UK Residential Property: Institutional Attitudes and Investment Survey 2018

DECEMBER 2018

COMMISSIONED BY THE IPF RESEARCH PROGRAMME

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This Programme supports the IPF's wider goals of enhancing the understanding and efficiency of property as an investment. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high-quality analysis on a structured basis. It encourages the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

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UK Residential Property: Institutional Attitudes and Investment Survey 2018

Report

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1. EXECUTIVE SUMMARY

- Contributors to the 2018 survey own or manage investments worth in excess of £8.2 trillion[1], of which UK real estate comprises c£246 billion (c.3% of all assets). There were 48 respondents to the survey, of which 34 have exposure to the UK residential sector.
- The overall value of UK residential exposure, from the 32 contributors providing data, is £16.6 billion, or 8.6 % of their UK real estate assets, the joint highest percentage since the survey began. The average holding of respondents with residential exposure is £520 million, considerably higher than the 2017 average of £432 million.
- Investment in the private rental sector (PRS) continues to be the most prevalent means of holding residential, accounting for just under half of total investment. Development for either investment stock or for market sales accounts for nearly a third.
- Just under 50% of the residential assets, covered by the survey, are located in central London (Zones 1-3). An additional 15% are situated in outer London (Zones 4-6) and another 13% in the South East (including East Anglia).
- Returns profile remains the principal reason for investing in residential, although it is not such a dominant choice compared to 2017. Stability of income remains the second most important criterion. Residential's defensive qualities appear to have become a more compelling reason to invest in the sector in the last year.
- Fourteen of the contributors to the 2018 survey do not invest in UK residential. The primary reasons they give for not investing are unattractive pricing and the low-income yield offered by the sector.
- Two-thirds (65%) of residential investors state that they intend to increase their exposure to UK residential over the next 12 months, compared to 80% in the 2017 survey. Three non-residential investors are also considering entering the sector in the next 12 months.
- A total net figure of £8.3 billion is reserved for future residential investment, the majority of which is expected to be channelled through development land for investment stock (£4.7 billion) and the purchase of existing (and newly completed) residential for private (market) rent (£2.7 billion).
- Geographically, outer London (Zones 4-6) is the most favoured locality, accounting for £2 billion of potential investment. The South East (including East Anglia) and the Midlands were joint second with £1 billion targeted for each location.
- Two-thirds of investors intend to work with the UK public sector in the next three years, with the main intention of accessing sites owned by these organisations, to develop then retain units for rental purposes.

[1] This excludes three large investors who did not disclose the relevant data.

2. INTRODUCTION

The IPF survey of institutional attitudes and investment intentions towards the UK residential market is now in its seventh year. Its principal aims are to monitor the changes that have occurred in residential investment by institutional and large-scale investors over the 12 months since the previous survey, as well as identifying any longer-term investment trends that have emerged during the past seven years.

Data from the survey was collected primarily from an on-line questionnaire, directed at major institutional and large-scale investors. Further comments were gathered during interviews with 16 of the contributors to the survey. All information was provided in confidence and is reported in aggregate. Data collection took place over 11 weeks from mid-July, with interviews taking place during September and October.

More than 60 organisations were invited to participate in the research, representing a range of real estate investors, comprising pension funds, life assurance companies, property companies, real estate investment trusts (REITs), sovereign wealth funds, fund and investment managers and other financial institutions. As with previous surveys, participants represented both investors with and without exposure to the residential sector. A total of 48 responses to the survey were received, although, due to issues of confidentiality, some parties declined to answer certain questions, primarily those requesting details of asset values.

While the survey does not provide a definitive picture of institutional/large-scale investment in the residential market, it offers a useful snapshot of the sector compared to the wider UK commercial real estate market. As a guide to coverage, the end-2016 value of the UK private rented sector (PRS) was estimated to be £1,110 billion[2] (end-2017 results were not available at time of publication). The institutional investor ownership of residential was assessed at £23 billion and a further £14 billion was invested in student accommodation. The value of the UK total commercial property investment universe was estimated at approximately £486 billion at end-2016. Survey respondents account for approximately half of the UK commercial property investment universe and nearly £17 billion of residential exposure (including student accommodation).

[2] The Size and Structure of the UK Property Market, End 2016 Update, IPF 2017

3. SURVEY RESULTS

The principal aim of the research was to measure current levels of investment, as well as future intentions of major investors towards the UK residential sector. In addition, non-investors in the sector were surveyed to identify the reasons for their lack of investment. Comparative analysis was undertaken, using data from core respondents who have contributed in every year of the survey over the past seven years.

3.1 Profile of Respondents and Current Investment

The headline total value of investments held or managed by the 45 survey respondents, providing relevant data for the 2018 survey, was in excess of £8.2 trillion[3]. Of this total, UK real estate comprises approximately £246 billion or around 3% of all assets. Three contributors did not disclose financial information for inclusion in this analysis.

Table 3.1: Assets under Management 2012-2018 (All Contributors)

	All Investors		Residential Investors		
	Number	**UK Real Estate AUM**	**Number**	**UK Residential Assets**	**Proportion UK Real Estate**
		(£bn)		(£bn)	
2012	28	180	33	7.6	4.6%
2013	43	166	37	10.9	7.0%
2014	46	204	37	12.8	6.5%
2015	43	221	38	15.4	7.5%
2016	46	232	37	15.6	7.4%
2017	54	237	42	18.1	8.6%
2018	**45**	**246**	**32**	**16.6**	**8.6%**

Note: Assets under management (AUM) are imputed from the 45 respondents that provided data. Returns may include an element of double-counting due to the inclusion of indirect investments managed by other respondents.

A comparison of responses to each of the seven years of the survey is contained in Table 3.1. Residential investment amounted to 8.6% of the UK real estate portfolio of the 32 contributors who supplied data on their UK investments, the same level as in 2017. However, the average size of residential holdings, at £520 million, was considerable higher than the previous year (£432 million).

