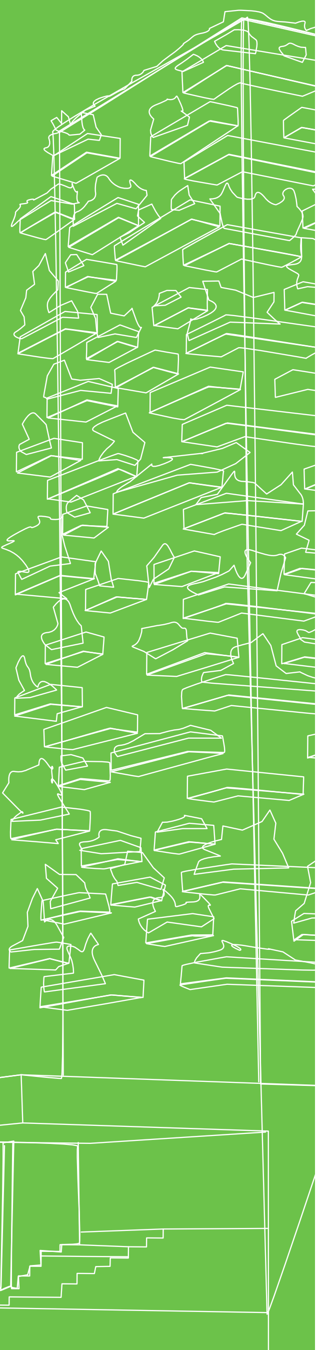

Housing middle income Europe:
the intermediary investment opportunity amid diverse residential market structures

Research

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Our aim is to improve the accessibility of non-listed real estate vehicles for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice.

As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate industry.

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Executive summary

Housing market structures are complex, diverse and impact on the PRS opportunity

Rental affordability varies with total housing costs as well as income

Demographic change requires increased scale, scope and range of purpose for PRS

Institutional PRS makes a crucial contribution to Europe's housing-for-all ambitions

There is a clear opportunity – and need – for institutional capital to greatly contribute to Europe's housing solution. The long-term nature of Europe's excess housing demand requires the rapid acceleration of housing supply across all segments. Importantly, this urgently requires an expansion of the private rented sector (PRS) to provide much needed intermediary housing.

This paper represents the first of an intended series of INREV research papers addressing opportunities, challenges and solutions for institutional investment in European residential. As the first paper in the series, this research sets out the position of intermediary PRS in the wider housing market landscape, exploring how housing market structures shape both the scale and scope of the PRS opportunity and their variation due to socio-political structures.

Institutional investment at scale has the capacity to expand the PRS and provide much needed long-term housing solutions for middle-income earners. In markets where institutional investment in the PRS is nascent, the delivery of professionally managed, purpose-built assets has the capacity to transform the suitability, quality and delivery of housing in this segment.

There is a natural alignment between the objectives of long-term income investors and intermediary PRS as it offers secure income, economic dislocation, strong opportunities to invest sustainably and a symmetry of purpose in respect of the underlying beneficiaries of both the investment return and the housing provision.

As the use and meaning of terminology concerning affordability and what constitutes affordable housing varies between the housing and real estate industries, across different stakeholders and across jurisdictions, the paper sets out a framework for how terms are to be interpreted for the reading of this paper. It acknowledges that what constitutes an affordable rent is not definitive and within the broad parameters of broadly accepted thresholds of affordability and the EU's definition of housing cost overburden, any affordable rent-to-income ratio should be considered as varying with total housing costs and income level.

Understanding the risk characteristics of the PRS requires investors to fully understand the range of the impact from structural change both within the sector specifically and in the context of the wider housing market.

Within this context, the key findings of this paper are:

- Intermediary PRS sits within a spectrum of public and private affordable housing provision, alongside other housing segments. Over preceding decades housing policy has failed to adequately anticipate and respond to strong and persistent socio-demographic change leading to a supply imbalance across all tenures, and particularly for affordable rented housing solutions, including intermediary for middle-income households.
- Housing market structures and the maturity of the PRS varies across countries, impacting on market risk and opportunity, and in turn capital allocations.
- The impact of socio-demographic trends points to a generational shift in housing demand and preferred and/or attainable housing solutions. The demand for intermediary housing solutions is not merely about scale, but also represents a recalibration of prevailing tenure systems. Intermediary PRS assists by establishing a new rung on the housing ladder targeting middle-income households seeking longer term leased housing solutions.

- Beyond the scale of demand, there is a need for the provision of PRS intermediary to expand its range of purpose. Investors seeking to deliver intermediary PRS should consider how existing landlord and tenant law impacts on the risk and viability of providing lifelong rented housing, particularly in countries where owning houses has traditionally been the long-term aspiration.

- There are significant differences across countries in the definition, size, scope, target population and type of provider of social and cost-rental housing. This shapes the intermediary PRS opportunity and in many countries, there is a blurring of the boundaries between publicly regulated cost-rental housing and intermediary PRS. A large social housing stock that is addressing the housing needs of a wide section of society can have a moderating influence on private market rents.

- Most countries have fallen behind in their housing targets, with surplus demand from social and cost-rental housing directed towards the PRS. Many countries have frameworks to harness institutional capital to finance social and cost-rental housing while others, including France, Ireland and the UK also invite equity participation to accelerate the delivery of cost-rental, and intermediary housing in France and the UK.

