Institutional investment in housing- searching for the holy grail?

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My Presentation

• Global interest in investment and PRS
• PRS in play in investment terms but considerable uncertainties
• My background for this – CML/IMLA/JRF/HCA/CCHPR
• I will cover;
  – The Context
  – Funding the PRS
  – Institutional Appetite
  – Making Progress
  – Conclusions
• We are making progress but a complex backdrop!
• Is the future renting?
The UK Context

- Falling housing supply and increasing unmet demand
- Falling home ownership and reduced access to the tenure
- FTB’s opting to rent based on choice
  - lifestyle/cost, quality, job mobility, opportunism
- and constraint
  - access to mortgages/credit scores/deposit/confidence/lack of knowledge
- Expanding demand and supply of PRS – primarily existing stock but also new
- No collapse in downturn and in general limited impact on FTBs
- But BtL buyers advantaged over FTBs re new build
- Overall supply/demand balance – demographics clear, supply limited & 1 million plus would be FTBs at parental home/renting
- Govt finance cut back, pressure to inc investment in housing
- Returns on investment –down and QE impact on gilts
Funding the PRS

- 1910 90% 2000, 10% rent controls and rise of home ownership
- Historically funded by institutions, commercial investors and small landlords. As it contracted over the decades some exits!
- Lenders funded PRS at commercial rates -2/3% over Libor, 10 year amortising term
- Sept 96 Buy to Let market emerged with a stronger ‘retail’ flavour and has become key driver of mortgage market
- Total outstanding – 2011 £158bn
- BtL mortgages - 12.7% of all mortgages outstanding
- Loan ceilings, min rental cover and max LTV
- Commercial lending continues and current debate re how to treat BtL in regulatory terms
- Student housing – the success story!
Funding the PRS

- Six initiatives to fund PRS since 1980s;
  - **Business Expansion Scheme** (BES) 1988-1995 – tax relief and exemption from CGT – 81,000 homes at cost of £3bn
  - **Housing Investment Trusts** 1996 – CGT exemption and lower Corporation tax for listed companies – none were created
  - **Real Estate Investment Trusts** (REITS) 2007 exempt from capital gains/corporation tax on rental business but no residential REIT formed (24)
  - **Further changes** made in 2011/12 after consultation in 2010– SD changed so not aggregate value, in 2012 abolition of entry levy of 2%, relaxation of listing, diverse ownership rule and joining REIT club!
  - **HCA Private Rented Sector Initiative** 2009 – create new asset class around instit investment and long term renting based on income returns not capital growth. Possible gtee structure/deal with vacancies but no support from HMT and some negativity from two funds who signed up (L&G/Aviva). Deal done with Berkeley Homes for PRS on new devts with HCA equity stake
  - **Montague Review 2011-12**, looking again at what is happening/needs to be done to get more investment in the PRS

- Evidence to date weak – small landlords to continue to dominate? Resi REITs rare and instit investment limited
Institutional Appetite

• There are a number of factors;
  – Rates of return too low? 6/8% net yield required; (though IPD research on total return suggests Resi does well compared to other assets). HM Treasury suggests net yield is 3.7% in March 2010
  – Few economies of scale – diverse attributes
  – Management – need distance/protection of reputation
  – Uncertainty re property values – overvalued on some measures
  – Alternative returns
  – Lack of understanding/track record
• UK 1% of inv portfolio in res property – average of 15% in EU
• 65 global investors, 13 don’t invest in resi and 11 of them are based in UK
Institutional Appetite