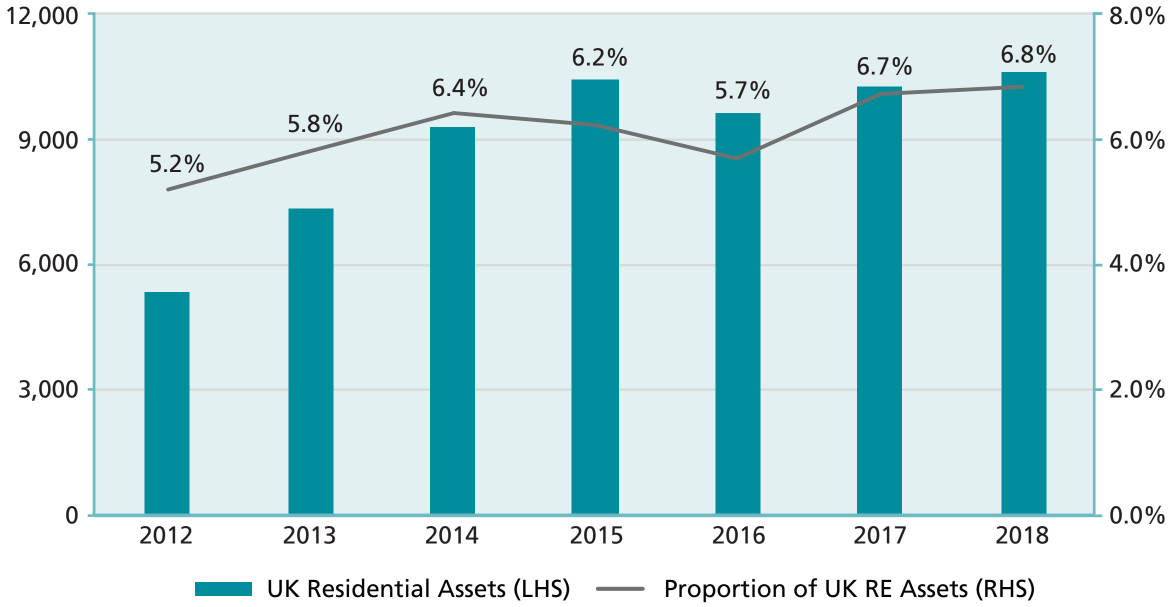
Respondents were asked if they held residential assets overseas. Interestingly, nine of the 14 non-investors in UK residential had exposure to the sector outside the UK. Overall, there was an almost even split between those that invested in residential abroad (23) and those that did not (25), a similar pattern to 2017.

A year-on-year comparison of residential assets owned by the 24 investors who have contributed to the survey in every year is contained in Figure 3.1. There was a small increase in the amount of residential held by these investors. In additional, the percentage of residential held within the real estate portfolios rose marginally to 6.8%, the highest recorded to date.

[3] Figures for overall real estate and residential exposures are gross, unadjusted for potential double-counting through indirect investments in funds, joint ventures, etc.

3. SURVEY RESULTS

Figure 3.1: Residential Assets under Management 2012-2018 (Regular Contributors)



There were three fewer regular contributors to the 2018 survey than last year due to the merger of two contributors and the non-participation of a further two major residential investors. Values reported are unadjusted for capital appreciation; however, the IPD UK Annual Residential Property Index reported a virtually nil increase in capital values for the sector in 2017.

Comparing contributors who provided data for both the 2017 and 2018 surveys (38), there was a net increase in residential asset values of just over £900 million with the increase spread across 18 investors. Of the remainder, the position of nine contributors was unaltered (of which, eight were non-investors) and 11 reduced their exposure.

3. SURVEY RESULTS

3.2 Exposure by Asset Type and Geography

Contributors were invited to provide details of how their residential exposure was split by type of asset. Categories defined in the 2018 survey comprised:

- Standing investments – market rent (Private Rented Sector, (PRS));
- Standing investments – sub-market rent/affordable (Social Housing);
- Development land for investment stock;
- Development land for market sales; and
- Other.

Table 3.2 provides a comparison with responses from previous years, including a breakdown between different asset types.

Table 3.2: All Contributors by Asset Type (£m)

Year	All Assets	PRS	Social Housing	Devt. Rent/Sell	Other
2012	7,594 (33)	n/a (21)	n/a (5)	n/a (15)	n/a (16)
2013	10,855 (37)	n/a (23)	n/a (3)	n/a (19)	n/a (18)
2014	12,792 (37)	4,389 (23)	369 (6)	3,064 (22)	4,970 (25)
2015	15,399 (38)	4,547 (30)	606 (5)	4,148 (21)	5,158 (28)
2016	15,545 (37)	5,854 (24)	622 (6)	4,039 (23)	4,041 (15)
2017	18,145 (42)	7,990 (29)	1,120 (7)	3,770 (24)	3,100 (12)
2018	**16,644 (32)**	**7,776 (23)**	**1,070 (7)**	**4,917 (23)**	**2,881 (9)**

Note: Number of respondents in brackets. Not all contributors provided a breakdown by type of their residential holdings.

