UK housing shortfall – crisis or opportunity?

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There is a saying that an Englishman's home is his castle. Although not all UK housing is medieval, it is starting to creak with age. The UK has the oldest housing stock in Europe. Nearly 40% of residential property was built before the end of the Second World War.[1] More than one in five dwellings has been standing for more than a century.

It's not just the buildings that are getting old: so are the homeowners. Two-thirds of "owner-occupiers" are over 65. The fabled Englishman's castle is increasingly the preserve of wealthy baby-boomers.

This pattern, to some extent driven by affordability pressures and the fact that people are living longer, is further exacerbated by the UK's consistent failure to build sufficient volumes of new housing. Local Authorities have all but stopped their own building programmes, and although Housing Associations have replaced them as social landlords, for the last ten years, the political agenda has pushed for the private sector to lead the delivery of housing.

This changing pattern of provision has, however, resulted in living costs for younger workers increasing while more than 1m households are currently on waiting lists for social housing.[2] So how much residential building is needed? A 2019 study for the National Housing Federation suggested the UK requires 340,000 new homes a year, of which 145,000 need to be affordable.[3] Annual construction in recent decades has been 100-200,000, leaving an enormous latent demand.

The opportunity

With existing stock facing obsolescence, supply constrained and an already high demand further fuelled by a growing population, this presents attractive investment fundamentals. Institutional investors have an opportunity to help remedy the UK's woeful record in providing modern, sustainable accommodation. With considered investment, charities, pension funds and insurers can enjoy stable returns from a sector that has consistently outperformed all other traditional real estate sectors in the UK, as shown in this chart. Furthermore, investors can benefit from an obvious correlation to wage inflation, while also satisfying their fiduciary responsibilities for sustainable and impact (SFDR 8 & 9) strategies.

Edmond de Rothschild Real Estate Investment Management (EdR REIM) is a successful property investment platform across Western Europe that has already raised two funds for the UK Build-to-Rent sector, adding to its already extensive residential expertise across both the Swiss and German markets. EdR REIM's UK Build-to-Rent strategy is aimed at mass-market renting, in areas across the UK where the demand-supply imbalance is at its most acute. EdR REIM targets urban areas with a high density of young professionals where economic prospects are healthy and transport infrastructure is strong, but existing housing stock is of poor quality and in limited supply.

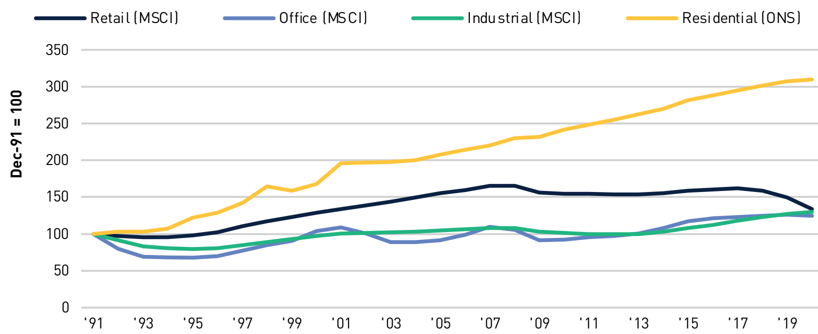
Build-To-Rent works

In a nascent sector where standing stock does not yet exist, construction is the solution. The yield on this type of asset in the UK is 150bps to 250bps more attractive than an equivalent German or Swiss asset.[4] This yield advantage can be further advanced through development returns and the value EdR REIM adds through the construction phase. These strong returns perhaps reflective of the underestimation of demand, especially among professionals ready for high-quality rental accommodation. They are also reflective of the relative immaturity of the UK Build-to-Rent market. A market that we still feel offers an early-mover advantage.

EdR REIM prides itself on modelling such demand per locale accurately and in great depth. EdR REIM uses various third-party data agencies, while also leveraging an already nationwide property management team, to provide inputs and market intelligence on demography; actual and prospective salaries; localised population growth forecasts; rival sources of accommodation and peer-city analysis. EdR REIM also uses an extensive network of contacts to source deals off-market, with access to a substantial pipeline to ensure committed capital is not sitting idle.

Unusually for real estate asset managers, EdR REIM believes in vertical integration. We don't just buy assets

Des Res: UK real estate performance by sector: 1991-2020



Source: CBRE, Knight Frank, Edmond de Rothschild REIM (January 2020)

and view them on a screen: we have our own inhouse leasing and property management teams, alongside our development and construction teams. By covering the full value chain we keep close to the buildings we own, avoid leakage to third parties and constantly refresh the loop of customer feedback and retention.

This latter point is crucial in the 'S' of our ESG strategy, which promotes sustainability via resident engagement. Our tenants are at the core of what we do, sustainable communities ultimately means better returns for our investors.

For the 'E', there is GRESB participation while all buildings are assessed against the BREEAM Home Quality Mark. The more efficient our buildings, the lower the cost of living for tenants, which translates into better tenant retention.

For investors seeking an impact strategy in UK housing, they can also do this via Funding Affordable Homes ("FAH"), an evergreen SFDR Article 9 Fund advised by EdR REIM. This product channels capital into the regulated housing sector, a subsector which has an even greater supply/demand imbalance.

FAH's portfolio covers General Needs, Extra Care and Specialist Housing, the latter two targeted more specifically at the elderly, those with specialist needs and housing for the homeless. Institutional investment is desperately needed to bolster all forms of social provision.

Government-backed income and inflation protection

Alongside the benefits of impact, the incentives for building and acquiring affordable regulated housing are numerous. The majority of rent in the affordable and social sectors ultimately comes from central government. In the case of Extra Care (targeted at over-55s) and housing for the homeless (including refugees and victims of domestic violence), the government typically pays 90-100% of rent. Furthermore, the lease structures available in the sector offer annual indexation which typically tracks inflation.

To manage the stock and engage with the residents EdR REIM employ strategic partnerships with specialist local Housing Associations, while we also utilise our own subsidiary Housing Association, to secure government grant funding and to maximise access to stock.

The regulated housing sector provides a reliable, inflation-linked income stream, with attractive yields comparable to the private sector, but at capital values that are typically at a 30 to 40% discount.

When attempting to predict paths for the UK economy, it is wise to look across the pond to the United States. Forty years ago, institutional investors owned just 2.5% of the entire private-sector apartment market in the US. Today they own more than 25%. Given UK residential's historic outperformance, the notion that institutional investors allocate to UK commercial real estate but not residential is as outdated as living in a castle.

FOOTNOTE
1 English Housing Survey (DCLG), 2019/20
2 https://www.insidehousing.co.uk/news/news/just-one-social-home-delivered-for-every-175-households-on-waiting-lists-69035, 2020
3 https://researchportal.hw.ac.uk/en/publications/housing-supply-requirements-across-great-britain-for-low-income-h, 2019
4 CBRE, Knight Frank, EdR REIM, 2020

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EdR REIM real estate funds are reserved to professional investors and might come with restrictions for certain persons and in certain countries. The funds do not guarantee or protect the capital invested, so investors may not recover the full amount of their initial capital invested even if they retain their units for the recommended investment period. Any investment in real estate funds involves exposure to certain risks, particularly, but not limited to, liquidity risk, concentration risk (Real Estate investments) and currency risk. Any investment in EdR REIM real estate funds may in any event only be made on the basis of documents and information that comply with applicable regulations.