Safe as houses? Thinking on the rise of investment into UK residential markets

Abstract

Purpose – In recent decades, institutional investment has become increasingly focused on residential property in the UK, reflecting interest in what was previously considered an 'alternative' asset class, but is now an evolving and ever more complex sector. This short thought piece considers how such processes may be understood through investment related research.

Design/methodology/approach – The UK residential market has experienced substantial capital inflows in the wake of the global financial crisis (GFC). This reflective piece suggests there is a need for more research into residential real estate as an institutional asset class to further unpack and understand shifting market dynamics within the UK. It offers insight into evolving market trends across a diverse range of investors and market sub-sectors.

Findings – This paper considers the diverse research opportunities within the residential investment markets, including but not limited to, the private rented sector (PRS), build-to-rent (BTR), and purpose-built student accommodation (PBSA), presenting opportunities for a burgeoning research.

Practical Implications – The viewpoint suggests how this research lacuna may be bridged through additional research in not just the UK residential market, but also how investors may further integrate and operationalise UK residential assets in diversified or specialised investments, from domestic to international propositions. The suggested research agenda promotes enhanced understandings of residential markets and processes driving investment decision-making.

Originality/value – As the integration of residential property into vehicles such as REITs, private equity funds and managed multi-asset portfolios continues to increase, there is an amplified need to understand the market context in which such investment flows occur, including the potential impact of COVID-19, Brexit, and the cyclical evolution of real estate markets more broadly.

Key words – Institutional investment, residential, build-to-rent, purpose-built student accommodation, risk, uncertainty.

Paper type – Viewpoint

The last 40 years has seen the Journal of Property Investment and Finance (JPIF) publish hundreds of insightful papers and articles across myriad topics, many of which have been focussed on investment, and valuation research into the more established and traditional sectors of office, retail, and industrial real estate. However, when we consider alternative asset classes across the world, residential real estate values substantially and consistently exceed those found in the commercial market, but institutional investors have historically only been a significant presence in a limited number of markets where scale, local contexts and market dynamics allowed (such as the USA).

At the turn of the twenty-first century, residential real estate was not recognised as an asset class worthy of note for institutional investment in the UK. Nor was the residential sector ever included in any investment teaching I received as a real estate Undergraduate student (2002-06). As an academic based in the UK in the initial years of my own teaching career from 2011, discussions about residential investment were centred around why it was *not* an appealing sector for institutional investors. To refer to the Victorian doggerel of my adopted title, if residential really is 'as safe as houses', why wasn't the market accommodating large scale investors? It was perceived by students as more of a problematic proposition in a market dominated by owner-occupiers in the UK, rather than one with latent potential for institutions, with challenges of liquidity and scale. However, the investment landscape has rapidly changed since then.

The residential market has developed scale, breadth, and depth, with this alternative asset class acting as an umbrella term for a diversity of different types of living experiences which include the private rented sector (PRS), the build to rent sector (BTR), and purpose-built student accommodation (PBSA), as well as senior and co-living. Although the weight of capital in the residential sector is comparatively small compared to that of the commercial market, investment volumes peaked pre-pandemic at almost £6bn in quarter one 2020, with investment in the first three quarters of 2021 reflecting an average of £2bn per quarter (CBRE, 2021). The demand in the sector is strong, with prime BTR yields at 3.25-4.0%, prime PBSA at 3.75-5.25%, and forecasted future returns in the next five years of 7.3% per annum (CBRE, 2021). Over the last decade IPF have gathered investor perspectives into the UK real estate market, and their most recent survey confirms increased exposure to residential: in 2012 it accounted for 4.6% of portfolios, today it is almost 13% as investors diversify (IPF, 2021). Today the residential market in the UK is also awash with instantly recognisable global investors, such as Blackstone and Greystar, more familiar domestic operators such as the Home REIT, and sovereign wealth funds like the Abu Dhabi Investment Authority (ADIA).