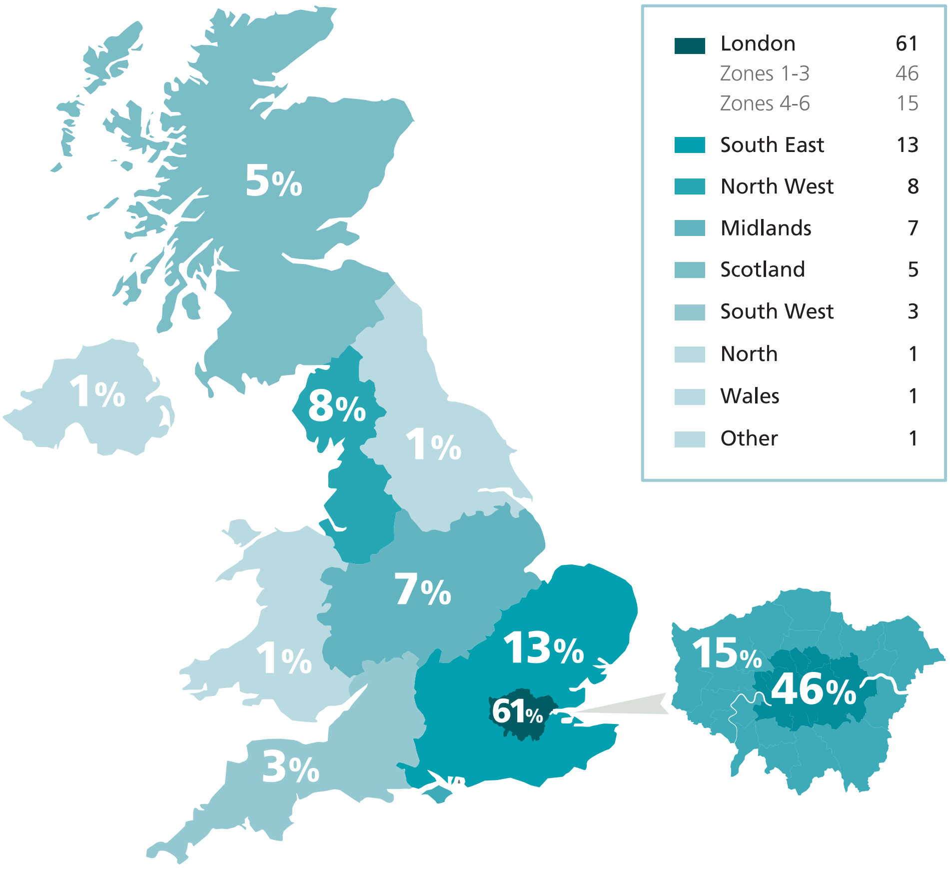
In 2018, PRS exposure was again the most popular residential investment type, accounting for just under half of the residential exposure reported (£7.8 billion). Development, for either investment stock (also known as build to rent) or for sale, was second with just under £5 billion of exposure, a significant uplift from last year. In 2018, exposure to land and development of investments to be rented and to be sold amounted to £3.1 billion and £1.8 billion respectively.

'Other' remained close to last year's investment levels at £2.9 billion. Examples of the type of accommodation contained in the 'Other' category include: ground rents, senior living/retirement housing, student accommodation and residential care homes. The value of the social housing/sub-market rent investments also remained similar to 2017 levels, at £1.1 billion.

For the first time, respondents were asked to identify where their assets were located within the UK, with 28 providing this information. The results, displayed in Figure 3.2, highlighted a strong London bias, with just under half (46%) of residential investments located in inner London (Zones 1-3). A further 15% was located in outer London (Zones 4-6) and another 13% in the South East (including East Anglia). The rest of the investments were spread across the UK, reflecting interest in the larger cities beyond London. The North West had 8% of assets, the Midlands 7% and Scotland 5%.

3. SURVEY RESULTS

Figure 3.2: Distribution of Current Residential Investments (%)



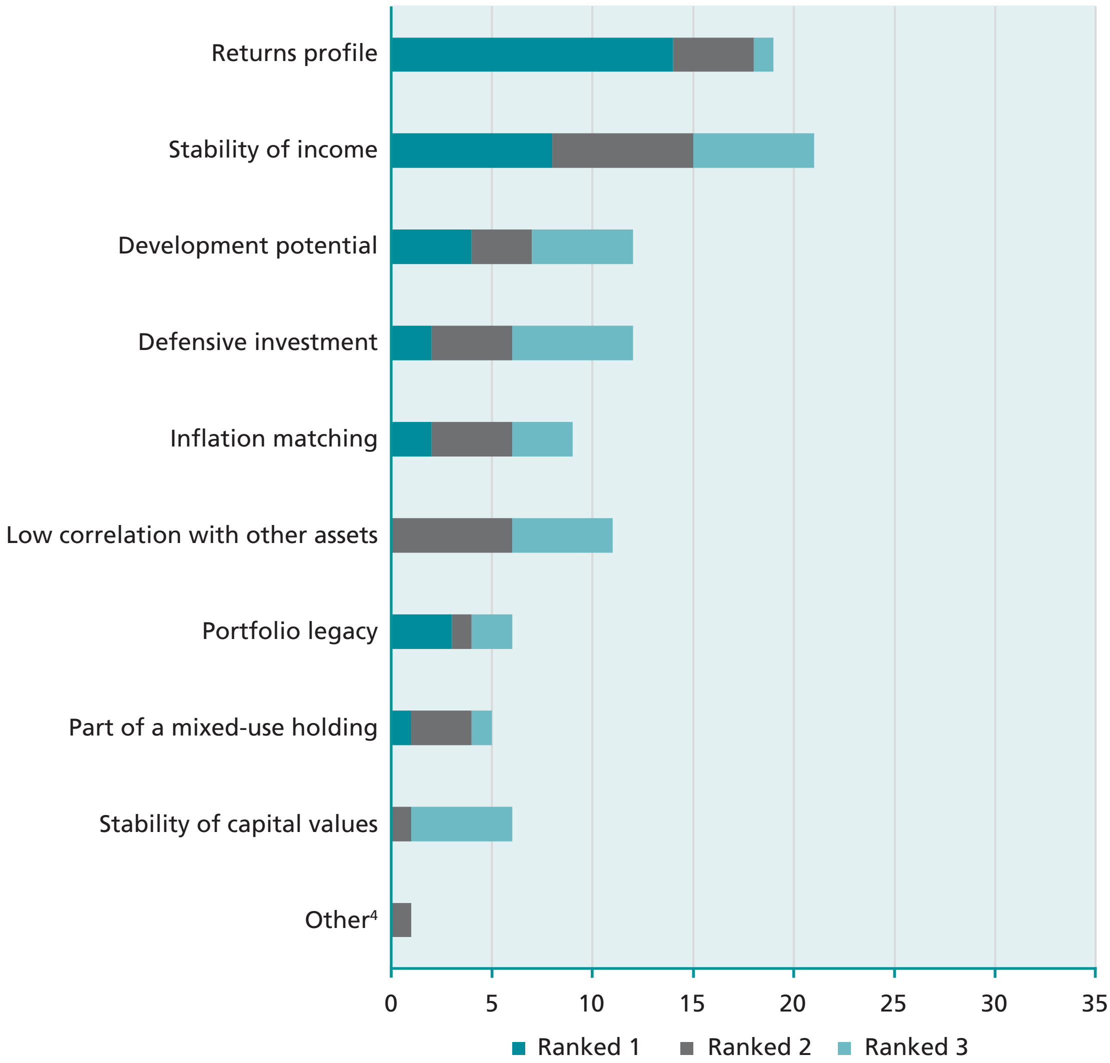
Note: Data collection amalgamated a number of regions: South East comprises: South East and Eastern; Midlands: East and West Midlands; North: Yorkshire & Humberside and North East.

