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Residential Investment in International Markets

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Residential Investment in International Markets

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1. INTRODUCTION AND BACKGROUND

The IPF has recently published its 2014 Survey on institutional investors' attitudes regarding UK residential real estate investment. Results show that only 4.3% of institutional investors' assets under management are allocated to real estate, of which a mere 6.3% are residential. Other real estate categories are clearly more popular. However, the majority of respondents (24 out of 38) intend to increase their exposure to residential property over the next 12 months, while only three of them are looking to reduce their exposure. But even if British investors were to, for example, double their exposure to residential property, it still would play only a minor role in their portfolios.

Interestingly, institutional investor appetite for residential property differs very strongly across countries. Britain is clearly in the "low residential" camp, together with, for example, Australia. On the other side are countries like The Netherlands and the United States, in which a strong tradition of residential investment exists among institutional investors.

In order to find out what the key drivers are for residential investment by institutions and to derive lessons to be learned for discussion of the British market, this paper looks at five overseas markets with very diverse attitudes towards institutional residential investment: The Netherlands, the United States, France, Germany, and Australia, and compares these markets with the United Kingdom.

Section 2 analyses the main characteristics of the different housing markets like home ownership rates, ownership by social housing providers and other investors, and housing typologies. It also looks at institutional investors' portfolio share in residential property in the different countries and the preferred investment method.

The historical performance of residential property in the investors' portfolio is then examined, comparing the risk-return trade-off, income streams, inflation hedging and diversification potential. These aspects are all named in the 2014 IPF Survey as key drivers for residential investment.

Section 4 looks further into the market structures of the different countries – specifically, regulation of the owner-occupied housing market (i.e. mortgage support, transaction costs) and the rental market (i.e. rental subsidies and availability of social housing). This analysis helps the reader to understand to what extent regulation in the various countries favours home ownership or renting, whether it is more protective for the tenant or the landlord, and to identify what aspects encourage or discourage institutional investment in residential property.

Not all factors are easily measured and comparable, and there are likely to be qualitative influences on institutional investor practices. Several market experts and institutional investors have been interviewed in each country regarding residential property investment, so as to derive some further drivers for (or for not) investing in residential property, including market customs and traditions, and also the availability of structures to enable investment.

The paper concludes with a summary of the results and of lessons which can be learned regarding institutional investors' attitudes to residential property. The many differences found between the six countries on market characteristics, historical performance, institutional aspects and market customs should all add to understanding why institutional investment in residential property is relatively uncommon in the United Kingdom.

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

The paper compares the residential property markets of six different countries in order to find key indicators for institutional investment in that sector. These countries are The United Kingdom, The Netherlands, Germany, France, the United States and Australia, chosen on the basis of their tradition for institutional residential investment or the lack thereof. Where residential investment is relatively common for institutional investors in The Netherlands, Germany, France and the United States, this is unusual for institutional investors in the United Kingdom and Australia.

This section outlines these six different housing markets, comparing the main characteristics of their dwelling stock (ownership, typology), analysing institutional investments in residential property and outlining the various ways to make these residential investments, either directly or indirectly.

2.1 Housing characteristics

Table 2.1 shows the ownership characteristics for the six housing markets. The first category 'Investors', includes both private and institutional investors. There is much cross-country variation: overall investor involvement is lowest in The Netherlands, at 12%, and highest in Germany, at 52%. There is a lack of consistent cross-country information regarding the distribution of this category between private and institutional investors, but it is clear that it is dominated by institutional investors in The Netherlands and France, while the opposite is the case in the United Kingdom, Germany and Australia.

With the exception of Germany, private home ownership is the dominant ownership form in the six countries. Interestingly, other than in Germany, the home ownership rate does not differ much across countries: it varies between 57% for The Netherlands and 68% for Australia. This implies that the extent of private home ownership is unlikely to be an explanation for institutional investor involvement in residential property.

There seems to be a much bigger difference in the role of social housing providers across the six countries: the percentage in the fourth row of Table 2.1 varies between 1% for the United States and 31% for The Netherlands. It would seem intuitive that a dominant role for social housing providers would crowd out institutional investors. However, the numbers in Table 2.1 show that the role of institutional investors is not necessarily complementary to that of social housing providers – despite their strong differences regarding the market position of social housing providers, institutional investment in residential property is important both in The Netherlands and in the United States. Moreover, France and the United Kingdom have the same percentage of social home ownership, yet differ strongly in the involvement of institutional investors.

Table 2.1: Ownership distribution of occupied dwellings

	AUS	FR	GE	NL	UK	US
Total number of dwellings ('000)	8,182	27,680	40,563	7,266	26,442	132,452
Investors	27%	22%	52%	12%	18%	36%
Owner occupied	68%	60%	43%	57%	64%	63%
Social housing providers	5%	18%	5%	31%	18%	1%

