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Golden dawn or chimera? Can institutional investment transform rental housing?

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Overview

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- Focuses on parallel policy developments in UK and Australia

- Draws on:

- Montague Report (Aug 2012)
- UK Housing Review 2013 (Feb 2013)
- AHURI investigative panel report (Mar 2013)

- Presentation structure

- Research context
- Contestation on the possible merits of institutional investment
- Institutional investment – barriers and opportunities
- Recommended policy interventions and the possible facilitating role of HAs
- Conclusions

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International housing market context

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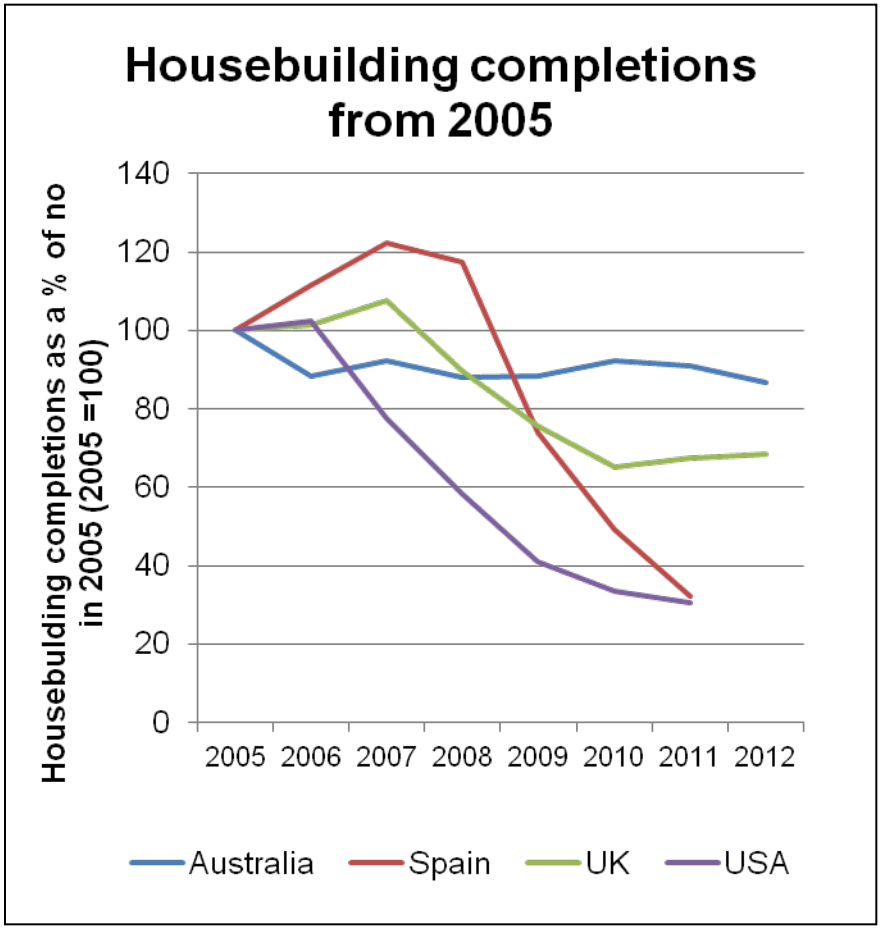
- Post-GFC housing output remains depressed in many countries
- Housing stimulus spending in UK and Australia significant but shortlived
- Ongoing constraints on availability of finance for developers and purchasers
- Lower traditional investor-landlord demand
- Problematic for growth-hungry governments
- Affordable rental housing output falling further below needs



Defining ‘institutional investment’

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- Ministerial aspiration for ‘institutional investment’ in rental housing long established
- Most recent ‘not immediately successful’ manifestations:
  - REITs – UK (2007)
  - NRAS – Australia (2008)
- A shorthand for ‘large scale’ ‘professional’ landlordism – antithesis of ‘amateur’ BTL landlordism
- Can be structured as either equity or debt (e.g. bonds) or both (asset backed securities)
- Increasing focus on pension funds – especially (in the UK) LA pension funds

Why institutional investment?

