After careful consideration

Private rented sector property investment has its merits, but market entry needs to be carefully considered. By Will Rowson, partner at Hodes Weill & Associates.

The provision of affordable, good quality housing is a global issue. Whether it is for sale or for rent housing, it has tended to be in short supply where people really want it – in pleasant environments, increasingly inner city, and close to transport hubs or nodes. There are rarely 'bubbles' of over-provision across the globe.

Consequently, the provision of affordable rental housing has become a hot topic, especially when referring to the most attractive cities around the world.

Understandably, the global investors of the world have recently caught on to the opportunity to be the providers of such accommodation as they search for dependable, defensive income returns either via direct assets, JVs, funds, or through the listed markets. Those content to have 3 percent to 5 percent net income returns per annum, are sensibly turning to the sector in the world's prime markets.

Those investors looking for value-add or opportunistic returns are also turning to the sector, either via the development route or in less established locations. We are working with one group, for example, focused on residential property in Central and South America.

But such investors represent the minority. The majority are seeking existing income producing product in markets like the UK, where the lack of supply of truly affordable housing in the country's south east, the most popular location for private rented sector (PRS) property currently, is acute.

For investors seeking opportunities in PRS in this market there are a number of ways in – via the longer term route of acquiring built and let product – or via the accelerated route of developing the product and taking varying levels of permitting, development and vacancy risk.

There are some barriers to entry for each strategy, though. Via the development route you will likely want a partner, probably an experienced developer, who knows a thing or two about PRS design. Then, you'll need to bid for and secure sites, which has proven difficult when competing with 'build to sell' developers – mainly large, efficient house builders. If you secure the site, get the design right, acquire zoning consent (an often laborious, time consuming, unpredictable process in the UK) construct it, and finally then let the product, the returns can be excellent with IRRs in the mid to high teens or higher on offer.

Should you decide to wait for the completed product to become available, you're also in for a fight as there's currently an estimated £30 billion [$43.9 billion; €39.17 billion] 'wall of equity' waiting to access the sector. Income returns will be low but stable at the aforementioned 3 percent to 5 percent net – the gross to net on PRS runs at between 80 percent and 85 percent – depending on location. With the current supply and demand imbalance across the country, your scheme should have little vacancy if it is well designed and constructed, close to transport, and the rents are reasonable.

The third way to get exposure is via the provision of debt to these development schemes, through either senior or mezzanine elements of the financing. Again, each has its different risk and reward balance. You can also become a long term provider of debt to the eventual owners of the product in whatever vehicle they are held.

Each of these routes will potentially provide access to a long term, defensive sector that should be in constant demand in the future, certainly in the UK's case. The UK's property industry has been a slow learner regarding the residential sector in general, with only 2 percent of the sector in institutional hands versus 45 percent in the nearby Netherlands. The UK industry needs to learn from the US, Dutch and German markets as, if it does not try to reinvent the wheel, it is likely to be a compelling place to do business. The best investors will design great schemes, get them delivered, create a trusted brand and enjoy long and stable returns at handy 'liability matching' levels.

But with the 'build to sell' housing sector under serious pressure to deliver product, the competition for the best sites will remain intense. So too will the fight for the best completed and let PRS schemes from the vast amount of equity chasing the sector.

In any country in the world with strong demographics, sensible zoning policies, attractive supply and demand balances and liquid markets, the PRS sector can provide just what real estate hungry institutions want. But given the current market dynamic patience will be the key. □