3.3 Rationale for Investing in Residential Property

Respondents to the survey were asked to rank the top three reasons for investing in UK residential from nine criteria, which are listed in Figure 3.3. The chart also illustrates the range of responses and the relative importance to contributors in the 2018 survey.

3. SURVEY RESULTS

Figure 3.3: Ranking of Investment Criteria 2018



The principal reason for investing in residential was the returns profile, with 56% of contributors nominating it as one of their top three reasons. Fourteen respondents considered it as their primary reason, with a further five respondents ranking it as either their second or third choice for investing. However, returns profile proved less popular than in 2017, when 70% of contributors chose it as one of their top three reasons for investing in residential.

Stability of income was also identified as a key rationale for investment in residential: just over 60% of respondents selected it as one of their top three reasons, a similar level to 2017. Other important criteria were development potential, defensive nature, inflation-matching ability and low correlation with other asset classes. Residential's defensiveness as an investment, reflecting the very different characteristics of each sub-sector of residential and its lower obsolescence compared to offices, for example, increased in importance as a rationale for investment with 35% of contributors in 2018 ranking it in their top three reasons compared to just 13% in 2017.

[4] 'Other' was described as "being a founder investor group in a sector that is likely to see significant growth institutional asset allocation over the next few years."

3. SURVEY RESULTS

3.4 Investment Intentions

Investors were asked if they intended to change their UK residential exposure over the next 12 months. Of the 34 current investors, 65% (22) stated that they intended to increase their exposure to the sector. This is lower than in 2017, when 80% of current investors were looking to expand their residential portfolios, but higher than in 2016, when 60% of respondents expected to increase their exposure to the sector. Six investors were not looking at making any changes to their residential exposure while only two indicated that they would be reducing their residential portfolio. Four investors were unsure of their intentions at the time of the survey.

Non-investors in residential also were asked how they expected their exposure to the UK residential sector to change over the next 12 months. Seven responded that they had no intention of investing in the sector in the near future, while three stated that they were considering residential purchases within the next year. The remaining four non-investors were unsure.

Contributors were invited to clarify their investment intentions by providing details of the type of property and approximate amount expected to be invested or disinvested over the next 12 months. The responses of 22 contributors are summarised in Table 3.3. The figures also include the investment objectives of those current non-investors who quantified their intentions. Nearly £8.3 billion has been earmarked for the next 12 months, the highest level recorded since the survey started in 2012.

Development of investment stock (build to rent) accounts for more than half of planned investment, at £4.7 billion. The acquisition of standing PRS investments is the other main category and is expected to attract £2.8 billion of new investment in the next year, with only a small amount of disinvestment. Other residential uses account for potential commitments of £250 million.

Disinvestment intentions are minimal, amounting to £125 million, the majority of which is in PRS.

Table 3.3: Investor Intentions over the next 12 months

	PRS	Social Housing	Devt. Rent	Devt. Sales	Other	Total
Invest (£m)	2,759	525	4,714	128	250	8,376
No.	10	4	13	4	2	33
Disinvest (£m)	100	0	0	25	0	125
No.	2	0	0	1	0	3
Net Invest (£m)	**2,659**	**525**	**4,714**	**103**	**250**	**8,251**
No. Net Investors	**10**	**4**	**13**	**3**	**2**	**32**

Note: A number of investors expressed intentions to invest/or disinvest in more than one type of residential asset. The table includes the results from both investors and non-investors.

3. SURVEY RESULTS

To understand better the extent to which investment intentions translate into actual changes in exposure, analysis has been undertaken to compare future intentions, as indicated in the 2017 survey, with actual investment activity measured during the year to the 2018 survey.

Table 3.4 presents a comparison of the results from the 30 contributors who provided responses to both the 2017 and 2018 surveys. The majority of investors (23) in the 2017 survey were proposing to expand their residential portfolio, while three were considering disinvestment. A further three contributors had no plans to alter their portfolios and one was unsure at the time of survey.

Data from the 2018 survey, indicated that seventeen investors (59%) matched their broad expectations (to increase, decrease or maintain their existing exposure). This is a decline on the 2017 outcome when three-quarters of respondents matched their stated investment intentions with their investment activity. Two-thirds of investors who were considering expanding their residential holdings in 2017 did so over the past year but a further six of the 23 actually lowered their exposure. Of the three respondents who expected to reduce their portfolio over the past year, only one did while the other two took no action. Of the three investors planning to maintain a stable residential portfolio, one did so while the other two disinvested.

