bshf

Building New Homes for Rent

Briefing for investors

Key points

- This summary outlines a new model for investment in rented residential property that has the potential to overcome current challenges and respond to the high demand for privately rented accommodation across the UK.
- Despite common perceptions, residential property has the potential to deliver viable and steady returns, and also offers an excellent opportunity for portfolio diversification.
- Housing associations are ideally placed to deliver portfolios of market rental property given their balance sheet strength and expertise in both the development and management of residential property.
- By partnering with large housing associations, investors will be able to invest at scale, and be confident of competent, reliable management.

"The residential sector is a great opportunity for investment and presents us with additional options for our clients' portfolios, which is something we are always interested in considering."
(Robin Goodchild, LaSalle Investment Management)

This summary is based on BSHF's report, **Building New Homes for Rent**. The report draws on the findings of a recent consultation at St George's House, Windsor Castle. Experts from a range of backgrounds, including investors, came together for a detailed and wide-ranging discussion on the delivery of new homes for rent.

The full report can be downloaded free of charge from **www.bshf.org/published-information**. For more information on the contents of this summary, please contact Jim Vine using the contact details below.

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Demand for residential property

For many years the UK has been building homes at a slower rate than the number of households has been increasing, a trend that has been exacerbated by the recession.

- The number of UK households is projected to grow by 272,000 per year until 2033.[1]
- The number of new dwellings completed in the UK each year has fallen sharply from a peak of 219,070 in 2006-07 to 140,790 in 2010-11.[2]

Demand for privately rented accommodation is continuing to increase, due to a range of factors, including mortgage constraints that limit access to owner occupation, and the attractiveness of the flexibility of private renting.

The UK's private rented sector is dominated by individual landlords, each owning a small number of properties. The stock largely comprises second-hand homes, with only nine per cent being newly built.[3]

There is therefore **increased interest in the potential for build-to-let developments**: housing projects built specifically to provide new homes for rent, with portfolios of homes under common professional management. It is anticipated that such portfolios, if suitably developed, would be **an attractive investment opportunity for institutional investors.**

Residential: a viable asset class

There are several features of residential property that make it viable for investment.

- **Rents** from residential lettings have historically **risen in line with wage inflation** and hence will often match institutions' long-term liabilities.[4]
- **Returns from residential property tend to have low correlations with other asset classes**, providing useful diversification in a portfolio.[5]

[1] This figure has been arrived at by aggregating data from the constituent nations of the UK:

England: www.communities.gov.uk/documents/statistics/pdf/1780763.pdf
Wales: wales.gov.uk/docs/statistics/2010/100929hseholdproj2008en.pdf
Scotland: www.gro-scotland.gov.uk/files2/stats/household-projections/2008-projections/household-projections-2008-based.pdf
Northern Ireland: www.nisra.gov.uk/archive/demography/population/household/NI08_House_Projs.pdf

[2] Department for Communities and Local Government (2012) House Building Table 2e: Starts and completions, UK, www.communities.gov.uk/documents/statistics/xls/2145681.xls
[3] Department for Communities and Local Government (2010) Private Landlords Survey 2010, www.communities.gov.uk/publications/corporate/statistics/privatelandlordssurvey2010
[4] Wilcox, S. (2008) UK Housing Review 2008/2009, Figure 1.2.4 (Coventry: CIH/BSA).

- While house prices are perceived as volatile, **the volatility risk associated with residential property over the last ten years actually compares favourably with other property sectors**. IPD reports that the volatility of residential property companies (measured as the standard deviation of total returns) was 10.7 per cent over the decade, compared with 13.5 per cent for the retail and office property sectors, and 11.8 per cent for industrial property. [6]

- **Residential property has historically outperformed commercial property when total returns are considered**.[7] It should be noted, however, that this outperformance has been due to strong capital growth.

Current challenges

Although residential property has the potential to become a viable asset class, there are challenges that currently prevent the sector flourishing.

- **Yields**, when capital gains are excluded, are typically lower than for commercial property.

- Investors typically require substantial portfolios to warrant developing expertise in an asset class, and to ensure that it would make a non-negligible impact on overall fund performance. However, there is **insufficient opportunity to invest at the required scale**.

- The current small scale of the sector means that **there are few examples to give confidence to investors** about the potential of residential property and there is a lack of expertise around the asset class.

- Those investors interested in the long-term rental streams from residential property would **typically be unwilling to finance the development stage**, as these two stages have different risk and return profiles.

- Some investors may be concerned about **reputational risk** around aspects of residential property management, such as evictions.

- Some investors have expressed concern about the **impact of rent control**. However, none of the main political parties have indicated a desire to introduce such controls, and controls of this nature do not adversely affect institutional investment in countries where they do exist.

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[5] Property Industry Alliance, Council of Mortgage Lenders and Association of Real Estate Funds (2010) Combined response to HM Treasury consultation on investment in the UK private rented sector, p. 23, www.ipf.org.uk/MainWebSite/Resources/Document/PRS%20Investment%20Response%20Final.pdf

[6] Weedon, M. (2012) IPD UK Residential Index Launch (presentation given 29 February 2012)

[7] Weedon, M. (2012) IPD UK Residential Index Launch (presentation given 29 February 2012)

- **Management requirements** are far higher for residential property than commercial. This both requires significant expertise and reduces returns.

By addressing these challenges, there would be an opportunity for investments in rented residential property.

A model way forward

There is a need to create **trail-blazing build-to-let developments**: portfolios of suitable scale, well-designed to enable management efficiencies and in the right location to meet housing need and demand. Such developments would have the potential to meet the requirements of investors and **demonstrate the potential of investment in residential property**.

Housing associations are ideally suited to this role, as they have the **skills, experience and resources to undertake the development of such portfolios**.

- Experience of (and willingness to take) development risk;
- Expertise in property management; and
- Financial capacity to bring forward developments.

Housing associations have substantial experience in the delivery and management of rental accommodation. Some of the largest associations are now responsible for portfolios in excess of 60,000 homes.

In recent years, **many associations have expanded their housing activity to deliver homes to generate surpluses**, including undertaking market rental activity.[8] Through this they have developed into substantial businesses, with sophisticated appreciation of risk, finance, and other commercial considerations.

As an established provider of homes for rent, housing associations would be **able to provide investors with peace-of-mind property management**, and ensure that tenants are decently housed with a high quality landlord service.

Once the portfolio is developed and tenanted, **housing associations could then create a fund, transfer the portfolio into it, and seek investment. The housing association would** remain a part owner of the portfolio and **retain responsibility for management**, but would be able to release most of its capital. The fund-based approach would also help to shield investors from the perceived reputational risk of direct sole ownership.

[8] Hollander, G. (2011) Housing Association Enters Market Rent Sector, Inside Housing, Monday 5 December, www.insidehousing.co.uk/6519435.article

Bury, R. (2012) Association Buys up 150 Flats for Private Rent, Inside Housing, Friday 6 January, www.insidehousing.co.uk/6519849.article