6. futureproof: Perspectives and Modelling

The futureproof approach is a balanced approach to the financial interests of all interested parties; but during the construction stage we needed to establish several key assumptions to inform the modelling.

futureproof for the Investor.

From the Institutional Investor's Perspective futureproof offers

- A de-risked investment opportunity that will generate index linked investment returns over the lifetime of the asset (house).
- An initial scale of investment that warrants serious involvement – c.£100m across 500 homes – and the resulting ability to spread portfolio risk.
- Increased liquidity over a standard 'build-to-rent' scenario.
- A high-quality building product delivered by specialists, with access to additional revenue streams over time.
- it significantly reduces the cost impact of rental voids.
- it increases the liquidity of the investment in 'bricks and mortar' for the institutional investor.
- it could facilitate the basis of a new tradable housing product to enable more third-party investment into the housing construction sector
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The sources of return for the investor are:

Asset Financing Streams	Additional Revenue Streams	Asset Value Increase
Rental Income Mortgage Debt Equity etc. (Managed by the INTEGRATOR)	Long Term, Locked-in, Services Additional, Non-compulsory Revenue Opportunities (Facilitated through the INTEGRATOR)	Proportional to Equity Stake

The Occupiers Perspective

futureproof has been designed to meet the needs of occupiers almost irrespective of their personal circumstances.

futureproof houses can be occupied using any combination of finance suitable to the resident – whether rental payment, equity investment or mortgage debt – and the mix will be modifiable at least quarterly to suit circumstances.

Occupiers will also benefit from a share in the property freehold of up to 100% (where personal equity or mortgage finance is used).

Landowners Perspective

Fundamentally, the landowner receives the same financial benefits with FutureProof as they would with any other market competitive offer, but there is additional flexibility:

- Market value for the land and/or
- Earlier receipt of land value payments because of shift of sales risk and speed of build and/or
- An opportunity to benefit from longer term revenue streams from the development.
- Opportunities for a greater role in the development process if required/requested, with greater influence over the land value.

Overall Perspective

The futureproof financial model takes all these issues into account and is no longer constrained by short term, local market demand conditions thus enabling delivery at much greater speed than a standard developer approach in addition it: will:

- generate acceptable returns to investors in the short term as well as returns over the long term.
- redistribute the value in the construction supply chain and operational phases to improve quality and sustainability and be highly innovative in its approach to infrastructure.
- deliver carbon reduction and create long term revenue streams from buildings and infrastructure.
- offers a truly flexible approach to home ownership and an opportunity to live sustainably.
- it significantly reduces the cost impact of rental voids.
- it increases the liquidity of the investment in 'bricks and mortar' for the institutional investor.
- it could facilitate the basis of a new tradable housing product to enable more third-party investment into the housing construction sector

OUTCOME: The futureproof team with the help of the experts and critical friends set up the parameters for modelling the financial model specifically to address the issues of the return to the potential investors whilst protecting the interests of the investor, the occupiers, the landowners, and the rewards to the project team. The maintenance of Land Value and Building and occupying 500 homes in four years were also essential goals.

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Land Value

Understandably it was not possible to use a real site to model these parameters, however as much starting data as possible was derived from a typical site in Essex.

The target minimum land value for the modelling was based on the Local Plan viability evidence base. The traditional approach to development is assumed to deliver that land value (exceeding the target minimum), and the developer profit is shown accordingly.

The risk allocated to the landowner is the same in the traditional and futureproof approaches and as such the landowner achieves the same residual land value per hectare disposing through either approach. In the futureproof scenario, the reward to the landowner remains at the same target land value. Although the key tenet of the futureproof approach is land market competitiveness, all other rewards are reallocated to those parties taking the relevant risk.

The total project cost under the FutureProof approach is higher due to number of key factors, including the additional design and development costs (and professional fees) associated with a solely offsite construction approach and the need for greater up front ground investigations to de-risk on site works.