These unfolding trends into the UK residential sector are something I have been lucky enough to be researching recently, as part of an ongoing European research project '*What is Governed in Cities'*[1], which examines the scale and nature of international and domestic investment into London, Amsterdam and Paris. This research project explores the inter-relationships between capital flows into residential assets across the three cities, and the governance and policy mechanisms that actively regulate such investments. One of the work packages specifically assesses the scale and nature of investment into each case study city, and I have been working on analysing the geographies of institutional investment, unpacking investor characteristics and reflecting on how the London residential market is being recreated and literally reconstructed by complex market dynamics. As with all research, preconceptions are challenged and lack of knowledge is exposed – investigation creates further questions, and research begets research. It has been fascinating to gain a little insight into how this sector is evolving, and this thought piece is advocating that now is the time for a renewed research agenda which prioritises advancing our knowledge of investment into residential real estate in the UK, and indeed the global real estate market more broadly. Both research and teaching can be enhanced by increased knowledge of the diverse dynamics driving the growth in this alternative but increasingly less niche investment sector.

What do we know so far? Market context and existing research

There was negligible investment into the UK residential sector in the decades prior to the global financial crisis (GFC) of 2007-08, however the impacts of the GFC provided the impetus for increasing investment in-flows. As we are all aware, an abundance of driving factors emerged post-GFC to stimulate significant market change across the global real estate market. In the UK, investors shifted into residential real estate due to a convergence of connected factors, which cannot be exhaustively considered here. However, influences included the poorer performance of commercial assets, cyclical movements in the economy and real estate market, the ongoing 'housing crises' of both supply and affordability in the UK, attractive risk return profiles for more opportunistic investors, as well as supportive regulatory shifts. For example, the UK government considered barriers to inward institutional investment into housing through the Montague Report in 2012, and resulting recommendations contributed to increased capital coming into the sector. The UK's residential market had not suffered in the same way as a result of the GFC when compared to other European market bubbles such as those in Ireland and Spain. There were opportunities across the sector, as demand from the private rented and PBSA sectors stimulated a market response through the trifecta of the investment, development, and occupier markets. The residential asset class was beginning to be seen as an increasingly viable and resilient opportunity for investors post-GFC, with institutional capital

[1] For more detail information on the project, 'What is Governed in Cities: Regulation of Investment Landscapes and the Governance and Regulation of Housing Production' (2019-22) visit https://whatisgovernedincities.eu/

beginning to invest in this 'alternative' sector in the UK, initially through purpose-built student accommodation (PBSA). A decade ago, PBSA and the PRS were seen as riskier propositions for investors, but these are now more firmly established and mainstream assets, offering attractive rewards, as the earlier reflection on yields and returns illustrate. Scale is no longer an issue in larger city markets, as the BTR sector has developed investment opportunities further, and the emerging co-living and senior living currently offer higher risk reward profiles. The market is increasingly liquid, operational efficiencies have been addressed, and large scale developments and transactions demonstrate scale. However, it is difficult to ascertain how the sector will be affected by ongoing impacts of the COVID-19 pandemic and the political and economic fall-out from Brexit. The diversification in asset classes within the residential sector itself offers further diversification opportunities for institutions and to borrow US parlance, both 'multifamily' and to a much smaller extent 'single-family housing,' have now very much arrived as key sectors in the UK.

Feeling motivated by these ongoing shifts in the UK's residential market and inspired by emerging findings from the aforementioned research project, for this short piece I then dived into JPIF's online annals to discover what has been written on the evolution of the sector in the first forty years of publication. The answer was – not a lot. In fact, investment trends into the residential market have been considered in more detail in critical geography journals, rather than real estate ones. Examples include Raco et al (2019) which presents investor perspectives on the London residential market, Brill and Durrant (2021) reflect on the growth of BTR, and Brill (2021) reflects on risk allocation in development. However, a selection of papers in JPIF considered residential real estate from various perspectives: Hales (1992) analysed mortgage valuations, Sidwell (1991) considered specialist residential real estate by looking at the valuation of nursing homes, McGreal et al (1998) and McCluskey et al (2000) looked at predicting residential values, Wolverton (1997) assessed specific influences on these values, and Stevenson (1997) used regression models to evaluate the inflation hedging capacity of the UK's regional housing markets. Regeneration, development and private sector investment in the Dublin housing market was considered by Adair et al (1994), with Kosavinta et al (2017), considering decision-making processes in residential development. More recently, the journal has published numerous articles on residential real estate research, including a growing body of work on the PBSA sector (Newell and Marzuki, 2018; French et al 2018; McCann et al, 2020; Livingstone and Sanderson 2021), with Lin et al (2019) evaluating residential REITs in Japan, and Fyfe and Hutchinson (2021) exploring opportunities in the Scottish senior living sector. Although the research in residential real estate is growing in momentum, neither the pace of change in the UK market, nor the channelling of institutional capital into this evolving and interesting asset class has been sufficiently considered in real estate research. How could this research lacuna be effectively addressed in JPIF?

