

CONVERTING COMMERCIAL BUILDINGS INTO LARGE HMO COMMUNITIES

Interview & words
Heidi Moment



NIALL SCOTT

MATT BAKER

Do HMOs still work? They sure do. Especially when you know your tenant inside out and tailor your build to what they want.

Your rooms will never be empty again. This month **Matt Baker and Niall Scott** tell us how they are converting commercial buildings into high-spec HMO communities and changing the future of HMOs forever.

Matt: I'm a musician. A professional piano player. I studied music at university and have spent most of my career doing session work and working with bands. I'm currently working on an album with some amazing Afro-Cuban musicians, which is really interesting. I'm in my element behind the piano, but the thing with being a session musician is that the money is pretty sporadic. It comes in and then there's nothing for a while, so I also set up a music school, teaching piano alongside other musicians teaching other instruments, but in terms of money there's a ceiling to what I am likely to earn. So, about four years ago, I started looking into property as a way of



bringing in more money so I could work on my music without having to worry about it being my sole source of income.

Niall: Before property I worked in the financial services industry, dealing with insurance complaints, then later telecommunication complaints. I was self-employed with no real benefits, such as a pension or sick pay, so it was always in the back of my mind that if I lost a contract or was unable to work, then I'd have no way of paying the bills, which isn't a position I ever want to be in. I also wanted to do something a bit more productive with my life than just working a nine to five job. And that's what led me into property investing.

JOINT SPEED AND EFFICIENCY

We both independently did some training with *Fielding Financial* and it was in 2015

on the advanced course that we met each other and became friends. Our investment journeys almost mirrored each other, with us each starting off investing in single lets then moving on to HMOs. Income generation was key at that time to supplement our other income.

After about a year of knowing each other we decided to do a project together. It was a simple BTL in Burnley. We quickly realised it was much easier and less stressful doing it together, so we decided to buy a couple more. We were moving a lot quicker buying together as a team than trying to do it alone, so we decided to form a proper business, *Scott Baker Properties*, and it's been that way ever since.

CURRENT STRATEGY

Our current strategy is to purchase commercial buildings and houses and convert them into co-living accommodation or HMOs. We're still all about income. We don't sell anything.

We do high-spec refurbishments aimed at, but not limited to, the young professional market - millennials from the age of 18 to 35. People who are working but are not yet able to afford their own place yet.

HIGH DEMAND FOR ROOMS

HMO rooms are a hugely growing market. We know some people say HMOs don't work anymore, but we 100% disagree with that. Demand for rooms is growing all the time, especially as landlords pull out of the market, due to everything that's going on in this country at the moment. We find areas where there is high demand for rooms and we haven't had any issues filling our properties. The transient nature of HMOs means there's a high turnover of tenants, but if the demand is high you'll have a good supply of tenants ready to take the empty rooms and it can work really well.

Nowadays people want flexibility, which could mean they're only looking to stay somewhere for three, six or nine months, which they are unable to get with a standard one person rental, but which we can easily accommodate. We often find some tenants stay for as little as three months due to contract work or similar, but others stay for longer with the average being around nine months, depending on their job or situation.

We aim to have lettable rooms that we can just keep filling, so when someone moves out, someone else moves in straight away. Our voids are pretty low, in fact, the biggest void we've had on Arpley Street (case study one) is about a week.

MANY LOCATIONS GIVE US A SECURITY BLANKET

We invest in several different locations in the UK, starting out in Burnley (Niall) and Warrington (Matt). There aren't many large employers in Burnley, which isn't ideal for HMOs, so it didn't make sense to start a HMO portfolio there (although we still buy BTLs in Burnley). And we have several HMOs in Warrington now, so were getting to the point where we were competing with ourselves, so it made sense to move on to pastures new, by identifying areas where demand is high and stock is low, such as Coventry, The Midlands and Stockport.

It's important to us not to put all our eggs in one basket, as if something were to change in that particular market, it would severely impact our portfolio and obviously our income as well. So being a little bit more diverse gives us a bit more of a security blanket in case anything happens in one of the areas.

FINDING DEALS

We do all our sourcing ourselves and most of our properties to date have come through estate agents. So we spend a lot of time building good relationships with agents in the areas we're investing in. It can take a while to build up these relationships but now we're more established we get properties coming to us before they hit the open market, which is great. And we try and act on all deals as quickly as we can to get them across the line. Agents appreciate this and that keeps them bringing more deals to us.

