UK Residential Institutional Investment Survey 2016

Introduction

The 5th annual IPF survey of institutional attitudes and investment intentions for UK residential property is based on responses received from 48 contributors. Since its inception, 69 different organisations have participated in this research.

The data collected is not a complete record of the current level of institutional investment in UK residential property, but is a useful indicator of investment in the sector as compared to commercial real estate (CRE) and all assets under management (AUM)[1].

By end-2015, the value of the UK private rented sector (PRS) was £1,015bn, compared to a total commercial investment universe worth around £483bn.

2016 Survey Results

The average proportion of residential assets (c. £15.6bn) was 7.4% among residential investors and 6.7% across all respondents (including 9 non-investors). Due to the high proportion of residential investors in the survey (over 80%)[2] the latter percentage is likely to be above the average for UK real estate (RE) investors as a whole.

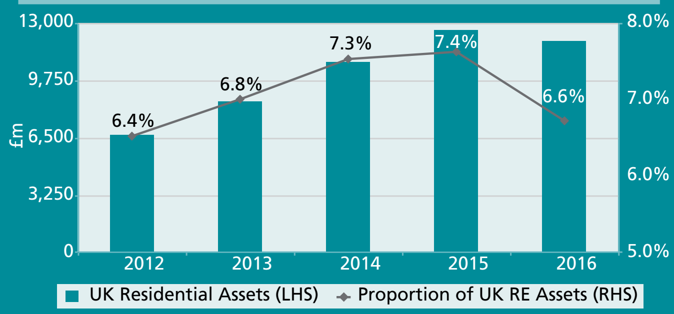
Table 1: Survey Results – All Contributors (£bn)

	AUM	All RE AUM	Resi AUM	Resi as %age of UK RE AUM
2012	1,299	180	7.6	4.6%
2013	2,904	166	10.8	7.0%
2014	4,845	204	12.8	6.5%
2015	3,040	221	15.4	7.5%
2016	**5,135**	**232**	**15.6**	**7.4%**

Note: Assets under management are imputed; not all respondents provide data. Returns may include an element of double-counting due to the inclusion of indirect investments managed by other respondents.

An analysis of data from the 27 regular contributors (Figure 1) shows that, despite heightened interest in the sector, growth in their residential holdings stalled in 2015, after a strong period of expansion. The sector declined as a proportion of their total assets, reflecting a sharp rise in the commercial market (the MSCI All Property Annual Index recorded capital value growth of 8%). Although the weighting declined among survey contributors, the proportion invested in residential by the institutions measured by MSCI increased – the 2015 MSCI Annual Index weighting rose to 4.3%, up marginally from 4.1% in 2014, and significantly higher than the 3.5% recorded in 2012. Relative changes in the different types of residential investment are explored later in the report (see Table 3).

Figure 1: IPF Regular Contributors 2012-2016[3]



Comparison to Previous Surveys

Comparing contributors common to 2015 and 2016 (32), a net decrease in value of assets of c. £770m reflects 15 investors having a reduced exposure (totalling £1,960m, this includes one that disinvested from the sector, albeit with a previous holding of less than £5m in 2015). Further analysis of actual investment activity versus intentions is set out in Table 2.

Of the remaining contributors' holdings (with one not disclosing data), three are unchanged year-on-year, whilst the value of residential AUM of 13 have increased by almost £1.2bn in total. Assuming capital appreciation in 2015 of c. 5.3% (MSCI/IPD), net investment was in the order of 12.5% or c. £840m. A comparison of the 2015 investment intentions of 30 contributors for the following 12 month period and actual outcomes is summarised in Table 2.

Table 2: Investment Intentions versus Outcome

		Actual (2015)		
Intention	No.	Decr.	Remain Stable	Incr.
Decrease	4	2	1	1
Remain stable	7	4	0	3
Increase	19	8	3	8

[1] A more authoritative measure of the value of UK residential stock and investments may be found in The Size and Structure of the UK Property Market: End-2015 Update, IPF 2016.

[2] The analysis contained in The Size and Structure of the UK Property Market: 2013: A Decade of Change, IPF 2014, estimated the average holding to be c. 5.25%.

[3] Data from the 27 respondents that have contributed to all five surveys conducted since 2012 includes two now part of other contributing organisations.

