home investor fund
RESIDENTIAL PROPERTY BY HEARTHSTONE
www.homeinvestor.fund

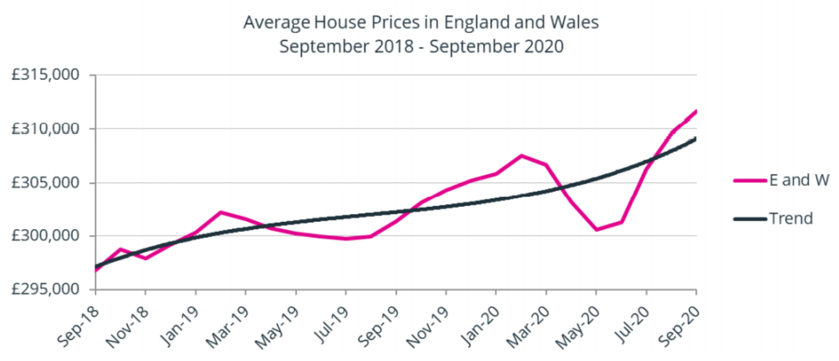
Hearthstone Investments: Positive social impact with innovative approach to tenant management

New Tenant Management agreement, emphasising positive social impact

As most of you know, Hearthstone appoints external specialists as Tenant Managers with responsibility for rent collection, property maintenance, rent reviews and re-lets. The external parties are managed via a Service Level Agreement with specific Performance Indicators which we oversee.

From the 2nd November, we are implementing a new approach to how we incentivise our Tenant Manager for the TM home investor fund. The traditional industry model is for the Tenant Manager to earn a % fee of gross rent collected. This creates a clear focus on rent collection which is in the best interest of investors. Our aim is to supplement this by giving the Tenant Manager an economic incentive to also ensure our tenants are well looked after. In an industry first, we agreed a new Tenant Management contract with a lower fixed fee, complemented by a success fee based on Tenant Satisfaction Scores, and a fee penalty should certain minimum standards not be met. Through this approach we hope to be able to gain a better understanding of our tenants' experience and needs which in turn gives us guidance on how to improve our service.

UK residential property market



Source: e.surv (LSL Acadata)

UK house prices continued to grow in October, with activity and price increases most pronounced in areas with higher house prices and for larger homes. This is a result of the higher benefit of the stamp duty holiday for more expensive homes, and a likely result of changes in working patterns leading some to consider more spacious residences. The overall figures do mask demographic divergences which are not unusual in a recession. More new sales are recorded in wealthier areas where homeowners are less impacted by the economic downturn. Less wealthy demographics are seeing a relative decline in new sales "where households are more sensitive to changes in the economic outlook and the availability, pricing and terms for credit" (Source: Zoopla UK House Price Index Sept 2020).

The strong market is expected to persist for the remainder of 2020 and into 2021. The Consensus forecast for 2020 house prices turned positive for the first time since April, which is remarkable given forecasters predicted a full year drop in house prices of nearly 4% only four months ago. This demonstrates the seesaw of mini Covid-cycles: periods with infection statistics worsening result in restrictions which are complemented by more economic stimulus (as seen in March and now again this autumn); and the cycle in reverse as seen between May and August. We expect this pattern to continue into 2021 – should the overall environment worsen, more monetary and fiscal support is likely to follow or current measures might be extended, and vice versa. The result is a housing market that is remarkably resilient, but with extremes to the upside and with the downside cushioned, leading to house price forecasts that are unreliable as changes to fiscal and monetary stimulus are unpredictable, sudden and their impact difficult to factor in.

Forecasts for the UK economy

Comparison of independent forecasts, month by month

		March	April	May	June	July	August	Sept	Oct
2020	GDP	0.6	-5.8	-8.6	-9.2	-9.1	-10.1	-10	-10.2
	Inflation RPI, Q4	2.2	1.4	1.3	1.2	1.4	1	1.2	1.2
	Unemployment, Q4	4.2	6.9	7.7	7.9	8	8.3	8	7.3
	House price inflation, Q4	2	0.5	-3.0	-3.8	-3	-2	-2	1.5
2021	GDP	1.3	5.0	6.2	6.5	6.6	6.5	7	6.3
	Inflation RPI, Q4	2.9	2.7	2.6	2.5	2.7	2.9	2.8	2.6
	Unemployment, Q4	4.1	5.5	6.3	6.6	6.5	6.6	6.5	7
	House price inflation, Q4	2.5	2.5	2.8	3.0	3	2	-0.2	-3

Source: HM Treasury

GDP, RPI and unemployment rate - average of latest forecasts

House price inflation - Q4 on Q4 a year ago. Median

On a practical level, as stronger restrictions and lockdown measures across England and Scotland are implemented, it is important to note that the housing market remains open, unlike during the Spring lockdown, with the Government once again seeing this as a way to keep the economy going in uncertain times . Generally, guidance emphasises a virtual viewing first approach whilst in-person viewings are still permitted. In Wales, the property market is currently shut temporarily during the two-week firebreak lockdown.