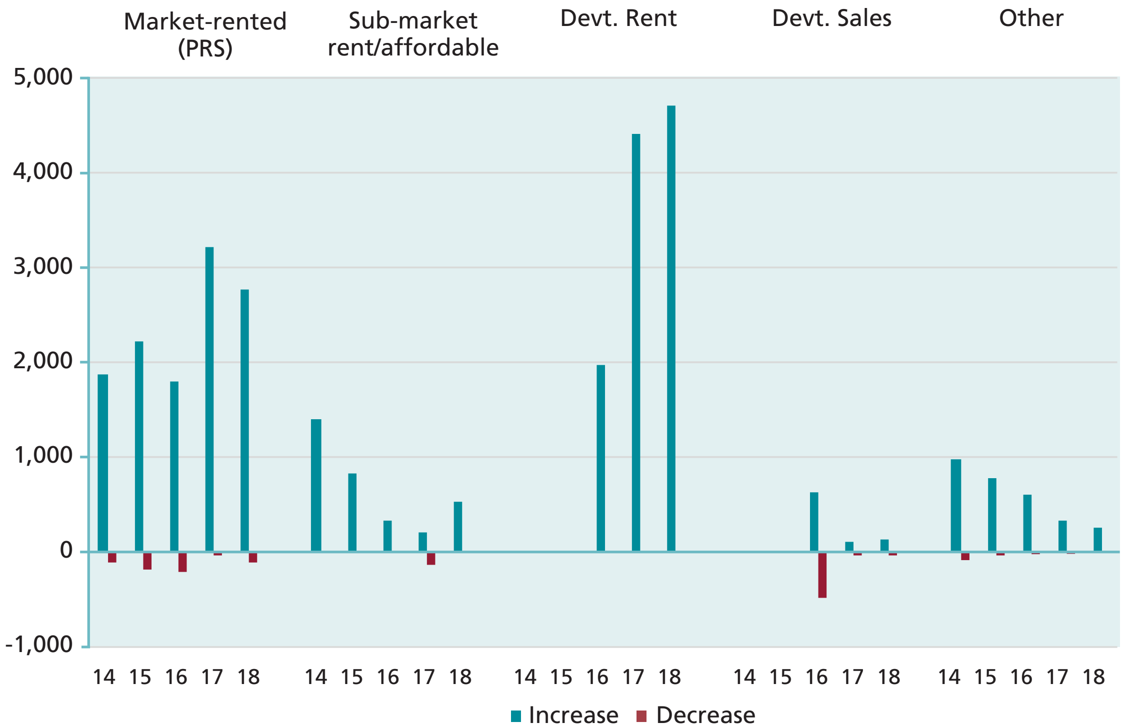
Table 3.4: Investment Intentions versus Outcome

			Actual (2018)	
2017 Intentions	**No.**	**Decrease**	**Remain Stable**	**Increase**
Decrease	3	1	2	0
Remain stable	3	2	1	0
Increase	23	6	2	15
Unsure	1	0	1	0

Investment intentions over the past five years are displayed in Figure 3.4. Accessing the sector through development for investment stock was again the most popular route in 2018, a considerable margin ahead of acquiring PRS standing investments. This would appear to reflect a continuing shortage of suitable large-scale investment stock, hence leading to a need for investors to develop this type of asset for themselves.

3. SURVEY RESULTS

Figure 3.4: Change in Investment Intentions 2014-2018 (£m)

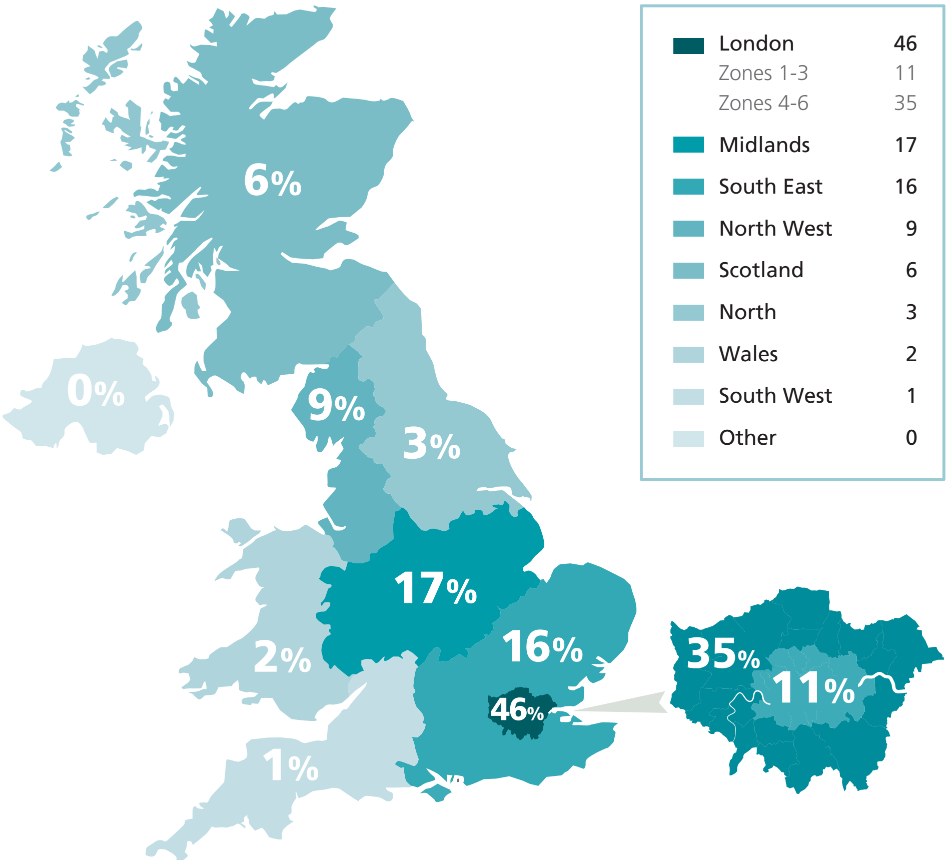


Note: Development for investment stock or for selling units into the private market were not separately categorised in the 2014 and 2015 surveys.

Investors were asked to indicate the geographical distribution of their intended residential investment. Information was supplied for £6.6 billion worth of investment from both current investors and non-investors. Outer London (Zones 4-6) was the most favoured locality for future investment, accounting for over £2.3 billion of potential investment. The South East (including East Anglia) and the Midlands were joint second with £1 billion for each. Other popular destinations were inner London (Zones 1-3, £750 million), the North West (£585 million) and Scotland (£405 million), as illustrated in Figure 3.5.

3. SURVEY RESULTS

Figure 3.5: Distribution of Future Residential Investment (%)



London	46
Zones 1-3	11
Zones 4-6	35
Midlands	17
South East	16
North West	9
Scotland	6
North	3
Wales	2
South West	1
Other	0

Note: Data collection amalgamated a number of regions: South East comprises: South East and Eastern; Midlands: East and West Midlands; North: Yorkshire & Humberside and North East.

3.5 Barriers to Investment

Fourteen of the 48 contributors to the survey do not currently invest in UK residential property. These respondents were asked to clarify the main reasons for their non-investment. The options provided are listed in Table 3.5, along with a comparison of results from preceding years.

