For professional investors and qualified investors only

Build to rent investment – performance, resilience, and a great diversifier

Guy Glover
Fund Manager

Emma Gullifer
Fund Manager

The total value of the world's stock markets is c. USD 95 trillion (Apollo Global Management) – a figure dwarfed by the estimated size of the world's residential real estate value at USD 258 trillion (Savills).

Given this context it is no surprise that institutional investors, and particularly pension funds, are increasingly allocating significant sums to the world's largest asset class as a stand-alone component of their portfolio. Residential property is no longer an emerging asset class or viewed solely as an ancillary part of a commercial property allocation.

Why is this shift occurring and how does residential investment deliver for a pension fund?

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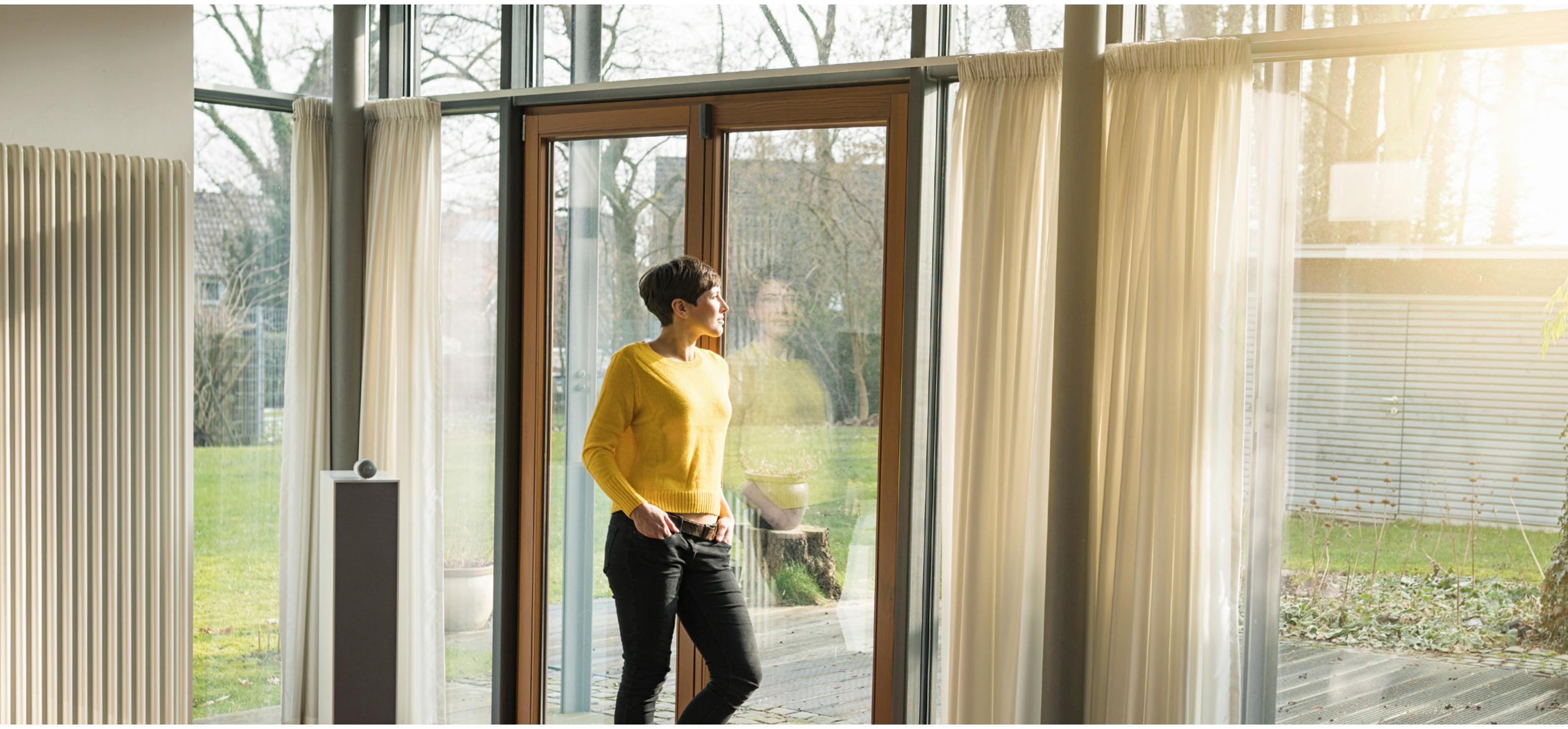


Performance & Diversification

Over the long-term residential real estate delivered 11.1% (per annum) on average, that is c.46% greater than equities, bonds, or even commercial property which each average between 7.3% – 7.6% over the period between 1990 – 2021. Residential also offers a resilient return which can outperform across market cycles and periods of market volatility; take the average of any rolling 5-year period since 1990 and residential real estate regularly outperforms against bonds and equities. Though please remember that past performance does not predict future returns.

It also acts as a true diversifier with limited correlation to either equities or gilts, with correlations at 0.27% and -0.05% respectively. To cap off residential's credentials from a portfolio perspective, it is also less volatile as detailed in the table below. Better performance, enhanced diversification, and reduced volatility – a pension fund's dream.