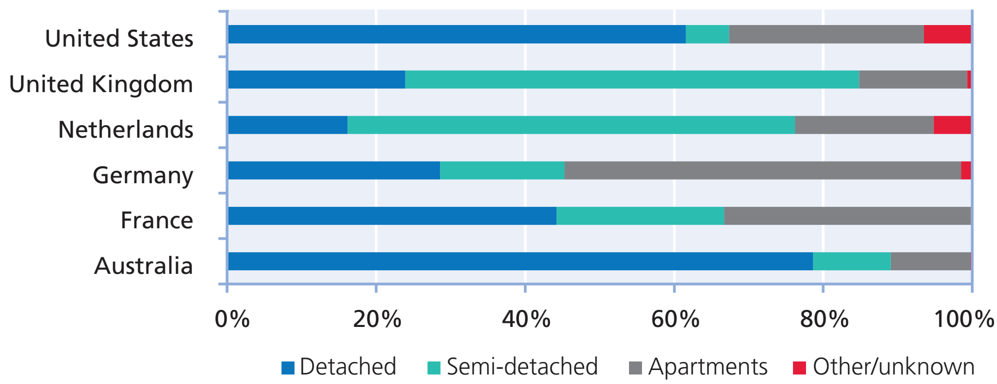
Sources: UK: ONS, 2011 Census, Tenure, local authorities in the United Kingdom; Netherlands: CBS, Woningvoorraad naar eigendom, regio, 2006-2012; Germany: Zensus 2011, Buildings with residential space depending on type of ownership of the building; France: INSEE, Statut d'occupation des résidences principals; United States: Census 2011, Estimates of the Total Housing Inventory for the United States: 1965 to Present, and HUD, Number of Public Houses; Australia, ID, Housing tenure.

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

Table 2.1 suggests that crowding out by the two competing ownership forms (owner-occupation and social owners hip) does not explain institutional involvement in residential property. Another reason could be investibility – specifically, does the housing market offer a physical investment product that allows management-efficient investment in order to minimise costs and optimise net income returns? Such efficiency is likely to be easier to achieve for large apartment blocks than for individual dwellings. Moreover, large apartments blocks require substantial investment, making them ideal for the institutional investors who have the ability and preference to invest at a large scale.

Figure 2.1 illustrates this. Apartment buildings make up a large part of the total housing stock, especially in Germany and France, so facilitating institutional involvement in the market. In the United Kingdom, semi-detached housing (including terraced housing) predominates. Hence, the nature of the housing stock appears to play a role in explaining cross-country differences in institutional investor involvement in the housing market, but the relation is not clear-cut – The Netherlands also has substantial quantities of semi-detached and terraced housing, but Dutch institutional investors have traditionally favoured that product, and their involvement in it is still important.

Figure 2.1: The physical housing stock



Sources: EUROSTAT (2014), Dwelling type; ABS (2014), Housing Types of Dwellings; Census (2011), Selected Housing Characteristics.

2.2 Residential property in institutional investors' portfolios

IPD is the leading source of data for institutional investor activity and performance in property; based on their market coverage, IPD estimates the size of the property holdings of the total institutional investor universe (i.e. not just IPD index participants). Estimates extend to all property types, including residential. IPD estimates have been used to establish the importance of residential property in institutions' overall property portfolios. Using data for institutional portfolios, Table 2.2 shows that residential investment is very important in The Netherlands, with an average weighting of 46% in institutional investor real estate portfolios in 2012. This high weighting is mostly caused by the traditional popularity of housing among Dutch pension funds, who view it as a perfect fit for liability hedging, due to its high correlation with inflation. Housing is also important in the institutional real estate portfolios in the United States (22% average weighting) and, to a lesser extent, in France (12%) and Germany (12%).

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

Australia is not covered by IPD's residential real estate index, due to institutional investment in housing being so rare in that country. Neither are institutional investors in the United Kingdom very active in residential property, with an average property portfolio allocation of just 4%. Interestingly, IPD started tracking residential investment in the United Kingdom in 1981, so there appears to be a relatively long history of institutional activity in the market, albeit on a very small scale.

Table 2.2: Residential property in institutional portfolios, 2012

	AUS	FR	GE	NL	UK	US
Start date of IPD residential index	-	1998	1996	1995	1981	1999
Total value of IPD index	£87.7	£79.3	£37.2	£30.2	£142.4	£99.5
Estimated institutional property holdings	£140.5	£195.1	£212.3	£93.1	£232	£1,267.7
Estimated institutional residential holdings	-	£24.2	£25.3	£42.5	£10.2	£282,5
Share of residential holdings in property portfolio	-	12%	12%	46%	4%	22%

Source: IPD Multinational Index Spreadsheet – Update 3 (2013).
Notes: IPD estimates volumes of institutional property holdings by property sector on the basis of IPD's actual databank sector values. The estimates are IPD approximations of the unleveraged total value. All values are in GBP billions.

To gain an appreciation of the dynamics of institutional investor involvement in residential property, the net investment recorded in IPD's residential property index is considered. Table 2.3 provides figures for 2012, for the five years from 2008 to 2012 and for the 10 years from 2003 to 2012. Again, no data is available for Australia. The Table suggests that institutional investors in the three European countries with sizeable institutional holdings in residential assets do not seem to have been very enthusiastic about the product in the last decade. On a net basis, they all reduced their investment between 2003 and 2012, but this disinvestment has largely come to a halt in recent years. In The Netherlands, this was mainly motivated by profit realisation and to a lesser extent, by a perceived over - exposure to the product. The United States, on the other hand, has seen structural growth in the volume of residential property investment over the past 10 years (with an average yearly increase of 10.9% by capital value), and this growth remains strong. Institutional investors in the United Kingdom, on average, have slightly increased their holdings of residential property.

Table 2.3: Capital investment in residential property in institutional portfolios

	AUS	FR	GE	NL	UK	US
2012	-	-£64.6	£79.1	£42.2	-£111.3	£1,727.7
		(-0.7%)	(+1.8 %)	(+0.3%)	(-1.8%)	(+7.8%)
2008-2012	-	-£3,174.3	£128.8	£168	£441.8	£5,023.7
		(-4.3%)	(+0.7%)	(+0.2%)	(+1.9%)	(+4.5%)
2003-2012	-	-£6,794.7	-£1,668.1	-£1,293.7	£528	£13,130.3
		(-6.5%)	(-5.8%)	(-1.5%)	(+0.9%)	(+10.9%)

Source: IPD Multinational Index Spreadsheet – Update 3 (2013).
All values in GBP millions. Growth rates are average year-to-year percentages of total capital value.