The principal explanations cited for not holding residential were its unattractive pricing and low-income yield. Political risk and a difficulty in achieving scale of investment, the following two reasons, were some way behind in terms of number of responses.

3. SURVEY RESULTS

Table 3.5: Reasons for not Investing 2012-2018

Factors	(no. respondents)	2012 (14)	2013 (7)	2014 (11)	2015 (9)	2016 (9)	2017 (10)	2018 (14)
Political risk		4	0	4	2	1	3	**4**
Reputational risk		5	3	5	2	2	3	**3**
Unattractive pricing		6	3	1	1	2	6	**9**
Too difficult/management issues		12	2	4	2	2	2	**2**
Income yield too low		9	5	5	4	3	5	**8**
Difficult to achieve scale		9	2	4	4	4	5	**4**
Lack of liquidity/insufficient market size		9	3	5	1	1	1	**3**
Development risk*		n/a	n/a	n/a	n/a	n/a	0	**0**
Currency risk*		n/a	n/a	n/a	n/a	n/a	1	**1**

Notes: Two investors did not select any of the above options; instead non-investment was attributed to off-benchmark risk and a lack of historical investment in the sector.
*Criteria added to 2017 survey.

In the last 12 months, three respondents disinvested from the sector. The reasons for this were not stated but one intends to reinvest in the next 12 months. None of the 2017 survey non-investor respondents gained exposure to the sector during the past year but three current survey participants are considering residential investment in the next year.

3.6 Partnerships with the UK Public Sector

With the UK market continuing to suffer from a shortage of suitable development land, the UK public sector may provide the solution as a potential source of appropriate sites. To examine the extent of current and future interest in working in partnership with local or central government, several questions were introduced into the survey in 2016.

Firstly, respondents were questioned about their involvement with the UK public sector in the previous three years, either by a land purchase or by entering into a partnership or joint venture. Thirty-one contributors responded, with only four having had experience working with the public sector over the preceding three years, half the number reported in 2017. This activity amounted to a gross development value of £530 million.

Respondents were also probed about their future intentions and whether they planned to work with the UK public sector to develop housing in the next three years. Two-thirds of those that replied anticipated working in some way with the UK public sector, the same as in 2017 (and a markedly higher proportion of responses than in 2016, when only half of contributors stated that they were contemplating such an arrangement). The majority of respondents quantified their development intentions, in the next three years, which amounted to nearly £2 billion. Access to land to develop out then retain units for rental purposes was the main reason, by some margin (13 of 19 replies), for building relationships with the UK public sector.

3. SURVEY RESULTS

3.7 Performance and Key Metrics

Survey participants were questioned about some of the key metrics they use to measure or analyse the performance of their residential investments.

Contributors were asked to quantify the range of reduction in gross to net income for maintenance and expenses that best fitted their experience over the preceding five years. Of the 25 responses, half reported a reduction of between 25% and 29%. Six investors indicated a range between 20% and 24% best reflected the leakage, with one investor commenting that economies of scale kept costs down. A further four respondents thought the gap was less than 20% but two investors suggested leakage between gross and net income was greater than 30%.

Investors were also surveyed about the average rental growth levels achieved on their residential standing investments in the last three years. Twenty-four contributors responded, with just over half (13) reporting rental growth of 2% to 3% per annum on average. Five investors achieved rental growth of over 3% per annum, exceeding inflation. Three investors achieved 1% to 2% per annum, while for two others rental growth ranged between 0% to 1% per annum on average. Only one investor experienced rental decline in their residential portfolio, the reason for which was not disclosed.

Investors were questioned about the other metrics used to measure the performance of their residential assets. The large selection identified reflects the wide range of characteristics of residential investments. The most prevalent metric mentioned, by seven respondents, was total return. A further four used an internal rate of return (IRR) to monitor performance. Five investors used occupancy or retention rates, as one form of measurement, with another using customer satisfaction rates. Other metrics cited were profit-on-cost, yield-on-cost, equity multiple, return on equity and gross margin.

4. POLITICAL INITIATIVES AND ISSUES

A number of external influences are creating uncertainty in the UK investment market currently, including Brexit and the forthcoming elimination of capital gains tax (CGT) relief for foreign investors. In addition, the main political parties have recently announced plans or provided recommendations for changing the way residential property is legislated. The repercussions of these issues were explored during interviews conducted with 16 survey contributors in September and October 2018, of whom 15 currently invest in the UK residential sector and one is looking to do so in the near future.

4.1 Impact of Brexit

As with last year's survey, this report would be incomplete if the views of investors towards Brexit and its impact on the UK residential market were omitted. In 2017, with the terms of a UK withdrawal still some way off, concerns appeared to be limited. While some unfamiliar with the market may have been deterred from investing, particularly those from overseas, existing investors were not, this being borne out by the high level of positive investment intentions reported in that year's survey.

One year on, and with a deadline for agreement looming, investors were asked if Brexit had had a noticeable impact on residential prices, rents and activity. The result was a dichotomy of opinion, evenly split between those that believed the forthcoming separation from the EU has had an impact on the residential market in the last year and those that had experienced little change as a result. Investing in different geographical locations and across different asset types may explain some of the contrasting opinions.

Some investors, who felt that Brexit was exerting a negative influence on the market, observed that the resultant uncertainty had led to a softening of residential prices, most noticeably in London and in the more prime parts of the capital, in particular. Conversely, one investor stated that the potential longer-term shortage of overseas construction workers and disruption to imported raw materials could lead to further prices rises. However, several others felt that the impact of Brexit had already been priced into the market.

A number of interviewees had observed a pause in buying activity in the residential market, with one commenting that they thought this would "persist for at least 12 months from now". This may relate more to individual investors rather than to institutions, as several contributors remarked that they felt institutional investment had showed no particular sign of slowing. Other investors said they had seen little or no impact on the residential markets that they were exposure to.

On a positive note, several investors commented that the uncertainty had a favourable impact on rental levels, particularly in the South East, as potential home buyers felt discouraged from purchasing and continue to rent instead. Another contributor added that a further, short-term benefit of Brexit was that developers were now keener to do deals to get stock off their books.