What next? A burgeoning research agenda

In pursuit of further knowledge into the residential investment sector in the UK, the following ten themes outline prospective research questions which have emerged through this insight piece and seek to encourage an extensive research agenda. Certain themes are broader, providing market overviews and reflections on general trends, others are more particular and nuanced; some may be more suited to qualitative exploration, others will fundamentally require quantitative datasets for interrogation, however many themes could be explored through mixed methodologies.

- **Investors:** What are the institutional characteristics of investment actors transacting residential real estate in the UK today, and how has the landscape changed in the Twenty-First century? Do investor profiles vary between BTR, PRS, PBSA and senior living, and if so, how do company specific attributes differ?

- **Financing:** What do we know about the capital structure and financing underwriting large-scale residential investments – how have wider economic changes in interest rates and debt availability effected investment trends and capital accessibility? How leveraged are investors, in terms of debt and equity, assets and liabilities? How are residential assets considered across the risk spectrum, from core to value added and opportunistic? How have Brexit and the COVID-19 pandemic impacted financing?

- **Diversification:** How discernible are diversification opportunities in the UK residential sector, where are the key locations and opportunities for investing at a suitable scale and level of liquidity? The role of residential real estate as a diversifier in portfolios is something to be modelled in more depth.

- **Data:** What can we do with existing data on the residential sector, and is it established enough to operationalise? What might future forecasts look like for investors into the sector? Where are the weaknesses in data provision and how can they be accounted for and overcome?

- **Listed performance:** What can we learn from analysing the performance of listed residential real estate investment returns; do decision-making processes and investment strategies differ between companies, and what historic trends have emerged in the UK in terms of divestment and investment decisions?

- **Temporalities:** What does scenario analyses and econometric modelling tell us about how to position and integrate residential investments into multi-asset or indeed more specialist and niche portfolios across varied time and return horizons?

- **Valuation and pricing:** Are there additional adjustments in valuation processes for residential assets compared to commercial, and do valuation standards effectively capture market nuances? What are the realities of residential transactions, in terms of transparency and negotiation, yields, pricing and transaction values? How is pricing manifest across markets; are there premiums or discounts for such assets in certain cities? Valuation may be an art and a science, but how has it adapted and developed in the residential market?

- **International integration:** How does the growth of institutional investment into the UK residential sector play out when compared to established European and global residential markets, such as the USA, the Netherlands and Germany for example? Where and how does it 'fit'?

- **REITs:** What can the emergence of residential REITs in the UK market, their structure, returns and risk profiles, from BTR to social housing, tell us about both REITs as a vehicle specifically, and the subtleties of the UK market more generally?

- **ESG & Sustainability:** Can we evaluate perceptions of value when considering ideas around sustainability and ESG in residential investment, across the spectrum of the 'alternative' assets such as senior housing, PBSA, BTR and PRS?

Considering the significant growth of investment into the residential sector in the UK in the last two decades, these questions build on foundations of existing work in this journal, and ideally act as a provocation for us to reconsider current market context and inform our future research. There is such a diverse range of both qualitative and quantitative research opportunities to explore in varied ways which capture the complex dynamics of this rapidly changing asset class in the UK, from granular perspectives on the very local, to the regional and global residential markets.

If I know one thing for sure, the way I will discuss and deliver investment teaching in the future will undoubtedly include a much more detailed consideration of the developing role of residential real estate, in addition to other 'alternative' asset classes. More work is needed to promote enhanced understandings of residential markets and processes driving investment decisions, not just for the benefit of our students, but also for ourselves as an engaged and energetic research community looking forward to the next 40 years of work in the Journal of Property Investment and Finance.

Acknowledgements: The author would like to acknowledge that this research insight was both inspired and supported by the Economic and Social Research Council (ESRC) and Open Research Area (ORA) as part of an ongoing funded research project, code ES/S015078/1, on 'What is Governed in Cities' (2019 - 2022) (https://whatisgovernedincities.eu/).