Around one-third of contributors (10) matched broad expectations (to increase, decrease or maintain their existing exposure). The extent to which most contributors failed to meet their intentions varied considerably. This was estimated by reference to target sums for investment/disinvestment compared to residential assets under management in the current year (even adjusting for capital growth). Under/over-shooting of targets ranged from as little as £10m to in excess of £1bn.

Exposure by Type of Asset

Three broad categories were defined in the 2016 survey: standing investments, development and 'Other', together with four sub-categories: market-rented (i.e. PRS), sub-market/affordable rented (including social housing), development for rent or sale, as well as Other. Table 3 provides a comparison with previous years' responses with an analysis of the break-down between different types of asset.

Table 3: All Contributors by Asset Type (£m)*

Year	All Assets	PRS	Social Hsg.	Devt. Rent/ Sell	Other
2012	7,594 (28)	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 (36)	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 (35)	5,854 (24)	622 (6)	4,039 (23)	4,041 (15)

*Note: Number of respondents in brackets ; figures may not sum to All Assets as not all contributors provided a break down by type.

PRS continues to dominate as the preferred type of asset, followed by development, both by size of investment and number of investors, although the average holding is more for Other assets, which includes student accommodation and ground rents.

Partnerships with the Public Sector

To measure the interest in working in partnership with local or central government, the 2016 survey posed a number of questions on this topic for the first time.

Table 4: Exposure by Type (£m)

Type	Total Value	Average Holding
Market-rented	5,854	244
Social housing	662	110
Build-to-sell	2,631	164
Build-to-rent	1,408	201
Other	4,041	269

Current Interest

Eight contributors had entered into relationships with central/local government over the preceding three years. These activities had an estimated total gross development value (GDV) of £3,555m (with the average size of deal being £419m). The primary objective identified was to access land, develop housing and manage units to generate a PRS cash flow (three instances). Only one respondent was solely motivated by an intention to sell units on the private market, although three indicated a mix of development to retain and sell.

Over the next three years, 18 parties intend to work in tandem with central/local government to develop housing, including all eight currently working with government. Reasons for those wishing to do so were, primarily, to access land, develop housing and manage units to generate a PRS cash flow (five), with only one intending to develop to sell and one to undertake both. Other reasons given were the purchase of existing blocks/estates and purchase of land suitable for purpose-built build-to-rent schemes or to access land, secure planning then sell on to house builders (hence avoiding any construction and sales risks).

A balance of 19 investors had no plans over the next three years to work with government. Reasons included: too much political change/uncertainty in the sector with a threat of rent caps and tenants' ability to buy, coupled with an adverse experience of the leasehold enfranchisement legislation and varying affordable housing criteria; had reviewed in the recent past and prepared to participate where schemes meet requirements; OJEC [now OJEU[4]] process too complicated and costly; too time consuming; prospective IRRs (at 9%-11%) too low for taking development risk; and a preference to work with established residential developers who have negotiated their position with local government.

Rationale for Investing – Existing Investors

The primary attraction of residential investment remains its returns profile (see Table 5), consistently ranking well ahead of all other factors suggested. In the 2016 survey, development potential declined to its lowest level over the four years it had been measured and ranked below income stability.

[4] The Official Journal of the European Union, where notices are advertised including invitations to tender, prior information notices, qualification systems and contract award notices.

Table 5: First Ranking 2012-2016

Factor	Year 2012 (28)	2013 (34)	2014 (36)	2015 (37)	2016 (37)
Returns profile	13	11	17	16	**15**
Stability of income	3	4	6	4	**7**
Development potential	n/a	8	6	5	**2**
Part of mixed-use portfolio	n/a	8	3	2	**2**
Low correlation with other asset classes	2	2	1	1	**1**
Stability of capital values	2	1	1	1	**0**

Note: Total number of respondents in brackets. The 2012 survey only suggested 4 criteria. Some respondents omitted to rank certain factors. Factors not summarised in the table included defensive investment and portfolio legacy. Other reasons mentioned were: demographics (one respondent had a major exposure to retirement housing) and lower obsolescence/less volatility than offices.