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

2.3 Different types of residential investments

In this study, three ways have been identified for institutional investors to build up an exposure to residential property: direct investment, investment through unlisted funds and investment through listed property funds or companies. This section does not provide a full quantitative overview of all institutional investments in the six subject markets but, rather, gives indicative and qualitative information for direct and indirect private holdings. For the listed sector, however, comprehensive numbers are given.

Direct investment

Formerly, investment in residential property used to be wholly via the direct route, but this method of building up exposure has become less common among institutional investors, especially the smaller ones. This may be due to a number of factors, such as an aversion to taking direct management responsibility. In particular, for residential property, which requires interaction with significant numbers of clients and the management of many small rent contracts, this is likely to be a significant influence. Also, a certain scale is necessary to make direct investment efficient, especially when there is a need to diversify across regions, which requires considerable local and market-specific knowledge to achieve diversification as well as negotiating direct deals at the same time.

Hence, the attractiveness of residential property investment is likely to be influenced by the presence of specialised indirect investment vehicles in the different countries. However, this gives rise to a 'Catch-22' situation, insofar as a lack of investor interest precludes these vehicles from emerging in the first place, which reinforces the lack of interest. It is probable, therefore, that some form of residential product needs to attract a number of leading institutional investors initially, following which further investible vehicles may be developed, so creating a virtuous circle.

Indirect investment through unlisted property funds

Non-listed property funds offer an alternative to direct property investment and the market for these funds has grown very strongly in the last decades, both in the number of funds and in total assets under management. For residential investment, this has become the most important way to build up exposure indirectly. For example, according to INREV, The Netherlands has 30 unlisted residential funds catering to institutional investors, with a combined market value in 2013 of €18.2 bn. Major examples include Vesteda, Amvest, Altera, BouwInvest, Syntrus Achmea, ASR, Delta Lloyd and the funds managed by CBRE. These organisations offer (Dutch) institutional investors a wide range of choice in investment approach, housing market segment, size and cost. Many of these funds are internally managed (i.e. the investors also own the management company), thus avoiding the inherent conflict of interest between an external manager and an investor, and keeping costs low. Fees can be as low as 30 basis points.

In Germany, this market is of more recent origin, and is dominated by the builders of closed-ended Spezialfonds such as Patrizia, which manages three German residential funds for institutional investors, as well as one pan-European fund and a Dutch fund currently in development. These funds comprise Patrizia Residential (£303 million), Patrizia Residential II (target size £341million) and Patrizia LB Wohn-Invest Deutschland I (with a size of £492 million) for the German residential market, and the pan-European Patrizia Eurocity Residential Fund I (£303million). Other providers of German Spezialfonds with a residential focus include AXA (one fund), HansaInvest (two funds) and Union Investment (one fund). However, the residential sector still forms a small minority among German Spezialfonds overall.

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

Australia's superannuation funds invest very little in residential real estate. This lack of interest is illustrated by the market for unlisted property trusts, which consists of only a few – quite small – trusts that develop individual apartments and communities. An example is Stockland's £42 million SREEF1. However, a change in the market is faintly observable, as the Australian residential market has recently started to attract the interest of Asian investors. This seems to have sparked interest among Australian superannuation funds.

French unlisted funds, in the form of SCPIs, have been in existence since the 1970s. Although these vehicles are popular with both individual and institutional investors, residential SCPIs are less common and their focus is more on reducing tax liabilities than on returns. Moreover, they tended to be quite small although 2014 saw an interesting new development in this market, as Caisse des Dépôts closed its Fond de Logement Intermédiaire (FLI), which focuses on the construction of 40,000 residences for lower to middle-income groups. FLI is a £390 million fund that includes investors such as CNP, BNP Cardif, EDF invest and Aviva. This may prove to be a path-breaker for similar funds in France.

Traditionally, United States institutional investments have been active in multi-family properties, with specialised investors, such as the KBS Legacy Partners Apartment REIT (£300 million) and the closed Steadfast closed Income REIT (£1,153 million). More recently, however, the United States has seen a rise in institutional interest in another form of residential property. Investors such as Blackstone Group LP, Colony Capital and American Homes 4 Rent have taken advantage of bargain prices, due to foreclosures, and a growing number of renters to increase their investment. Between 2010 and 2013, over 200,000 single-family properties were purchased by institutional investors. The investment opportunities that followed after the housing market crisis have also attracted specialised foreign investors, such as The Netherlands' Bouwfonds, which has set up a US residential fund. Another example is the US Masters Residential Property Fund for Australian investors (£141 million).

Indirect investments through listed property companies

Listed real estate investment companies offer a third way to build exposure to real estate, but here also, most existing vehicles focus on property other than residential. Table 2.4 shows that listed residential investment companies are most widely available in the United States and Germany and, to a lesser extent, in Australia and the United Kingdom. In France and The Netherlands there are no listed residential investment funds.

The United States' listed residential property companies are fairly numerous, with 23 companies, giving institutional investors a wide range of options to choose from. The situation is very different in Australia and the United Kingdom, which host three and five companies respectively.