We do quite a bit of networking as well and one or two deals have come to us that way, just by people talking to us, finding out what we're doing and saying, "Oh by the way, my friend has a property for sale, are you interested?"

RULES & GUIDELINES

When looking for a property to develop our criteria is basically this:

- Residential or office building
- Space to have living bedrooms, at least 10.5 sqm, but usually 12.5 sqm
- Space to put an ensuite in every bedroom
- Five or six rooms to one shared living space
- With a larger property we divide it into cluster flats
- An area of high rentability and high demand
- Three sources of potential tenants, so we have a back up plan if the market changes
- Close to a major employer
- Close to a major train station, major road and motorways for easy commuting.

Over the next two or three years, we're looking for much larger living spaces where we can create fantastic living spaces for young people that are more like communities. Tenants will have ensuite living bedrooms as well as access to high-spec shared facilities, such as kitchen, living room, gym, cafe, and co-working spaces as well.

"Tenants spend a lot of time in their rooms, so large living bedrooms are a must"

PICK THE BRAINS OF POTENTIAL TENANTS

Before we do any project we like to find out what the potential tenants in that area are looking for. We speak to people that are investing or managing properties in the area, to start with. Plus we tap into all the information online, which is where most of the millennials are most of the time.

People are constantly posting on various forums and groups looking for accommodation. So when we go into a new area, or develop a new property we start by doing a bit of research to find out what people are looking for. We go on Spare Room, Facebook and Gumtree and just start chatting to people. It might sound straightforward, but that's because it is, really. We simply tell them we're a landlord developing a property in the area and ask them to tell us what their ideal shared living space would look like, and also what they're not looking for.

People are very direct these days and will happily tell you what they want, rather than beating around the bush. They aren't willing to accept substandard or basic amenities any more, and no-one will move in if you haven't got super-fast broadband. That's a must.

As you can imagine doing this research makes our lives a lot easier because we then just cater the properties to suit the tenants.

ROOM RATES

We generally find the better the property, the higher the rent and the easier it is to fill. And location is key as well. In the northwest, on average our rooms are £500 - £550 in the town centre. On other properties that are a bit further out we get £450. On larger rooms we manage to get £595, which are our best performing rooms at the moment in the area.

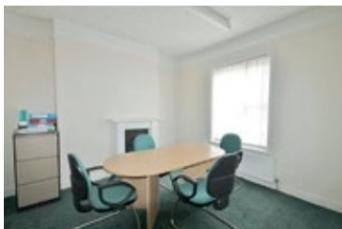
"Better facilities = higher rents"

We're very happy to say that the standard of our HMOs is recognised as being high by both tenants and local agents. When we had our valuation on Arpley Street the valuer said it was the best he's seen in the northwest, which we were blown away with. Because of this, at the moment, we are getting about £100 per room more than our competitors, but that may change as the market changes. We'll have to see what happens.

CASE STUDY ARPLEY STREET, WARRINGTON



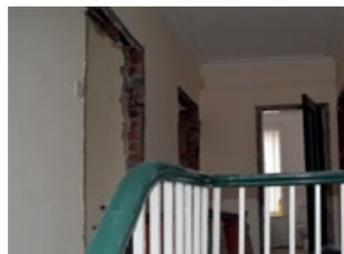
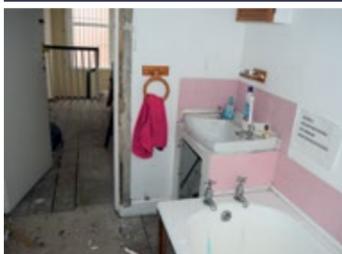
BEFORE



Permitted development on a prior notification takes 56 days. If you haven't heard back by the deadline it is assumed it has been granted.



Sui generis planning permission is needed for HMOs with seven people and above sharing one property.



RIP OUT

Works include

- Full rip out back to brick
- Removal of some structural walls and creation of new walls/structural beams to allow for new layout
- New roof to the front and wide dormer to the back to create extra space
- Dig down four or five inches and tank basement
- Dig out the existing lightwells and enlarge one to form a small outside space
- Form 8 ensuites throughout – 1 per room
- Form 8 large living bedrooms
- Form a large 22m² shared kitchen/living space with amenity to exceed licensing requirements
- Install Grade A fire detection system for the entire building
- Create new access at the rear for flat
- Install covered cycle storage for 8 occupants and enclose the rear yard
- Fully redecorate throughout
- Furnish throughout.

