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

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Overview

- 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
International housing market context

- 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’

• 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?

- 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
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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<th>Possible change in circumstances/response</th>
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| ‘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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| 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 |
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

- 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
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

Conclusions
Key source references

- Social Housing (2013) Genesis and M&G in £125 million sale and 35-year operating lease; *Social Housing* p1, February [http://www.socialhousing.co.uk/News/Genesis_and_MG_in_125_million_sale_and_35-year_operating_lease](http://www.socialhousing.co.uk/News/Genesis_and_MG_in_125_million_sale_and_35-year_operating_lease)