Living delivers higher density housing compared to traditional living accommodation, with this comes a more efficient use of limited resources. In its production, purpose-built Co-Living accommodation largely utilises modern technology and construction methods. Co-Living pools the use of carbon generating utilities such as heating, energy and water and centralised resource management also helps drive energy efficiency. With new buildings comes the opportunity for low impact heating, such as ground source heat pumps and the compact, well insulated, apartments retain heat.

[5] CBRE

[6] Savills

Additionally, the buildings are often in urban centres and located in close proximity to transport hubs, which encourages the occupants to use public transport. There is also the ability to car share with other residents in the building.

'S' Social: Co-Living addresses the issues of housing stock shortage and housing unaffordability. It offers a reasonably priced solution to those unable to afford to buy a property.

The allure of urban living often runs parallel to the issue of loneliness but Co-Living combats this by promoting a sense of belonging and community cohesion. Studies suggest living with others can help anxiety and improve mental wellbeing. Wellbeing and mental health are prioritised with gym classes and personal and professional development events often organised by onsite management teams. The buildings are designed to integrate the wider community; shared facilities, for example kitchens, gyms, cafes, restaurants, co-working spaces and other shared amenities are shared by residents and may be open to the wider community.

Investment trends

Co-Living is establishing itself as the next asset class in the 'Living' sector.

Globally the most active region for Co-Living has been Asia, whilst increasingly the US and European markets are gaining greater traction. There is limited operational stock due to the infancy of the sector with much of the existing stock concentrated in the UK and Germany. However, there are several sizeable transactions that have occurred recently in the Co-Living arena, and these illustrate the increasing level of capital being deployed into the sector; a selection of these are detailed in Figure 11.

Figure 11: Recent examples of transactional activity for operational Co-Living schemes.

Transaction date	Scheme	Location	Beds	Est. Net Price	Est. NIY	Est. Cap val (per bed)	Purchaser
Oct 2022	The Collective Canary Wharf	London, UK	705	£190 M	Confidential	£269,000	Crosstree
June 2022	Münster	Münster, Germany	345	€51 M	Confidential	€148,000	Patrizia
June 2022	Av. Parallel 101 & Marina	Barcelona, Spain	635	€110 M	Confidential	€173,000	Greystar
April 2022	Smart Studios portfolio	Lisbon & Porto, Portugal	2,106	€200 M	Confidential	€94,000	Round Hill Capital
Dec 2021	1A The Mall	Ealing, UK	81	£20 M	4.50 %	£245,000	Moorfield
Sep 2021	Gladstone Road	Exeter, UK	81	£17 M	4.90 %	£130,000	Moorfield
March 2021	College Road Tower	Croydon, UK	817	£200 M	4.50 %	£245,000	Oaktree

Forward funding is often the preferred route for many investors due to the lack of standing stock. For example, in the table, Oaktree forward funded the College Road Tower in Croydon and Moorfield forward funded 1A The Mall, Ealing.

There is also growing confidence from lenders for Co-Living financing opportunities. This is evidenced by borrowers increasingly being able to borrow on terms in parity with the more traditional Built to Rent and PBSA sectors, for example Vita's Union Towers scheme in Manchester, of 1,670 beds with debt of £191m.

Investment income

The growing Co-Living sector is emerging as a valuable alternative investment opportunity and operational income-generating asset. Several factors make Co-Living generated income particularly appealing to investors.

Diversification of income

With Co-Living schemes there is the opportunity to diversify the core rental income stream by partnering with commercial occupiers, for example restaurants, gyms and cafes.

Another approach is to secure services that not only benefit the existing residents but also the wider community. For example, for a fee, co-working spaces or gyms could be made available for non-residents at certain times.

Inflation and Covid

Co-Living provides long term, dependable rental income with inflation growth characteristics. It offers an inflationary edge over other traditional real estate sectors as landlords do not have to wait for rent reviews but instead have the ability to secure rental increases via operating dynamic pricing. As Co-Living lease lengths tend to be shorter, e.g. 6 months, compared to longer traditional lease lengths of 12 or 24 months, rental uplifts can be captured more readily. Pre-Covid-19, some operators experienced uplifts of over 30% per annum, driven by market demand and supply imbalance and an ability to capture uplifts through dynamic pricing.

More generally, whilst Covid-19 affected some of the shorter-term Co-Living occupancy, Co-Living assets quickly recovered following the easing of the pandemic restrictions. Many residents realised that having a live-in community is appealing, particularly during the time of Covid-19 related lockdowns. The pandemic amplified some of the motivations for consumers to be drawn to Co-Living.

Summary

The combined real estate and social trends of urbanisation, declining home ownership, rental inflation, socio-demographic changes and housing shortages, and the need for social engagement, are being witnessed across the UK and parts of Europe, particularly in urban centres. Co-Living is responding to these trends and to the increasingly flexible ways that people live and work today. Co-Living provides the opportunity to diversify a real estate portfolio while creating an attractive form of alternative living.

There is considerable opportunity for growth for the sector with a variety of macro demand and supply factors at play that underpin the investment case for Co-Living. The demand and supply drivers backing this sector are robust and not likely to weaken any time soon. The growing inclusion of Co-Living in planning policy, together with the increasingly active investment market, and the ability to deliver ESG goals through the Co-Living product are also evidence that the sector is here to stay for the long term.

Gravis is always keen to explore new investment ideas and ventures in the residential and commercial real estate sectors. If you are interested in investing in the Co-Living sector, wider real estate industry or have assets you would like to discuss with us, please do get in touch with one of the team at Gravis.

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