The property

An office in the town centre in Warrington owned by a family run insurance broker since 1957. 3min walk to the train station. It is a lovely end-terrace on a residential street, so was ideal for conversion to residential use. The property hadn't been touched in years and still even had the Victorian features down in the basement including the old mangle!

The plan

To convert the building into two dwellings – a flat in the basement and a house on the ground, first and second floors.

Then convert the basement into a one-bed flat and the house into an 8-bed HMO.

Planning permission

- Class O permitted development (office to resi) to split it into two on a prior notification - that went through without any issues.
- Class L permitted development (change of use) - to go from C3 (a family house), to C4 (up to a six person HMO).
- Once we had established the use as a house (when it no longer looked like an office, after the first fix) we applied for Sui Generis planning permission (for up to 7 people sharing one property) so we could go up to 8 bedrooms.
- Planning permission to re-instate the lightwells, add patio doors and really nice railings at the front of the property.



"We can have 3 empty rooms and still make a profit"

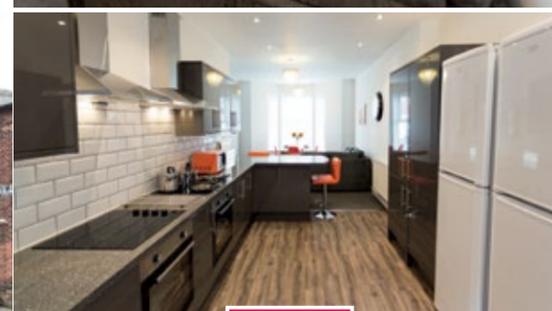


The Numbers

Asking price:	£150,000
Purchase Price:	£147,000
<i>(not much of a reduction but it was a bargain for what it was and it stacked for us)</i>	
Refurb:	£254,000
Monthly rental income:	£4,920
Monthly management fee:	£640 per month when full
Monthly bills:	£800
Monthly mortgage:	£1,494
Maintenance allowance at 5%:	£246
Monthly cash flow:	£1,740
End value post refurb:	£483,000

Timescales

Permitted development for change of use	56 days
Sui generis planning permission	11 weeks
Works	20 weeks
All tenants moved in	6 weeks



AFTER



TREATING TENANTS LIKE OUR FAMILY MAXIMISES PROFITS

This business can be very profitable when it's done well. We like to think about the longevity of the business and that starts with the lettings. Our tenants are our income. They pay for us to have the lifestyle we have, so we try to love them and look after them like we love our family, because it's them who are paying our bills.

By keeping our properties to a high standard and maintaining them well we reduce the amount of void periods, increasing our profits and putting food on our own tables. The most expensive period for any landlord is changing tenants or having empty rooms. Especially with HMOs as we're still paying the council tax, utility bills, broadband etc. So empty rooms means less cash flow, which isn't good. So we try to mitigate that as much as possible.

Having larger properties also helps, as the bills are not necessarily that much higher for a nine bed, versus a six bed, but you've got more leeway with the nine bed and are still making a profit even with one, two or sometimes three empty rooms.

"Bills are not that much more expensive for a 9-bed versus a 6-bed"

PLANNING PERMISSION STRATEGY

Converting commercial buildings happened partly by accident to be honest. When we bought the first one, a fantastic double-fronted end-terrace property, which was being used as an office, we didn't realise at the time of purchase that so much could be done under permitted development. And this really opened our eyes and opened doors for us.

Our planning consultant, Jon McDermott, really helped us with the planning strategy, which we needed because it's not necessarily one planning application to get a commercial conversion through. From this process we learnt we could do a combination of permitted development and planning permission to really maximise the building. Since the first project we've gone on to replicate the process in different locations but on a larger scale.

"Utilise PD rights first to get a faster 'Yes'"

TOP PLANNING TIPS

- Utilise your permitted development rights first to maximise what you can do with the existing building, then go for planning permission for further development if you need to. This makes it easy for the planning department to say 'Yes'.
- The simpler your plans the more likely you are to get a 'Yes'.
- Ultimately the value in commercial buildings for HMO purposes is by getting Sui Generis planning on them.

DO WHAT WE DO BEST, AND GET THE PROFESSIONALS IN FOR THE REST

PROJECT MANAGER

We don't live near any of our investments (Matt Brighton, Niall South East London), so having a project manager is essential for us. We identified early on that managing builders and tradesmen doesn't really suit either of our personalities so it makes sense to get a professional in to do it. Plus, it saves us a lot of time travelling up and down the motorway, so we can focus on doing what we do best and finding more deals.