Table 2.4: Size of listed residential property markets

	AUS	FR	GE	NL	UK	US
Number of Companies	3	-	10	-	5	23
Full Market Cap	£6,621	-	£18,582	-	£2,749	£70,942

Source: GPR (2014).
Note: All values in GBP millions; full market cap is total shares outstanding times market price as of 5 May 2014.

2. OVERSEAS RESIDENTIAL INVESTMENT MARKETS

When comparing listed companies in Australia, the United States, Germany and the United Kingdom, the difference in size is particularly remarkable. In the United States, the largest two listed residential REITs are Equity Residential and AvalonBay, with market capitalisations of £16.4 billion and £12.9 billion and managing 109,465 apartments and 72,814 apartments, respectively. These REITs dwarf the largest listed residential companies in the United Kingdom, being Grainger and The UNITE Group, with respective market capitalisations of £1.1 billion and £1.0 billion.

Germany is clearly the more developed market for listed residential companies in Europe, where its two largest companies, the 185,000 residential unit Deutsche Annington and the 150,000 residential unit Deutsche Wohnen, have market capitalisations of £4.9 billion and £2.5 billion, respectively. Even taking into account that both companies are substantially leveraged, these numbers suggest that the two German giants focus on affordable housing.

The Australian residential market only has one exchange-listed fund of significant size, being Stockland, with a market capitalisation of £6 billion. The other two listed funds are each less than £350 million.

3. PERFORMANCE OF RESIDENTIAL PROPERTY IN INVESTOR PORTFOLIOS

Investors look for high returns for a given level of risk, or for low risks for a given level of returns. The question is what residential property has to offer in that regard. In this section, the housing market performance of the six countries is analysed in order to compare their main performance indicators for institutional investors (long-term return, income streams, inflation hedge and diversification potential). The overall finding is that residential investment is relatively low risk, offers interesting diversification benefits, and is a reasonable inflation hedge. However, some considerable differences occur between the countries.

Most of the analysis is based on IPD data and data from the Bank for International Settlements (BIS). It must be noted that IPD data is limited for some countries (Germany and the United Kingdom) and non-existent for Australia, where only BIS data is used.

3.1 Good long-term returns

Table 3.1 provides data on the return and risk of residential investments in the six countries for the 15 years since 1999. The average total return on residential investment varies between 5.2% for Germany and 11.8% for the United Kingdom over the last 15 years. Looking at the risk of these assets by calculating the standard deviation, it can be seen that the volatility has been limited and that high returns tend to come with high volatility. The United Kingdom is an example of this. Only the United States demonstrates a higher volatility in total returns. Germany has the best return-risk ratio, but that is caused by the extremely low volatility in that market, which may be the result of a very market-specific valuation method.

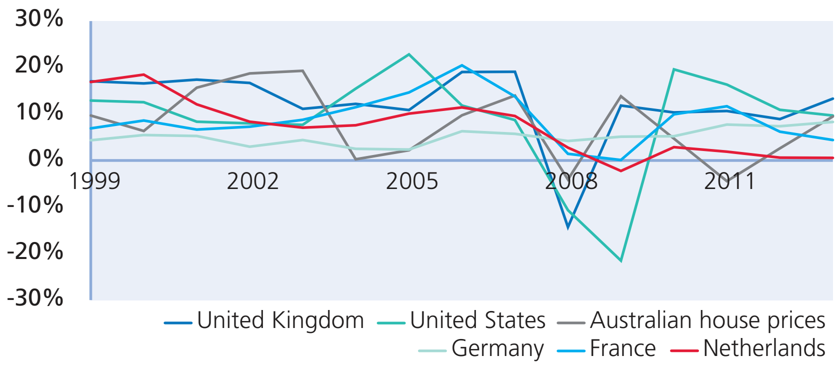
Table 3.1: Annual residential property performance (1999-2013)

	AUS	FR	GE	NL	UK	US
Total return	7.6%	8.7%	5.2%	7.1%	11.8%	8.2%
Risk	7.6%	5.2%	1.8%	6.1%	8.0%	11.2%
Return-risk ratio	1.00	1.68	2.88	1.16	1.46	0.73

Sources: IPD Multinational Index Spreadsheet – Update 3, (2013); BIS data (2014) for Australia's house price development.

Another measure for risk is the chance of getting a very unfavourable return. By that yardstick also, residential property has done quite well. The total returns on institutional residential investments have hardly been negative in this period (see Figure 3.1). Only the United States displays more than one year with a negative total return to residential property investment. In the United Kingdom and The Netherlands, returns have been negative in only one year of the 15, and very slightly so in the latter country.

Figure 3.1: Annual total returns (1999-2013)



Sources: IPD Multinational Index Spreadsheet – Update 3 (2013), BIS data (2014) for Australia's house price development.

3. PERFORMANCE OF RESIDENTIAL PROPERTY IN INVESTOR PORTFOLIOS

3.2 Volatility of income returns vary between countries

Looking at the income returns on residential investments across the six countries, strong differences exist. Strikingly, income returns are currently lowest in the United Kingdom (2.4%) and France (2.9%), while the level of income returns in Germany, the United States and The Netherlands are all above 4.5%. For the United Kingdom, the income return has been low for a number of years, steadily decreasing from 3.7% in 1999 to 2.4% in 2013.