Investors were also questioned about any specific plans made in advance of 29 March 2019, being the date on which the UK is scheduled to leave the EU. Most commented that they had either made no specific plans or that they were monitoring the market more closely, with some adjustments to forecasts. One respondent commented that the situation may create buying opportunities with the softening of prices. None said they would disinvest from UK residential as a result of Brexit. However, one stated they would avoid London, while another investor had recently ventured into European residential markets, something they would never have considered before the referendum decision.

4. POLITICAL INITIATIVES AND ISSUES

4.2 Forthcoming Changes to Capital Gains Tax Relief

Shortly before the publication of the 2017 survey report, the government announced plans to broaden the scope of CGT to cover non-residents owning UK real estate. This change is due to take place in April 2019. Whilst the government has indicated it will exclude foreign pension funds from the proposed changes, other potential sources of capital for the residential market, such as private equity firms and high net worth individuals, will not be exempt.

Participants in last year's survey were invited to comment on the proposed change in CGT relief and responses were received from 35 contributors. As this took place almost immediately after the announcement, there was little clarity as to the implications and industry consultation had yet to be sought. The most common reply (13), from respondents, was that the proposal would be significantly detrimental to the residential market, particularly in the short-term, as potential investors considered the impact of the proposed changes on their investment aspirations. However, others felt the change would have a negligible impact and four overseas pension and sovereign wealth funds commented that, as long as there are suitable tax efficient structures in place, the impact will be minimal.

With some six months remaining until the proposed changes are implemented, participants were asked if their opinions had altered and whether there had been any adjustment to activity in the residential market as a result.

Seven of the 16 interviewees stated their belief that the proposed changes in CGT relief have already had a negative impact on the UK residential market. One commented that it is "another reason for continental European investors to hesitate to buy in the UK". Another attributed the softening in the London transactions market to these changes.

Three further investors commented that the changes would potentially impact on high net worth individuals targeting the UK, but the institutional market would be relatively unaffected. In contrast, two investors felt the changes had had little influence on the residential market. "London is still viewed as a safe haven with its own pool of investors", observed one.

Four interviewees were unable to comment on whether the impending change had had a specific impact on the residential market, due to the difficulty in differentiating between this and other influences, most particularly Brexit. Two investors thought the 2016 change in stamp duty land tax legislation, requiring owners of more than one residential dwelling to pay an additional 3% charge, is causing bigger issues for potential investors. Many investors view residential as a long-term hold so additional taxation to purchase costs, rather than sale costs, is more detrimental.

4.3 Potential Reforms to the Private Rented Sector

Legislative reform of the residential sector continues to attract considerable political interest. Interviewees were asked if they welcomed or had a major issue with four recommended policy changes (some of which have been raised in previous surveys):

- Landlord licensing;
- Inflation cap on rent rises;
- Three-year tenancies; and
- New consumer rights in respect of unacceptable property.

Some local councils, such as Liverpool and Nottingham, have already introduced **landlord licensing schemes** in attempt to tackle rogue landlords, while others are contemplating the idea. The majority of interviewees (10) were supportive, in principle, if it is effective in tackling problematic landlords. All expressed concern, however, about practical implementation. Some of the current schemes are accused of being "draconian and costly", as

4. POLITICAL INITIATIVES AND ISSUES

a licence is required for each unit rather than for an entire block, if within the ownership of the same landlord. There is also a lack of consistency between different local authority schemes. One investor commented that institutional investors should be eligible for a national licence to cover all properties under ownership, whilst another voiced concern that it is "another tax" and could make some schemes unviable. One stated there was little value in it for "decent" landlords. Three investors readily welcomed licensing while two thought it was unnecessary, causing another layer of paperwork and stretching under-resourced local authorities further.

An **inflation cap on rent** rises drew a more negative response. Nine of the 16 interviewees would not welcome what they saw as "rent control". There was concern that such a policy could deter further institutional investment into the sector. Two were concerned about how the landlord would be rewarded if they make improvements to a property.

Three contributors had no issue with having a cap on rent rises within a lease, as long as rents were allowed to revert to market value at the lease end. Four others said that they did not have a major issue with a cap; one stating that it would "take out some of the unnecessary bubbles in the market" while another was keen that tenants stayed as long as possible and not be discouraged by large rental hikes.

In the summer of 2018, the government announced plans to provide tenants with a minimum **three-year lease**. The proposed lease would prevent landlords from evicting tenants at short notice; however, tenants would be able to leave the property before the end of the lease. In principle, all the investors welcomed the idea of three-year leases, citing greater certainty of tenure, reduced voids and letting costs as positives. Many already offered longer leases.

However, a number of concerns were raised, particularly if three-year leases were to become compulsory rather than being granted to suit the circumstances of individual landlords and tenants. For example, what happens if a landlord needs to refurbish or redevelop an asset? There may be little concern about granting longer leases when a property is new and establishing itself, but the situation will be more ambiguous for older buildings.

In addition, not all tenants will welcome a blanket imposition of longer leases. For some, one of the attractions of renting is flexibility. One investor explained that granting longer leases had required some education of prospective tenants and, to make them feel more in control, each tenant was offered the opportunity to determine their own contractual expiry date. Another investor suggested that the length of lease on offer should depend on the covenant strength of the potential resident and be dealt with on a case-by-case basis. Not every tenant is a model renter, so a further concern regarding such proposed legislation would be whether it would make it more difficult to remove unreasonable occupants. Longer leases would also be less workable in shared households.

Finally, several investors mentioned the proposed break clause inequality – tenants, unlike landlords, will be able to end a lease early. One suggested that if there is a tenant break, there should be some form of penalty, such as a payment of three-months' rent. Another commented that a minimum two- to three-months' notice of a break should be provided.

In a recent manifesto, the Labour party proposed to introduce **new consumer rights** in respect of unacceptable property to "empower tenants to take action if their rented homes are sub-standard". Generally, investors were welcoming of the proposal, to help drive out rogue landlords and improve the image of the rental market and to better educate tenants of their rights. However, there were concerns regarding how such a process would be managed, policed and paid for. One investor felt that the cost would be another tax passed onto tenants in the form of rent rises while another commented that it may reduce the supply of cheaper stock, so making it more difficult for lower income renters to find suitable properties.

