UKAN’T IGNORE MULTIFAMILY

With a possible shift in the U.K. to include an institutional PRS market, investors should look for opportunity

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In 2016, more UK lenders were willing to finance hotel properties than multifamily properties. This may come as a surprise, since multifamily has long been an investment darling and an important part of US institutional core commercial real estate portfolios. In the UK, however, investors view the country’s multifamily sector, commonly referred to as the “private rental sector” (PRS), as a relatively untested asset class unfit for inclusion in an institutional portfolio.

Over the past few years, a handful of institutional players have entered the UK market with the goal of changing that view. They have had some early successes, but headwinds remain. Conditions are rife for the PRS market to attain the size necessary to justify inclusion in institutional portfolios. But will scale be achieved? If it is, investors who avoid PRS will miss an opportunity to add an asset class that, in more mature markets such as the US, has proven to be an important core portfolio diversifier.

Market growth despite institutional reluctance

US investors view multifamily as a low volatility, highly liquid, stable income-producing portfolio diversifier. In the UK, however, where institutional portfolios are dominated by office and retail, investors eye multifamily with scepticism. To date, the UK multifamily market has largely operated as a cottage industry in which the majority of landlords own just one unit. This approach has not allowed for the economies of scale, data, or liquidity necessary to create an institutional asset class. Despite this, PRS has proven itself to be a viable asset class. The size of the £1.4 trillion PRS market has doubled over the last 15 years and now makes up roughly 20% of the overall housing stock, compared to 37% in the US. Mainstream investor PRS ownership is low but grew by over 30% in 2016.

Going pro

The UK government has been vocal about the important role that multifamily will play in its plan to address the severe housing shortage, estimated to be 90,000 homes per year. It would like to shift away from the mom-and-pop rental model, which it views as driving up prices for first-time home buyers, toward an institutional multifamily market, commonly referred to as “build-to-rent” (BTR). Large-scale multifamily operators bring the expertise necessary to build new housing supply that offers tenants what they need – the comfort of long-term tenancy while they save up to buy a home, landlord professionalism, prime locations, and - important to a growing renter segment - common spaces and amenities that create a sense of community.

Over the last few years, several major players have moved into the UK with the hopes of creating a U.S.-style multifamily product. A recent study suggests that BTR could deliver 240,000 new homes by 2030. To date, over 15,000 units have been delivered under the BTR scheme, and more than 68,000 are under construction or in planning.

Planting the seeds for growth

For PRS to achieve an institutional scale, an accommodative national policy framework will be vital. In the US, for example, dedicated public agencies provide multifamily financing and liquidity. This has helped lower volatility for both multifamily value and borrowing costs, allowing the asset class to grow beyond where it might have without the presence of such support. Currently in the UK, converting existing housing stock into rentals is difficult. Limited land is available for new development, and new projects often get delayed. Unlike the US, the UK doesn’t differentiate zoning between multifamily and residential, and market dynamics favor developers building units for sale.

Fortunately, the UK government has recently taken steps toward a more accommodative policy. Going forward, local authorities will be required to plan for realistic housing needs, including multifamily rentals. Approval processes will be streamlined and, once approved, projects will commit to faster delivery timelines. New developers will be encouraged to enter the market. This is a good start, but more may ultimately need to be done.

Home sweet home

Multifamily has long been an important component of any institutional US real estate portfolio. Will UK housing policy aimed at establishing an institutional PRS market be successful? If it is, UK investors should take advantage of the shift toward institutional sponsorship and diversify their portfolios. After all, in a downturn, office tenants may downsize and consumers may stop spending, but everyone needs a home.
References

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5 http://www.nmhc.org/Content.aspx?id=4708 (US Households, Renters and Owners)


7 Government Housing Paper

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