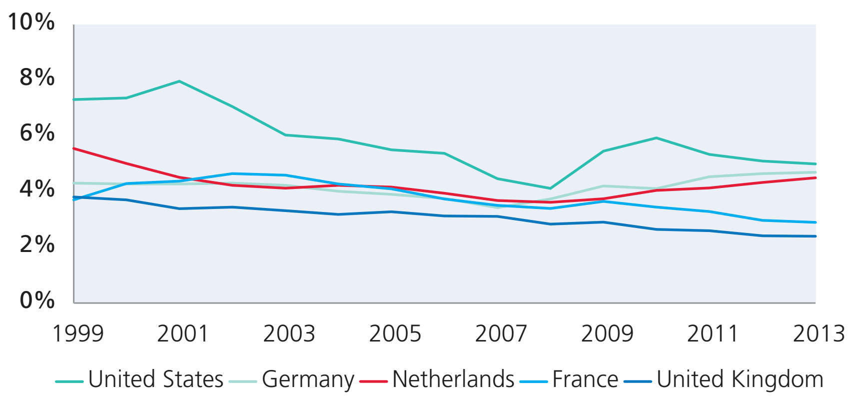
Table 3.2: Income returns of residential property

	AUS	FR	GE	NL	UK	US
Income return (2013)	-	2.9%	4.7%	4.5%	2.4%	5.0%
Average income return (1999-2013)	-	3.8%	4.2%	4.3%	3.1%	5.9%
Risk (1999-2013)	-	0.6%	0.4%	0.5%	0.4%	1.1%
Gross-to-net leakage	-	27.2% (2011)	30.6% (2011)	24.8% (2011)	30.6% (2012)	not available

Source: IPD Multinational Index Spreadsheet – Update 3 (2013).

Institutional investors active in residential property usually mention the steady income return of the asset as a motivation to be involved in the product. The very low standard deviation of the income returns reported in Table 3.2 support this notion, varying between 0.4% in Germany and 1.1% in the United States over the last 15 years. Figure 3.2 further illustrates the low volatility of the income return: with the exception of the United States, the trend of the income return is almost a straight line, albeit a downward sloping one.

Figure 3.2: Yearly income returns, 1999-2013



Source: IPD, Multinational Index Spreadsheet – Update 3 (2013).

IPD collects data on the relationship between gross and net yields for four of the countries in the research sample: The Netherlands, Germany, the United Kingdom, and France. Data are for 2011 or 2012, depending on the country, and are reported in the last row of Table 3.2. It appears that the gross-to-net leakage is relatively uniform for these countries, varying between 24.8% (The Netherlands) and 30.6% (the United Kingdom). Accordingly, the country in which residential investment by institutions is most common also appears to have the most efficient investment management organisations in place, passing on most of the returns generated by the assets to the investor.

3. PERFORMANCE OF RESIDENTIAL PROPERTY IN INVESTOR PORTFOLIOS

3.3 Moderate inflation hedge

Institutional property investors often name inflation hedging characteristics as one of their key investment drivers. Especially for pension funds, which have liabilities in real terms due to their indexed pension contracts, assets demonstrating a positive correlation with inflation constitute an essential part of their investment portfolio.

In order to compare the inflation hedging potential of the European residential property markets, the correlation between house price growth and local inflation was investigated. BIS data was used for this analysis in order to cover as long a time frame as possible, with the BIS data going back furthest. Besides comparing inflation hedging potential over one-year investment horizons, two- and three-year horizons were also considered.

The results, in Table 3.3, show that the correlation between (local) inflation and annual house price growth is highest in France at 0.52, and weaker in Australia and the United Kingdom, at 0.23 and 0.11 respectively. This may explain why institutional investors from these two countries do not appear to have much appetite for residential property.

If the investment horizon is increased, the correlation with inflation becomes much stronger in all six countries, especially in Australia, the United States and The Netherlands. For investors with a longer investment horizon, residential property appears to make sense. In other studies, it was found that increasing the investment horizon from one to three years does not affect the inflation hedging potential for bonds, and only weakly so for stocks.

Table 3.3: Correlation with local inflation for annual house price growth, 1970-2013

	1 year period	2 year period	3 year period
Australia	0.23	0.44	0.55
Germany	0.39	0.42	0.49
France	0.52	0.56	0.59
Netherlands	0.30	0.35	0.41
United Kingdom	0.11	0.17	0.26
United States	0.29	0.36	0.44

Note: Correlations based on BIS (2014) data. For Australia, data from 1987 to 2013.

3.4 Opportunities for international diversification

In order to reduce non-systematic risk, investors look to diversify their investment portfolios by combining assets whose returns correlate less than perfectly. The attained diversification benefit depends on the correlation between these assets' returns. A perfectly positive correlation (1) implies no diversification benefits whilst a perfectly negative correlation (-1) implies full diversification and, potentially, a complete avoidance of risk. In reality, correlations among assets and asset markets tend to be less extreme.

Finance Ideas (2014) Dutch Residential Investment in European Perspective (p.9)

3. PERFORMANCE OF RESIDENTIAL PROPERTY IN INVESTOR PORTFOLIOS

One way to reduce the risk of an investment portfolio is to broaden it across national borders. Returns on different national asset markets may fluctuate in different ways and in different times. This study therefore looked at cross-correlations for residential investments in the six countries, again using BIS house price growth data.

The results in Table 3.4 show correlations between the housing markets in the different countries, which are quite low. Studies of international correlations in stock and bond markets find correlations somewhere between 0.5 and 0.9. The average correlation in Table 3.4 is 0.27, i.e. substantially lower. This implies that international diversification opportunities are much stronger in housing markets than in other asset markets, which makes economic sense – housing is an asset driven by very local demand and supply fundamentals. Even if more international housing investment were to take place, correlations would be likely to remain lower than that between, for example, stock markets. Remarkably, the correlations of house prices in the United Kingdom with international markets are relatively high when compared against other residential markets' cross-country correlations, except for The Netherlands. From a diversification perspective, therefore, an investment product in United Kingdom residential should cater well to Dutch investors. This also implies that, whilst international diversification potential seems relatively small for residential investors in the United Kingdom, it is still better than the diversification potential offered by international stock or bond investment.