References

Adair, A., Berry, J. and McGreal, S. (1994), 'Investment and Private Sector Residential Development in Inner-city Dublin', Journal of Property Valuation and Investment, 12(1), pp. 47-56. https://doi.org/10.1108/14635789410050502

Brill, F. (2021) 'Governing investors and developers: Analysing the role of risk allocation in urban development', Urban Studies, https://doi.org/10.1177/00420980211017826

Brill, F. & Durrant, D. (2021) 'The emergence of a Build to Rent model: The role of narratives and discourses', EPA: Economy and Space, 53(5), pp.1140-1157, https://doi.org/10.1177/0308518X20969417

CBRE (2021) 'Residential Investment Totals £2bn in Q3'. CBRE Research, London. Available from: https://www.cbre.co.uk/research-and-reports [Last Accessed: 19/10/2021].

French, N., Bhat, G., Matharu, G., Guimaraes, F.O. & Solomon, D. (2018) 'Investment opportunities for student housing in Europe'. Journal of Property Investment and Finance, 36(6), 578-584. https://doi.org/10.1108/JPIF-08-2018-0058

Fyfe, A. and Hutchison, N. (2021), 'Senior housing in Scotland: a development and investment opportunity?', Journal of Property Investment & Finance, 39(6), pp. 525-544. https://doi.org/10.1108/JPIF-10-2020-0119

Hales, P. (1992), 'Valuation for Mortgage Purposes: An Update', Journal of Property Valuation and Investment, 10(2), pp. 483-490. https://doi.org/10.1108/14635789210031136

IPF (2021) Large scale UK residential investment: Achieving market maturity. March 2021. IPF Research Programme 2018-2021. March 2021. IPF: London.

Kosavinta, S., Krairit, D. and Khang, D.B. (2017), 'Decision making in the pre-development stage of residential development', Journal of Property Investment & Finance, 35(2), pp. 160-183. https://doi.org/10.1108/JPIF-05-2016-0030

Lin, Y.C., Lee, C.L. and Newell, G. (2019), 'The significance of residential REITs in Japan as an institutionalised property sector', Journal of Property Investment & Finance, 37(4), pp. 363-379. https://doi.org/10.1108/JPIF-03-2019-0036

Livingstone, N. & Sanderson, D. (2021) 'All grown up? Market maturity and investment in London's purpose-built student accommodation sector', Journal of Property Investment and Finance, https://doi.org/10.1108/JPIF-08-2021-0072

McCann, L., Hutchinson, N. & Adair, A. (2020) 'Student residences: time for a partnership approach?' Journal of Property Investment and Finance, 38(2), pp. 128-146

McCluskey, W.J., Deddis, W.G., Lamont, I.G. and Borst, R.A. (2000), 'The application of surface generated interpolation models for the prediction of residential property values', Journal of Property Investment & Finance, 18(2), pp. 162-176. https://doi.org/10.1108/14635780010324321

McGreal, S., Adair, A., McBurney, D. and Patterson, D. (1998), 'Neural networks: the prediction of residential values, Journal of Property Valuation and Investment, 16(1), pp. 57-70. https://doi.org/10.1108/14635789810205128

Newell, G. & Marzuki, M. (2018) 'The emergence of student accommodation as an institutional property sector', Journal of Property Investment and Finance, 36(6), pp. 523-538

Raco, M., Livingstone, N. & Durrant, D. (2019) 'Seeing like an investor: urban development planning, financialisation, and investors perspectives of London as an investment space'. European Planning Studies, 27(6), pp. 1064-1082, https://doi.org/10.1080/09654313.2019.1598019

Sidwell, A. (1991), 'The Valuation of Nursing and Residential Homes', Journal of Property Valuation and Investment, 9(4), pp. 352-356. https://doi.org/10.1108/14635789110031029

Stevenson, S. (1997) 'The performance and inflation hedging ability of regional housing markets', Journal of Property Investment and Finance, 17(3), pp. 239-260. https://doi.org/10.1108/14635789910270503

Wolverton, M.L. (1997), 'Empirical study of the relationship between residential lot price, size and view', Journal of Property Valuation and Investment, 15(1), pp. 48-57. https://doi.org/10.1108/14635789710163801