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Barriers to Investment

Nine survey participants were not residential investors and were asked to identify pre-defined barriers to investment. Responses are summarised in Table 6:

Table 6: Barriers to Investment 2012-2016

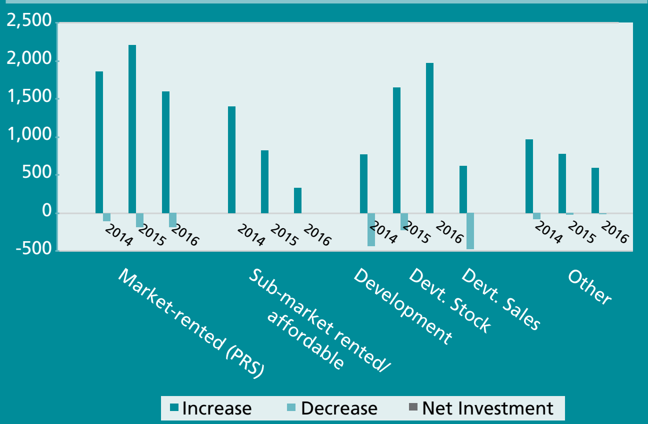
Factor	2012 (7)	2013 (14)	2014 (11)	2015 (9)	2016 (9)
Difficult to achieve scale	9	2	4	4	4
Income yield too low	9	5	5	4	3
Pricing not right	6	3	1	1	2
Reputational risk	5	3	5	2	2
Too difficult/ management issues	12	2	4	2	2
Political risk	4	0	4	2	1
Lack of liquidity/ insuff. market size	9	3	5	1	1

Note: Total number of respondents in brackets. Three chose not to select any options although two commented: "We're not really discouraged – we just don't do it yet because we are building our business first with commercial real estate." and "Focus in other areas."

Appetite over Next 12 Months

Thirty-seven contributors (including three currently not invested in the sector) responded to questions regarding investment intentions by type of property and the approximate amount they expected to invest/disinvest over the next 12 months. In summary, intentions were for 11 investors to maintain their positions, with 21 seeking to increase their investment overall and five to be net dis-investors.

Figure 2: Investment Intentions 2014-2016 (£m)



A number expressed intentions to invest and/or disinvest in more than one type of asset. Of the 11 that indicated a stable position over 12 months, two nonetheless specified net investment intentions. Four net investors did not disclose target figures for acquisitions nor did two net dis-investors for disposals. Investors recorded an appetite for each market segment, with PRS and development of investment stock attracting the largest potential commitments (at £1,600m and £1,975m net each). Disposal intentions were confined to sales of development stock (at c. £475m) and some PRS (£185m). Of a net balance of £4,428m of investment requirements, over 10% (£587m) was ear-marked for other assets (primarily student accommodation and ground rents).

Key Findings/Emerging Trends over 5 Years

There appears to be a growing allocation to income-producing residential investment, although, as noted in Table 1, the 2016 survey recorded a slightly lower proportion of holdings overall than in 2015, primarily due to the greater growth of commercial real estate values over the period.

Consistently ranked as the number 1 rationale for investing, the primary attraction of residential investment is its return profile. A heightened awareness of risk may be the cause of stability of income becoming an increasing attraction, which may serve to underpin the appeal of residential as an asset class. This may also reflect investors overcoming concerns about short initial lease terms compared to commercial assets.

Registering a 29% increase in PRS standing investments in the year, this is the strongest growing residential segment and consistent with an industry focus on build-to-rent as a route to investment. Development land holdings of £4bn currently will supply funds with income-producing residential units – which may go some way to countering the recurring issue of the difficulty in acquiring stock, as demonstrated by the shortfall in investment versus appetite.

The majority of respondents want to be net investors in resdiential. Market-rented stock remains the preferred route for investment, being three times more popular than any other type of residential asset.

Barriers to non-investors appear to be softening, although there is a continued focus on low income returns and lack of scalability, as well as an unwillingness to take on development risk. Management and reputational issues plus the threat of political interference seem to be declining in importance. Lack of expertise and resource may be holding back those who do not identify any particular feature of residential as being a disincentive to investment. However, the complexities of the sector and limited availability of standing stock, relative to commercial, are perceived as ongoing obstacles to achieving investment objectives.

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Deutsche Asset Management
Dorrington
DTZ Investors
Eastdil Secured
Europa Capital LLP
Fidelity International
Frogmore
Grosvenor
Hammerson
Hearthstone Investment Management Ltd.
Invesco Real Estate
LaSalle Investment Management
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Lend Lease
M&G Real Estate
Mayfair Capital Investment Management
Moorfield
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Rockspring Investment Management
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