However, the high levels of short term, traditional developer reward are no longer relevant, with a more efficient allocation of risk and reward between the various parties

The results of the proof of concept shows that the futureproof model currently works with developments of at least 500 homes (of which 35% will be regulated affordable housing, and the rest futureproof homes). futureproof is therefore a model that accelerates construction on large scale developments and the case study financial modelling shows how it compares with traditional approaches.

Our thoughts are that the quality of homes would also improve if the investor, the developer, the landowner and the supply chain were rewarded for the delivery of quality focused outcomes, not just ‘completed units’.

Also, by ensuring that the Investor reward is both immediate, in terms of a discount to market value of the asset, but also long term secured as an ongoing income / investment return during the holding phase may be attractive to some investors new to the residential market.

Other Modelling Assumptions

Acquisition of completed homes
Whilst the investor would acquire homes and occupiers would move in as the homes are completed, for the simplicity of our modelling the 325 FutureProof dwellings are assumed to be completed in three equally sized tranches, one year apart. The investor acquires these at a discount to open market value of around 5%.

Initial disposals
The 325 FutureProof dwellings are assumed to be disposed of within the same year as acquisition i.e., in three equally sized tranches. We have assumed an initial client funding mix based on the 2011 Census data for Chelmsford, with adjustments to reflect the positioning of the FutureProof product, and affordability constraints.

Ongoing capital income and expenditure
The following capital cash flows over the 60-year appraisal period have been modelled:

- Occupiers repaying debt – This results in a positive cash flow of principal to the investor from the occupier, reducing the investor’s loan book
- Occupiers ‘staircasing’ – This results in a positive cash flow to the investor from the client and reducing the amount upon which rent is due. This is assumed to change based on the difference between wage inflation and general inflation
- Investor buyback of FutureProof homes – This occurs when occupiers wish to move home and is assumed to be followed by disposal within the same year. Whilst we would expect there to be a churn each year, for simplicity at this stage we have modelled one-third of stock changing hands roughly every five years 60-year appraisal period (11 tranches). Whilst we have assumed disposal in line with the initial occupier and funding mix, the amounts involved change due to house price inflation.

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Ongoing revenue income and expenditure
The following revenue cash flows over the 60-year appraisal period have also been modelled:

- Rental income
- Clients paying interest on debt
- Recovery of revenue expenditure (subject to equity share)
- Non-recoverable revenue expenditure
- Recoverable revenue expenditure

Headline Results

	Weak economy	Baseline	Strong economy
NPV of project (discounted at general inflation)	£102m	£215m	£831m
IRR	3.8%	6.7%	14.5%
Return over base rate	+2.3%	+5.7%	+9.0%
Peak debt (Year 3)	£59.9m	£57.1m	£51.5m
Net annual cash income Year 4	£3.0m	£4.1m	£7.4m

Exit from the investment

We assumed that after the 60-year appraisal period, the investor would dispose of its equity stake and loan book to another party. In the baseline scenario, this amounts to £488m before discounting, or £149m after discounting at 2.00%.

These results show that for the same land value the developers profit of £27.466m is transformed into a total reward fund of £39.762m, creating a surplus of about £12 million. There is significant flexibility in how this surplus can be used, including greater supply chain reward, creation of further social housing, allocation to other ESG related impacts, and so forth. The main point being, however, that the concept works: we can create a better product with a financial surplus if we take this view on the delivery model.

OVERALL OUTCOME

These results show that for the same land value the developers profit of £27.466m is transformed into a total reward fund of £39.762m, creating a surplus of about £12 million.

There is significant flexibility in how this surplus can be used, including greater supply chain reward, creation of further social housing, allocation to other ESG related impacts, and so forth.

The crucial point is that the futureproof model works for the investor, with a better deal for the occupier and the contractors with a financial surplus that can be used for example on the next site or building more affordable homes on the current site.