5. OTHER ISSUES

The 16 interviewees were also questioned about two further concerns relating to the residential sector.

5.1 Performance Measurement

The 2017 survey posed questions about how investors measured the performance of their residential assets and, where applicable, what benchmarks were used for such assessment. None of the 31 investors who responded utilised a residential index as a formal benchmark, although two used one for comparative purposes. The majority of investors adopted an absolute return target. The most mentioned residential index was the IPD Residential Index but its lack of size and representation, both by asset type and geographical location, were considered to be major challenges to its application.

In the 2018 interviews, the 16 investors were asked if there was demand to develop a more robust residential index or were investors content to continue measuring their assets against an alternative benchmark.

While no investors said they had plans to move to a residential index as a benchmark, if a more representative one was developed, over half (9) of interviewees were strongly in favour of pursuing that option. The main driver of this demand was the requirement for greater transparency within the residential market, one investor remarking that "opacity is one of the main impediments to investment". Two contributors commented that, if the UK residential market hopes to attract further global investors, it should have a robust index as found in other countries. It is required "to be a fully recognised asset class". In addition, one investor considered that a more representative index would help support the creation of innovative investment products, as seen in the wider commercial real estate market.

Other interviewees expressed interested in the concept of an improved index, particularly to aid a greater understanding of the underlying factors driving performance but were concerned about the cost of contributing to a more developed index and how representative it would be given the current market structure. Four investors felt a more representative index is not achievable at this time but potentially in the future, when more assets will be available for benchmarking purposes. "In five years" was cited by several interviewees. One investor expanded on this point, explaining that currently there is insufficient depth to most residential sub-markets to allow for meaningful comparisons of large-scale investments. Owners of these assets must be encouraged to provide the data.

Only three investors expressed a lack of interest in improving the current index, due to a lack of relevance for their particular investment requirements.

One investor, however, highlighted a potential drawback to the increased usage of a residential index for investors and, particularly, fund managers. The ability to properly benchmark assets may encourage investors to act in a short-term way to out-perform their peers over shorter time horizons, particularly if pressurised by clients. Residential is regarded by many investors as a long-term investment; hence, performance must be viewed over a longer time frame to avoid reacting to short-term volatility.

5. RESIDENTIAL ISSUES

5.2 Affordability

In April 2018, the Office of National Statistics (ONS) released figures indicating that buying a home in the UK is becoming increasingly difficult. The average house costs nearly eight times the average annual salary (2017 figures), the highest multiple since the time series was first reported in 2002. Interviewees were asked for their views on where they believe affordability levels will be in 10 years' time.

The most common-held view is that affordability levels will be similar to those of today, being shared by six contributors. House price inflation is not anticipated to be as high as currently but housing construction is not expected to be sufficient to lead to a major improvement in housing supply and mortgage rates are expected to be higher.

Four interviewees judged that affordability will be worse in 10 years' time; the lack of delivery of new housing stock to meet demand being the main reason. In addition, one investor was of the opinion that future home buyers are likely to be saddled with increasingly heavier debts, such as student loans, which previous home-buying generations have not had to contend with.

Four contributors presented a more positive view, believing that affordability levels will improve, although none thought that there would be a significant change. One investor pointed out that the ONS had recently reduced the projection of the number of household formations for 2018-2028, by a considerable margin, as a result of lower population growth forecasts. This should make delivery of required new housing levels more achievable. Another interviewee considered that the recent government announcement to scrap the cap on borrowing for local authorities should hopefully kick start the building of more affordable housing. The lack of council house building in the 1980s and 1990s was cited in several interviews as one of the causes of the affordability challenges today.

Two interviewees did not express an opinion on this issue.

6. SUMMARY AND CONCLUSIONS

The IPF survey of UK residential attitudes and investment is now in its seventh year and covers £16.6 billion worth of residential assets, compared to £7.6 billion in 2012. This represents 8.6% of the UK real estate portfolios of those contributors who provided relevant data.

PRS remains the most popular route for gaining exposure to the sector, accounting for just under half of all residential investment. However, development, either for investment stock or for sale, now makes up nearly 30% of the total, at £4.9 billion. This is the highest level reported since these numbers were first published in 2014 and the increased commitment reflects a lack of modern, purpose-built stock, desired by institutional investors.

Questioned about the geographical exposure of their residential portfolios, central London dominates, at just under half of all assets covered by the survey. Outer London and the South East (including East Anglia) account for another 15% and 13% respectively.

Net investment intentions over the next 12 months have risen to a new high, with contributors reporting a total of nearly £8.3 billion available for potential purchases. Build to rent is the largest element of this allocation, reflecting the lack of suitable standing investment supply. Outer London, the South East (including East Anglia) and the Midlands are the most sought after locations.

In the last three years of the survey, investors have been questioned about their current and future relationships with the UK public sector. In every year, at least 50% of respondents have expressed an interest in working with the public sector, with one of the key objectives being to gain access to the land banks held by these authorities. However, the number of partnerships coming to fruition, that have been reported in the last couple of surveys, is much less evident. Building these relationships may not necessarily be an easy option for acquiring the right type of sites for residential development.

Despite the positive investment demand picture, residential faces considerable challenges in the shape of Brexit, the imminent changes in capital gains tax relief for overseas investors and a plethora of initiatives under consideration by various political parties. While investors familiar with the UK market may be less concerned, given their view of residential as a long-term hold, the uncertainty caused by these issues may deter others. There are indications of some nervousness and uncertainty in the survey: a decline in the popularity of residential's return profile as the principal justification for investing in residential (although it remains the number one reason); the rise of residential's defensiveness as a reason for investing; as well as less certainty of future intentions, when compared to 2017.

The residential sector does, however, remain a popular destination for new investment, despite the current climate. As one investor pointed out, "there is still a queue for the right type of residential investment, it [the queue] just may be a little shorter at the moment".

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