Table 3.4: Correlation between residential markets, 1970-2013

	Netherlands	France	Germany	United Kingdom	United States
France	0.16				
Germany	0.09	0.21			
United Kingdom	0.11	0.45	0.41		
United States	0.19	0.54	0.18	0.54	
Australia	0.06	0.38	-0.28	0.74	0.30

Note: Correlations based on BIS data (2014).

4. INSTITUTIONAL ASPECTS OF RESIDENTIAL PROPERTY MARKETS

An important driver of future housing market developments is the institutional framework surrounding this market in each country. Housing market regulation and tax incentives for housing rarely change, so choices that countries have made in that regard are likely to influence the market in a structural way. That holds, for example, for subsidies and protective measures for tenants, support for home owners taking out a mortgage, but also for the tax treatment of (institutional investor) landlords. The institutional aspects of both the rental and owner-occupied housing market differ significantly across the six countries studied. Tables 4.1 and 4.2 provide an overview of the most important of these institutional aspects. The following sub-sections describe these regulations in more detail, which may explain the level of institutional residential investments in each country.

Table 4.1: Institutional aspects on the rental versus the owner-occupied market

	AUS	FR	GE	NL	UK	US
Impact of social housing providers	low	high	low	high	high	low
Subsidies for tenants	yes[1]	yes[1]	yes[1]	yes[1,3]	yes[1]	yes[1]
Subsidies for home owners	yes	yes[1]	no	no	no	yes[1]
State guarantees on mortgages	no	no	no	yes	yes	yes
Mortgage interest deductibility	no	no	no	yes	no	yes
Transfer tax (low–high)	0%-7.25%	5%	3.5%-6%	2%	0%-7%	0%-2%[2]
Housing expenditure[4]	20%	21%	21%	21%	24%	19%
Pro-owners or tenants	pro-owners	neutral	neutral	neutral	neutral	pro-owners

Table 4.2: Tenant versus landlord protection

	AUS	FR	GE	NL	UK	US
Initial rent freely agreed upon	yes	yes	yes	partly[3]	yes	yes
Yearly rent increase is free	yes	no	no	partly[3]	yes	No
Deposit of rental contract (months)	1-2	2	< 3	2-3	2	1-3[2]
Tenant eviction (easy/hard)	easy	hard	hard	hard	easy	easy/hard[2]
Pro-tenant or landlord	pro-landlord	pro-tenant	pro-tenant	pro-tenant	pro-landlord	pro-tenant

Sources:
General: OECD (2014), PWC (2012), Royal Institute of Chartered Surveyors (2012); Australia: Australian Government Productivity Commission (2012), Australian Government Departure of Human Services (2014), NRAS Australia (2014), Report on Government Services (2012), Australian Taxation Office (2014); France: French Ministry of Public Finance (2014); Germany: Bundeszentralamt für Steuern (2014),DG Hyp (2013); Netherlands: Belastingdienst (2014), Nationale Hypotheek Garantie (2014); UK: HM Revenue and Customs (2014), United Kingdom Government (2014); US: U.S. Department for Housing & Urban Development (2014), Internal Revenue Service (2014), Federal Housing Administration (2014), U.S. Department for Housing & Urban Development (2014), Institute for Real Estate Management (2013), National Association of Home Builders (2013), National Conference of Commissioners on Uniform State Laws (1972).

[1] Only available for certain target groups, for example for low-income households or unemployed.
[2] State-dependent.
[3] The rental market in The Netherlands is split into a regulated market (88% of all rental dwellings) and a non-regulated market.
[4] Percentage of gross adjusted disposable income.

4. INSTITUTIONAL ASPECTS OF RESIDENTIAL PROPERTY MARKETS

Subsidies for tenants

In general, tenant subsidies are aimed at lower income households – those who do not have the financial ability to rent a home at free market rents. In the six countries, two kinds of tenant subsidies were noted: general housing benefits, aimed at tenants as well as home owners, and tenant-specific subsidies. France and Germany offer general housing benefit programmes. In France, this involves three mutually exclusive programmes aimed at different target groups. Roughly 22% of French households benefit from such programmes. In Germany, home owners and tenants can apply for a housing allowance, with approximately 2% of German households using it. The United Kingdom, The Netherlands, Australia and the United States all have tenant-specific benefits in place. In the United Kingdom, tenants can apply for housing benefits, depending on income and circumstances, and roughly 19% of households use these benefits. The Dutch government supplies about 18% of households with housing subsidies if their rents are classified as regulated. Dutch rents below €699.48 (£529) are considered social rents and are regulated, therefore. Australians can apply for rent benefits through the National Rental Affordability Scheme and around 15% of Australian households do so. Families earning below 50% of the local median income level can apply for housing vouchers in the United States. Roughly 2% of households do so.

Subsidies for home owners

Home owner benefits are often more focused on helping citizens create wealth rather than on ensuring social security, and those benefits are therefore not necessarily aimed at the lowest income families. Most countries in the sample, the United Kingdom, The Netherlands, France and the United States, offer their citizens affordable financing for their first home. In the United Kingdom this has been achieved through a temporary five-year 0% interest loan on 20% of the cost of a new-build home for example. The Netherlands, Australia and the United States operate national funds (SVN, HAF and HOME respectively), which distribute grants to support home affordability and improvements. France offers a zero-interest loan similar to the United Kingdom, known as PTZ.