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- Re-branding private rental
- Scale – only by accessing institutional funds can provision expand sufficiently
- Efficiencies – fewer transactions, promote housing industry restructuring
- Individual investor activity a ‘volatile’ source of funds too reliant on capital gain
- Long-term players needed to reform nature of the rental product

- But ...
  - Non-professional nature of small landlordism may provide hedge against market cycles
  - False parallels drawn with commercial property investment
  - Small scale individual investor PRS domination was ever thus
  - No ‘superior management’ evidence to justify preference for institutions over BTL investors

‘Actually existing’ institutional investment

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- Arguably, large scale institutional investment already finances UK HA development
- Most HA private finance (in England) now sourced from capital markets
- 75% of 2012 funds sourced via bonds and similar (rather than bank debt)
- Has enabled HAs to access long dated finance at competitive rates
- Arrangement of capital market finance has:
  - enhanced relations between HAs and institutions
  - cemented the professionalisation of HA financing

Barriers and opportunities (1)

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Barrier	Possible change in circumstances/response
'Inadequate' rates of return on capital	• Property market cyclical trends recently pushing up rental returns - alternatives (global shares & commercial property) also less attractive • Growing recognition of need to consider risk-adjusted rates of return • Scope for portraying residential sector as akin to infrastructure (low risk low return) not a property asset class
High provision costs (depressing rates of return)	• Scheme dev'ment costs potentially cut by discounted sale of government sites or land secured through planning system at below market value • Construction and management scale economies potentially realised through block procurement • Price discounts for mass presales
'Unacceptable' landlord risk exposure	• Separate development from 'take out' or operational phase • Establish revolving fund

Barriers and opportunities (2)

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Barrier	Possible change in circumstances/response
Pension fund reluctance to enter market (historically)	• Stock market volatility means premium on diversification to spread portfolio risk • Structure of fund liabilities subject to cohort effect moving from 'accumulation phase' into 'pension phase' – hence, attractiveness of rental returns which match liabilities
Novelty – residential property an unfamiliar 'asset class'	• State-assisted 'proof of concept' program
Investment scale threshold	• Potential for intermediary agencies to package investments
Illiquidity of residential property investment	• Establish appropriate institutional structures and mechanisms – e.g. REITs, housing investment bonds

UK/Australian policy recommendations compared

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- Albeit generated by parallel processes, many common recommendations – e.g:
  - Emphasis on ‘build for rent’
  - Public funding required for ‘proof of concept’ schemes (countering the ‘novelty’ barrier)
  - Otherwise, no new subsidy programs
  - Need to separate incentives/support for development and ‘take out’ phases
- But some significant points of difference:
  - Specific measures to promote ‘affordable housing development’ only in Australian proposals
  - (Limited) Govt guarantees proposed for Australia; firmly rejected by Montague but subsequently announced by UK Government along with £1bn ‘build to rent’ revolving fund

Facilitating institutional investment in rental housing: possible HA roles

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- Strong interest from HAs in govt 'build to let' fund
- Possible future role as developers and managers – but not owners
- Model perhaps prefigured by Genesis/M&G Olympic Park deal
- Market rent scheme developed by HA, sold to investor, leased back to HA for management
- '...the first significant move into the [PRS] ...by institutional investors' (Social Housing, Feb 2013)

Genesis HA Olympic Park scheme – 401 homes sold to M&G Investments, Jan 2013

Conclusions

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- Prospects for institutional investment ‘golden dawn’ more promising than historically because:
  - Post GFC investor sentiment more amenable to steady/lower returns – possibly more compatible with residential exposure
  - Cohort effects in the pension-entitled population also incentivising diversification
  - Policymaker appetite for more active intervention
- Consequential sector transformation could include:
  - Improved property quality
  - More professional property/tenancy management standards (via HAs)
  - New landlord cadre more focused on rental returns not capital growth
- BUT no prospect of filling gap in UK affordable housing supply due to Coalition Govt cuts, or providing for very low income households in Australia
- AND perhaps the key question is not how to incentivise *institutional investment*, but how can the tax system be reformed to create a level playing field for *all* rental investors

Key source references

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