When projects are going on we only go to the site around once a month, which we feel is enough. We have a great relationship with our project manager who we trust completely, so we'd only be getting in the way. We know he's on site dealing with everything and he sends us updates and photos each week. We sometimes Skype too if he has something to show us or needs a decision to be made right away.

MANAGEMENT AGENTS

In each location we invest in we work with specialist HMO management agents to manage the properties. They are worth their weight in gold. They do a lot of research and background checks on tenants before they move in. They make sure they have good steady incomes, which helps eliminate or eradicate the void periods and unpaid rent. Yes, there'll always be that rogue tenant who causes a problem or disappears without paying their rent, and that can't be avoided, but the agents do a really good job of keeping that to a minimum.

If something is going wrong or there's an issue with the property the tenants contact them and it gets sorted out immediately, which keeps the tenants, and us, happy.

CASE STUDY

WELLINGTON ROAD SOUTH, STOCKPORT



The property

A 400 sqm detached Victorian building over three storeys used as an office. An eight to ten minute walk to the train station in Stockport, so you can be in the centre of Manchester within 30 minutes door-to-door, making it attractive for people working in the Stockport or Manchester area. Stockport is also a massively growing area with millions being spent by the council on regeneration.

The plan

We are working on this project at the moment. The plan is to convert the building into seven cluster apartments, with 22 ensuite rooms. 4 x 3-beds, 1 x 5-bed, 1 x 4-bed and one studio. 18.5 sqm of communal space per shared flat on average, and all bedrooms will be living bedrooms with ensuite bathrooms.

There are 3 levels of spec, one for the basement apartments, one for the ground and first floor apartments and one for 'loft-style' living in the converted loft apartment. These will have differing price points to attract different tenants with different wants and budgets. It will be the first purpose-built co-living space in South Manchester.

The numbers

Asking price:	£400,000
Purchase price:	£370,000
Estimated refurb:	£500,000 (inc fees and contingency)
Expected average room rate:	£525 - £600
Expected monthly rental income:	£12,100
Expected management fee:	£1,815
Expected monthly bills:	£2,200 (conservative estimate)
Expected monthly mortgage:	£3,750 (conservative estimate)
Maintenance allowance at 5%:	£605
Expected monthly profit:	£3,730
Estimated end value post refurb:	£1.2 million

Planning permission

We bought it with permitted development already in place for up to nine apartments. This means we can implement up to nine apartments, however due to the constraints of the building we decided seven is the ideal number to create for best number of rooms and amenity.

We got planning permission for new windows, light wells and roof lights. We went for something bigger than we wanted by applying for changing the shape of the roof to a French mansard. The council didn't like this and suggested that we amend the drawings to only install roof lights instead. They then gave us all the rooflights we wanted, up to 3 per side, which might not have happened if we hadn't 'gone big' first.

Works include

- Remove the external ramp, dig down new lightwells and open up existing ones
- Tank one room in the basement (the rest are already watertight)
- Form new window openings and roof lights (the roof is in good condition)
- Install new conservation-style windows (these have to meet noise reduction criteria on 2 sides as per planning application as we are on a main road)
- Remove all chimneys, some internal structural walls and replace with steel work
- Form 6 new apartments with shared living space and 21 all-ensuite living bedrooms
- Form 1 20sqm micro apartment designed to maximise the use of space
- Install Grade A fire detection system for the entire building
- Fully redecorate and furnish throughout to our interior designer's spec.



Timings

We're aiming to have it finished by July 2019.

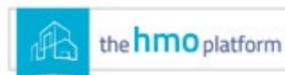
BUYING FOR CASH

Neither of us started in property with our own money, so we've had to leverage other people's money in order to create our own equity. Now we're more established we fund our investments using a combination of cash we've created through our portfolio, bridging loans, development finance and private investor cash. This gives us the option to buy for cash, which vendors and agents like.

PROJECT 96 AND THE HMO PLATFORM

We're excited about this year. We've got an office now in Brighton, so we're planning to work from there to grow and develop the business. We've got some clear goals, which came out of a retreat we went on last year with *White Box Property Solutions*. One of which we call Project 96, which is to add 96 rooms into the portfolio over the next 12 months. That's basically 12 rooms per month for 8 months.

We're also going to work on helping others to do the same and have set up a mastermind group called *The HMO Platform*, which people will be able to use as a platform to get their property businesses to the next level. We both love working with people and we're really interested in helping like-minded people get where they want to be.



Now listen to the full interview with Matt & Niall

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