Mortgage interest deductibility and mortgages structures

Only the United States and The Netherlands offer full tax deductibility on mortgage interest payments, a consequence of which, especially in the case of The Netherlands, appears to be a relatively high level of household mortgage debt. In order to reduce this debt, the Dutch government has started reducing tax relief on mortgage payments, by reducing the maximum deduction from 52% in steps of 0.5% a year to 38%. In all the countries in the study, home mortgages are full recourse, the only exception being 10 states in the United States, where borrowers can avoid personal liability for their mortgage by opting for a non-recourse mortgage. A non-recourse mortgage is secured only by the collateral, the value of which is determined by asset value at the time of the loan. This gives the debtor a strategic option to default or negotiate a workout in the debtors' favour, which is not the case in the other countries in the sample.

4. INSTITUTIONAL ASPECTS OF RESIDENTIAL PROPERTY MARKETS

State guarantees on mortgages

In the United Kingdom, the first 15% of a mortgage of a house with a value up to £600,000 can be guaranteed by the government, although this scheme is temporary. The Netherlands and the United States also offer guarantees on home mortgages. The Dutch national guarantee covers mortgages up to £200,870 and home buyers pay a small premium to obtain the guarantee. The United States Federal Home Owner Administration guarantees first-time buyers and home owners with the financing or re-financing of their mortgage. In Australia, the Lenders Mortgage Insurance is mandatory for homes with a loan to value (LTV) ratio of more than 80%. In Germany, mortgage guarantees are not arranged by the state, which also holds for France, where the banks initiating the mortgage play that role. Mortgage costs, of 1.5%-2% of the loan amount, are paid by the home owner.

Rent prices and deposit

In most of the six countries there exists some sort of government involvement in rent levels. In The Netherlands, a point system is in place that determines the maximum initial rent for dwellings renting for less than €699.48 (£529), while maximum rent increases for such dwellings are linked to inflation. In the United Kingdom, the regulated rent sector consists of properties where the rental contracts of which were signed before 1989. These renters can apply for a ‘fair rent’. For all other rental dwellings, the landlord and tenant can freely negotiate the initial rent and rental increases, and this is also the case in Australia. In Germany and France, initial rents are freely negotiated but rent increases are regulated and linked to inflation. In the United States, rent regulation differs across states.

Security of tenure

In continental Europe it is difficult to evict a residential tenant. In France, The Netherlands and Germany, eviction processes may take several years. In the Anglo-Saxon countries in this study, the rules tend to be less favourable to the tenant. The notice to quit period ranges from just two weeks to three months in Australia, one to two months in the United Kingdom and similar periods in the United States, where they are set by state law. This may explain in part why rental periods are relatively short in the United Kingdom: each year, approximately 34% of the rental contracts are renewed in that country.

Tenant versus landlord protection

From Table 4.2, it could be concluded that regulation in the United Kingdom and Australia tends to favour the landlord over the tenant. In particular, the security of tenure differs strongly from the other countries. It may be logical to reason that a strong position for a landlord is beneficial to all landlords, including institutional investors, and that this could act as a spur to investor interest in the housing market. However, this does not appear to be the case, as these are the two countries in which institutional investors are least involved in the residential property market. Conceivably, tenant protection gives the rental market a better status, resulting in more willingness to rent, and not only by low-income households. Also, when rents are highly regulated, they tend to be less volatile, possibly also leading to a reduction in the volatility of the asset values. This would clearly be beneficial to institutional investors.

5. MARKET CUSTOMS AND SOFT FACTORS

As has been shown, cross-country differences in the way regulation favours landlords or tenants do not obviously lead to more or less involvement of institutional investors or vice versa. For example, The Netherlands seems quite pro-tenant, yet has very strong institutional involvement. Nor do other market characteristics, such as the rate of private home ownership or the involvement in social housing providers in the market, appear to provide a clear-cut explanation for the weight of influence that institutional investors exert in the different residential property markets studied.

As a result, interviews were conducted with market experts in all six countries, to investigate whether there were other market influences in addition to the data and regulation already analysed. The views of academics and market experts were sought and Table 5.1 categorises the type of experts that were interviewed.

Table 5.1: Interviewed market experts

	AU	FR	GE	NL	UK	US
Professor of housing economics		x		x		
Professor of real estate finance	x		x		x	x
Leading housing market expert, industry			x	x		
Leading global real estate expert, industry					x	x
Institutional investor in residential property			x	x		

The interviewees stressed the importance of regulation and taxation. For example, investing in rental housing is very attractive for German private investors, since this allows them to deduct the interest from the mortgage loan, while the capital gain from house price increases is not taxed unlike capital gains on most other types of investment. In contrast, as institutional investors would pay tax on capital gains, private investors are at a clear advantage in the German residential rental market. In the United States, it appears that most involvement in housing finance by institutional investors is in the mortgage market, which seems to be driven largely by federal regulation.

Nevertheless, comparing the different interviews, some ‘soft’ factors become apparent. What is especially striking is that the same characteristic of residential investment can be considered to be a significant attribute by investors and market experts from countries with strong institutional investment in the sector, yet a highly negative deterrent to investment by those in other markets.

For example, the fact that housing investment involves consumers rather than business clients was considered a very big plus in the countries where housing investment is common: most other property types are business-to-business, giving the investor exposure to the business cycle (which is what investment in equity stocks do as well), while housing investment creates strong diversification benefits at the overall portfolio level. Yet the same aspect was considered a major disincentive in countries without an established market of institutional housing investment. These latter interviewees stressed the managerial hassle of having to deal with ‘irrational’ consumers.