Correlation

	Residential	All Property	Equities	Gilts
Residential	1			
All Property	0.75	1		
Equities	0.27	0.42	1	
Gilts	-0.05	-0.08	0.09	1
Average, %y/y	11.1	7.3	7.6	7.5
Standard deviation	8.4	9.2	15	9.4

Source: Real Estate Strategies

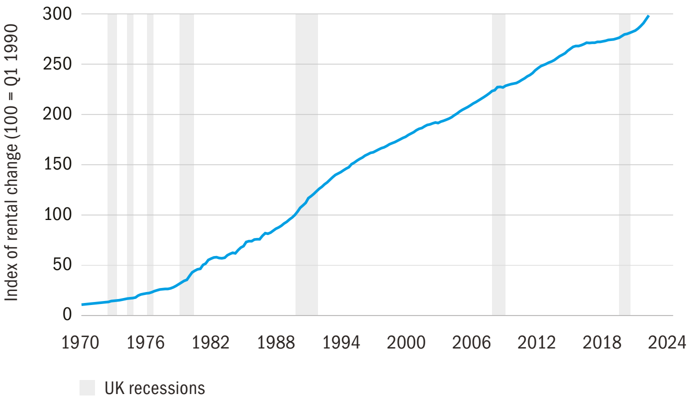
The long-term rental growth evidenced in the sector is very resilient

Higher income with inflation aligned income growth

Residential real estate can also provide long-term income growth aligned to inflation, while typically delivering a significantly higher net income than government backed inflation linked gilts. While residential market rents are not typically directly linked to inflation, the correlation is understandable due to the obvious link to wage growth which determines an individual's ability to pay and provides a remarkable alignment to inflation (98% correlation).

The long-term rental growth evidenced in the sector is very resilient, going some way towards neutralising market cycle volatility from an investor's viewpoint. While a buoyant economy can always support growth across all types of assets, the residential sector benefits from a degree of downside risk protection. In more challenging economic times, individuals are less likely to seek to make a major housing purchase, which can boost rental demand and hence rents in what is a dramatically undersupplied sector. Higher income, inflation aligned growth and income resilience – again, a pension fund's dream.

Proven long-term counter-cyclical rental performance



Source: Knight Frank Research / OECD

The fundamental imbalance of demand and supply has never been as compelling

The fundamentals – supply and demand

The fundamentals of the sector are compelling. On the demand side, increased household formation, higher immigration and urbanisation, reduced household average size, and positive population growth are all driving the rise in the number of rental households. On the supply side, a long-term undersupply of new housing across the UK and an ongoing net reduction in buy-to-let stock is putting increasing pressure on the availability of accommodation and unlikely to be resolved any time soon.

On average, every year the UK delivers 100,000 fewer homes than is required and due to limited construction starts, a complex planning system and cost of building combined with a restricted supply of labour, this number is unlikely to improve for the foreseeable future. This has coincided with a significant shift in current supply with the traditional provider of stock – the small buy-to-let investor – regressing from the market. This is the case for multiple reasons, but mainly tax changes, and they have been net sellers of stock at a significant rate of 76,000 units in 2022 and 300,000 over the past 5 years. The fundamental imbalance of demand and supply has never been as compelling, and importantly for the future performance outlook, many of these drivers are structural and likely to play out over the long-term.

Delivering on the ESG agenda

Delivering on the ESG agenda is where build-to-rent investing can really move the dial. The sector not only offers the opportunity to enhance supply of much needed homes and address quality concerns in the private rental sector by providing professionally managed purpose-built accommodation; investment can also target affordability to provide houses for the mass market in areas historically overlooked. This offers a broad spectrum of the population access to quality rental accommodation on longer term leases, enabling them to settle into the neighbourhood and integrate, create homes for their families and build lives.

The social benefits of providing additional rental accommodation to a community cannot be underestimated. New buildings are 60% more energy efficient on average, not only delivering cost savings for occupiers, but also reducing the impact homes have on energy consumption. Institutional and informed capital investing into the sector provides greater impetus for the creation of operationally net zero homes and provision of biodiversity net gain across new schemes. The ability for a real estate asset manager to specify and undertake direct interventions to deliver on the environmental agenda can go so much further than indirect engagement can typically deliver. It can benefit people and the planet.

Mainstream asset class

So why should pension funds be increasing allocations to residential real estate, and why now? Residential can deliver long term outperformance compared to other traditional asset classes, proper diversification benefits, lower volatility, high income, and inflation alignment, and is well placed to deliver growth over the long-term. The opportunity lies in a rapidly expanding institutional-grade market backed by compelling imbalance between supply and demand fundamentals, and additionally it can deliver on the ESG agenda which is increasingly a focus for trustees, members, pensioners, and pension fund managers.

Residential can deliver long term outperformance compared to other traditional asset classes

Investment risks

The value of investments and income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested. Past performance does not predict future returns.

The value of directly held property reflects the opinion of valuers and is reviewed periodically. These assets can also be illiquid and significant or persistent redemptions may require the manager to sell properties at a lower market value adversely affecting the value of your investment.

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