- Investors include pension funds, life assurance companies, private equity funds, sovereign wealth funds, hedge funds, commercial property funds
- Institutional investor portfolios are a mixture of cash, gilts and equities – across the least/most risky spectrum and looking for negative correlations and taking a long term view
- Resi does well on this score – good returns and neg correlated with gilts and equities and Resi also matches well with liabilities – rents/wages/prices correlate
- But poor index measurement, not measured daily, no resi index fund, questions re volatility and liquidity
- On liquidity resi not so good as equities – can be a shortage of buyers, discounts might apply and no derivates to hedge risk with. Plus market dominated by home owners not investors
- So outlook mixed! Expectation there will be some but slow build and don’t want to displace existing exposure, eg, purchase of HA paper
- Push and pull – partly turns on alternatives
Institutional Appetite

- Investment in existing and new stock – build to let – Birmingham CC and partners, London Rental Housing Company
- Terra Firma and Annington Homes, CBRE UK Property Fund, Carlyle, Land Securities, London and Stamford, AVIVA
- BARCAP £3bn mixed development fund and now Hearthstone PAIF a property authorised investment fund aimed at retail and instits
- So we are seeing investment - mainly in London/South East and mainly new build/mixed developments with discounts
- Some pension fund activity on local authority side –Newham in Investors in Housing Fund set up by Mill Group for a co-investment product.
- Hometrack map highlights most obvious potential – London leads the way but other areas have potential
- Mainstream PRS but some affordable
- Student housing market now well established and attracting investors (£770m in 2010; see Knight Frank Student property 2011) but it has attractive features - £245m by early 2011
Types of Rental Market; Hometrack 2011
Making progress

- There is clearly the beginnings of some appetite and a case – this can be built upon. Unlikely to lead but could be big.
- The launch of IPD UK Residential Index in Feb 2012 significant
- Evident hot spots across UK and some activity
- Mainly full market – possible re affordable market?
- Building a forward view of the market – getting the basics in place – stable framework, indices, management capacity
- Question re guarantees, voids, losses, index linked finance
- Building dialogue with institutions and approaching this from their perspective – different language
- Terra incognita and the herd instinct
- But case can be made. Question what are the alternatives?
Conclusions

- Considerable uncertainty re demand/supply, appetite/need, revenue and capital subsidy
- Gap between owning and social renting – market will fluctuate
- Distinguish institutions and investors
- Institutions v slow to respond but options have narrowed and housing now creeping onto the agenda
- Could regulation put a baseline under the affordable PRS sector? Work now underway on social housing REIT
- Best chance of activity in highest pressure markets for PRS
- Some appetite for affordable renting but early days
- Building a prospectus for the UK – address supply but demand?
Useful References

- There are a number of research streams working around the PRS.
- The Resolution Foundation has been working on housing for low and middle income families and has just produced a report Making a Rented House a Home; Housing solutions for generation rent. Further work on institutional investors is on-going
- The IPPR has done a housing policy review, one stream of which is institutional finance
- CCHPR has a stream of work on the PRS including work for a Danish Real Estate Fund and the New Zealand Government. CCHPR also recently published a report for the HCA Private Finance Working Group
  - [http://www.cchpr.landecon.cam.ac.uk/Downloads/110311%20Institutional%20Funding.pdf](http://www.cchpr.landecon.cam.ac.uk/Downloads/110311%20Institutional%20Funding.pdf)
- HM Treasury Report on the UK private rented sector is a useful source
  - [http://www.hm-treasury.gov.uk/d/consult_investment_ukprivaterentedsector.pdf](http://www.hm-treasury.gov.uk/d/consult_investment_ukprivaterentedsector.pdf)
- London Councils and British Property Federation (2011) Invest to Rent: A guide to developing partnership investment in new private rented homes for Londoners
  - [http://www.londoncouncils.gov.uk/policylobbying/housing/finance/investtorent.htm](http://www.londoncouncils.gov.uk/policylobbying/housing/finance/investtorent.htm)
- Deloitte (2011) UK REITs A summary of the Regime, Real Estate, December, London
- Finally the details of the current Montague Review are to be found at [http://www.communities.gov.uk/documents/housing/pdf/2092762.pdf](http://www.communities.gov.uk/documents/housing/pdf/2092762.pdf)