5. MARKET CUSTOMS AND SOFT FACTORS

Also, the interviewees in countries with significant institutional housing investment spoke of the social benefits of housing investment, treating it as a type of corporate social activity, with the resulting public relations benefits - a representative of a major Dutch pension fund made this very clear. However, other interviewees stressed the big PR risks of housing, in having to deal with non-paying tenants. Having to "evict a granny in the week before Christmas" would create a PR disaster, which would not occur in commercial real estate. Utilising a dedicated external asset and/or property management organisation between the ultimate investor and the consumer should resolve that problem.

A third way in which residential property investment differs from commercial property is in the size of individual rent contracts, and, thus, in the number of contracts required to employ a significant amount of capital. This was regarded as very beneficial by interviewees from the "residential is great" countries, who mentioned the risk-reduction effect of this: large numbers imply predictable cash flows. The interviewees from the "no residential" countries talked mostly of the quantity of work resulting from the management of all these contracts. Again a professional asset/property manager could address this.

A further factor that was mentioned several times (in Australia, Germany and The Netherlands), when explaining the strong involvement of private investors versus institutional investors in residential, was the difference in required return. It appears that private investors are satisfied with lower returns, so that they seem able to outbid institutional investors. However, interviewees did not give a clear or convincing answer as to why private investors tend to settle for a lower return.

The conclusion of this aspect of the study is that market perceptions and customs do seem to play a role in institutional investor preferences for or against residential investment. However, that also holds for market institutions, particularly institutions that can deal with the managerial issues pertaining to residential investment. The countries in which residential investment is popular among institutional investors all possess a well-developed asset and property management industry that allows the investors to reap the benefits from residential property, without needing to suffer the disadvantages. Such an industry would appear to grow out of a symbiosis with an active institutional investor community in residential, yet also seems to be a prerequisite for its success.

6. IMPLICATIONS AND LESSONS TO BE LEARNED

Although it is commonly known that institutional investors in the United Kingdom allocate only a small portion of their assets to residential property, little is known of the reason for this. In this paper, the authors have investigated five different overseas residential property markets, comparing them to the residential property market in the United Kingdom.

Results show that it is not the usually cited reasons that determine the level of residential investment by institutional investors. For example, no relationship was found with the level of home ownership. Also, the dominant position of social housing providers in The Netherlands and other investors in Germany does not appear to deter institutional investors from the residential market. Although the relationship is often not entirely clear, there are some factors that appear to be drivers for institutional investments in residential property. Having said that, it is important to acknowledge that this study is of only six countries, so it remains to be seen whether the results can be generalised. Nevertheless, looking at the different international markets, there are four main factors that seem to influence institutional investors' involvement in the residential property market:

- Income stream
- Inflation hedge
- Level of tenant protection
- Maturity of the investment market

Looking at the performance indicators for residential investments, there are significant differences across the six countries. Firstly, income returns are currently lowest in the United Kingdom (2.4%) and France (2.9%), while the level of income returns in Germany, the United States and The Netherlands is consistently above 4.5%. But in all six countries that income stream is very stable.

Also, the inflation hedging potential of residential property seems to be relatively weak for residential investments in Australia and, especially, in the United Kingdom. In the other four markets, the inflation hedging potential is significantly better than what is commonly found for equities and bonds. Since inflation protection is an important consideration for institutional investors, this finding suggests that residential property investment is more attractive for investors in these other four markets, and relatively unattractive in Australia and the United Kingdom, which may, in turn, explain the differences found in institutional investors´ housing involvement between these two groups of countries.

It can also be concluded that regulations affecting the residential market play a large role in the amount of institutional investment in a certain market. One might suspect that strong tenant protection limits the possibilities for landlords, including institutional investors. Results, however, show that this is clearly not the case. Tenant protection is low in the United Kingdom and Australia, for example, where rental increases are free and tenant eviction is relatively easy. Although this seems advantageous for investors, this does not act as a trigger for institutional involvement. In the other countries tenants are far more protected, and institutional investor involvement in the market is much stronger there. Apparently, regulated rent levels and security of tenure creates a stable rental market. It seems likely that this attracts other types of households that may be more reliable in their rental payments and more inclined to rent for a longer period of time. This, in turn, may lead to the stable cash flows favoured by institutional investors.

6. IMPLICATIONS AND LESSONS TO BE LEARNED

Apart from the straightforward differences in housing market characteristics and structures, there are further differences that are not easily measured. These aspects were explored during interviews with market experts and investors in the six countries. The interviews showed that market customs and traditions play a very important role in the popularity of the residential product. The second main lesson from these interviews is that the maturity of the investor market and a well-developed asset and property management industry are very important. A strong relationship was clearly observed between institutional investor involvement in the residential sector and the availability of investment management organisations in the different markets. For example, Dutch investors can choose from a wide range of asset management organisations, varying in investment approach, size and specialisation, whereas that is not the case for their colleagues in the United Kingdom and Australia. Moreover, these Dutch institutions appear to achieve a lower gross-to-net leakage than the other markets in the sample. However, such organisations are also emerging in other countries, most clearly in Germany and France, which may help mobilise institutional capital to residential investment.

Finally, it has also become clear that it is most often not one aspect that determines whether institutional investors are attracted to the residential market, and that the effects of different factors may differ by country. There is no simple recipe to create an institutional investor market in residential property.

NOTES

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