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The housing market continued to flourish in October 2020, with Zoopla reporting house price growth in October at a two-year high of +3%, up from 1.1% in 2019 and e-surv (formerly LSL Acadata) reporting a 3.4% increase. Zoopla goes on to state that the pipeline for sales is up 50% in the last year and, although demand is tailing off, it is still 44% higher than pre-Covid levels. This increased market activity has again been reflected in the Fund's property portfolio which increased in value in October for the fifth consecutive month - valuations for October were up 0.12%, giving a cumulative increase of 0.48% over the last five months.

As outlined above, some of the current headline house price growth figures are driven by the premium end of the market, some of which will be less relevant to the mainstream homes held in the TM home investor fund. The Standing Independent Valuer, CBRE, is keeping a close watch on the fast-changing picture of the UK housing market and the implications on the Fund's portfolio. One specific point to mention is that the RICS Red Book guidelines stipulate that, when valuing a property, transaction prices of comparable properties are only relevant if contracts have exchanged on those sales. Given the sharp rise in transaction volumes, there is significant strain on the various participants in housing transactions leading to some delays; even if there are indications of rising prices from agreed sales, these can't be factored into the Fund's valuations until sales of comparable properties reach exchange of contracts.

The Fund once again demonstrated the resilience of the residential sector with rent collection at 98.25% in October, taking the average monthly collection to 97.6% since the start of the Covid crisis, and in significant contrast to the commercial property funds. We are also seeing the number of vacancies within the portfolio continue to fall, with occupancy, excluding a small number of properties for sale, now back up to 98% from a low of 90% at the height of the pandemic, resulting in the highest monetary rent collection for 2020. In short, valuation up, rent collection up – a positive start to Q4.

The following table contains the latest performance metrics for the Fund:

TM home investor fund

Key Performance Metric	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20
Total return, C-Class Acc, month	-0.14%	-0.28%	-0.07%	0.07%	0.14%	0.00%	0.21%	0.21%
Total return, C-Class Acc , 1 year	1.48%	0.98%	0.70%	0.70%	0.77%	0.70%	0.70%	0.77%
Property valuations, as % of property portfolio	-0.22%	-0.38%	-0.14%	0.06%	0.21%	0.06%	0.02%	0.12%
Distributed Income, C-Class Inc	n/a	Launched 20/04/2020	2.41% gross *	2.41% gross *	2.41% gross *	2.41% gross *	2.41% gross *	2.41% gross *
No of voids (vacant properties), end of month	17	23	21	17	24	17	13	13
+ Completed Acquisitions / - Completed Sales	+ 0 / - 3	+ 0 / - 0	+ 0 / - 0	+ 0 / - 0	+2 / -1	+0 / -0	+0 / -0	+0 / -0
+ Move ins / - Move outs	+ 9 / - 5	+ 0 / - 6	+ 3 / - 1	+ 10 / - 6	+2 / -8	+9 / -2	+13 / -9	+9 / -9
Rent collected as % of rent invoiced	99%	96%	98%	95%	102%	98%	97%	98%

* estimated annual yield, based on Class C Acc historical yield

The TM home investor fund re-opened over 3 months ago, and we are pleased that it was onboarded to the Fidelity FundsNetwork platform on 26th October making it available to even more investors.

Looking beyond our fund at the Commercial Property sector, Threadneedle, Royal London and LGIM re-opened their UK Commercial Property funds for dealing over the past few months, and will shortly be joined by Aberdeen Standard. Commercial Property funds managed by Aviva, Aegon/Kames, BMO, M&G and Janus Henderson, as well as the TIME Commercial Long Income fund remain closed at the time of writing.

Stuart Springham

Fund Manager

5th November 2020

Important information

Past performance is not necessarily a guide to future performance and future returns are not guaranteed. Investors may get back less than the amount invested.

Residential property values are affected by factors such as interest rates, economic growth, fluctuations in property yields and tenant default.

Property investments are relatively illiquid compared to bonds and equities, and can take a significant amount of time to trade.