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Private Rented Sector in the UK

For many years, pension funds and institutional investors have sought to access residential rental income streams in the UK, with no real success. The concept of a diversified rental income stream which is indirectly linked to the Retail Price Index looks, on the face of it, like the perfect match for a typical pension fund's long term obligations to its policy holders. But a lack of appropriate quality of product and the culture of an Englishman's home being his castle (exacerbated by increasingly easy access to high LTV mortgages for borrowers) fuelled a strong shift towards home ownership in the UK.

The shift toward home ownership was greatly accelerated in the 1980s, when Margaret Thatcher's Right To Buy scheme created a generation of home owners – more than 2 million homes were bought under this scheme. Historically, private rented housing ownership has always been fragmented, with a large proportion of stock held by buy-to-let landlords owning a few properties each. The stock therefore is inconsistent and generally sub-standard. In 2010, 37% of private rented homes were classified as 'non-decent'. In particular, partly due to the age of the stock, private rented housing tends to perform poorly in terms of energy efficiency and lacks basic amenities such as central heating. This fragmentation and inconsistency within the market is not what serious investors want. As a result (excepting the Wellcome Trust and Grainger), the private rental sector has historically not been seen as particularly attractive to institutional investors.

However, the current climate has forced a reversal in the trend towards home ownership. In 2008, the Private Rental Sector accounted for 13% of UK households. It has been rising steadily since, and is predicted to rise to 22% by 2025. The increased demand for rental properties is in large part driven by constraints upon mortgage lending terms, which appear likely to remain in place, as both the Government and the Bank of England have vowed to step in to prevent 'reckless' mortgage lending in future. The requirement for perhaps 25% deposits has caused the average age of a first time buyer without parental help to rise to 38.

The demand story is even more compelling when one considers that housing supply lags behind household formation on a year-on-year basis: Demand for extra homes in England is now estimated at around 210,000 properties a year, compared with average output from house builders and social housing providers of 154,000 extra homes a year over the past five years. The accumulating gap between demand and output points to a shortfall of 1.1 million homes in 20 years' time.

Rental housing stock is a growing segment of an already under-supplied asset class. Where there is a supply/demand imbalance, investment opportunities arise. Some of the most highly promising investment strategies will be in this sector over the coming years. All investors should be ready for the opportunities that this presents.

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