- Only an expansion of new supply can address the long-term shortage of housing to meet underlying, unmet demand. Current challenging market conditions and regulatory change are creating multiple headwinds for institutional investors seeking to deploy capital in the sector. Direct and indirect public supports could enable the continued flow of institutional capital to deliver intermediary housing supply through challenging market conditions as part of a long-term solution to meet Europe’s unmet housing need.

- Amid rising unmet need, affordability will remain under pressure until supply accelerates faster than demand and begins to erode the housing shortfall. By expanding the intermediary PRS sector, institutional investors can assist in restoring housing market equilibrium and in turn, housing affordability. Harnessing institutional capital to focus on intermediary housing frees up public and not-for-profit (NFP) capital and expertise to focus on where it is most needed and most effective.

Chapter 1

Introduction

Europe's urban centres are enduring a housing crisis. Underestimation of the impact of long-term demographic trends on housing need has resulted in excess, unmet demand. Population growth, rapid urbanisation and shifting socio-demographics are changing housing demand patterns in terms of volume, location, tenure and required utility.

The scale of the challenge has resulted in policy analysts identifying the need for a multi-decade policy response to expand new housing supply to address both the existing and projected shortfall. Supply gaps are being experienced across the spectrum of housing tenure segments, which include the private rented sector (PRS), public and third sector not-for-profit (NFP) subsidised housing, and the owner-occupied segment.

The scope and role of the PRS within existing housing structures varies across countries, but usually includes housing solutions for economically mobile workers, younger and more transitory households tailored to a range of income profiles, and longer-term affordable housing solutions for predominantly middle-income households, often termed 'intermediary housing'. It is this intermediary segment of PRS that is experiencing the greatest pressure as, in the search for housing, unmet demand from other segments refocuses on it by default.

Middle-income households, which are likely to earn too much to either qualify or be prioritised for social housing and yet, earn too little to be able to qualify for a mortgage to access the owner-occupied market are as a result, disproportionately experiencing the burden of Europe's housing crisis. In recent years, both public and private investment capital has had a major focus on expanding intermediary housing supply for these middle-income earners.

The long-term nature of Europe's excess housing demand requires the rapid acceleration of housing supply across all segments. Importantly, this urgently requires an expansion of the PRS to provide much needed intermediary housing and represents a significant opportunity for institutional capital to contribute to Europe's housing solution.

Institutional investors – both global and domestic – seeking long-term secure income are an appropriate partner to achieve this objective for a number of reasons. First, due to their scale of capital, real estate expertise and long-term investment horizon. Second, the scale and scope of their investments and long-term liabilities require them to consider the long-term impact of structural trends – including climate change, wealth polarisation and demographic shifts – on the wider economy and society, as these also impact on the future performance of their total portfolios.

As a result, institutional investors have cascaded environmental and social objectives throughout their organisations, investment objectives and decision-making. These are naturally aligned with investing in affordable housing.

Third, the lower liquidity characteristics of real estate means that the source of institutional capital allocated to real estate is strongly skewed towards patient capital, including public sector pension plans. These funds represent the pension interests of public and private sector key workers, including education, health and emergency service professionals, who are over-represented in the middle-income target audience for intermediary PRS housing.

Over the past decade, institutional investment in the residential sector rapidly accelerated. Total direct and indirect invested capital more than trebled to €606 billion between end 2015 and end 2021, of which 39% is accounted for by the non-listed sector (Figure 1)[1]. The pace of growth in residential investment has seen the sector usurp retail and industrial/logistics in terms of scale of assets under management (AUM) and rival that of the office sector and – within non-listed – it continues to be a strong focus for capital allocations.

Although the residential sector represents a range of segments including student accommodation and senior housing, it is multi- and single-family housing that represents over 75% of residential investment by value[2]. This includes PRS investments targeted at a range of socio-economic profiles.

This paper is primarily focused on the institutional investment opportunity to address the shortfall in intermediary housing for middle-income earners.

1 INREV/EPRA (2022) European Real Estate in the Real Economy; INREV/EPRA (2016) European Real Estate in the Real Economy
2 Analysis of INREV quarterly index, 2023 Q2

Although institutional investment in purpose-built assets in the PRS is long-standing in some countries (for example, Germany, the Netherlands and the Nordics), especially those where long-term renting is well-established as an alternative to owner-occupation, it is more nascent in others (for example, Ireland and the UK).

Excepting markets such as Austria and Germany, the PRS sector has traditionally been a narrow segment of the market that addresses the relatively short-term needs of younger and/or a more transient and economically mobile population, provided by small private investors and/or individual accidental landlords. In these markets, the majority of existing PRS stock is usually not purpose built and widely dispersed. These differences shape the investment risk characteristics associated with the sector in respect of scale, maturity, lease and regulatory frameworks.

Institutional investment at scale has the capacity to expand the PRS and, in particular, provide much needed long-term housing solutions for middle-income earners. In markets where institutional investment in the PRS is nascent, the delivery of professionally managed, purpose-built assets has the capacity to transform the suitability, quality and delivery of housing in this segment.

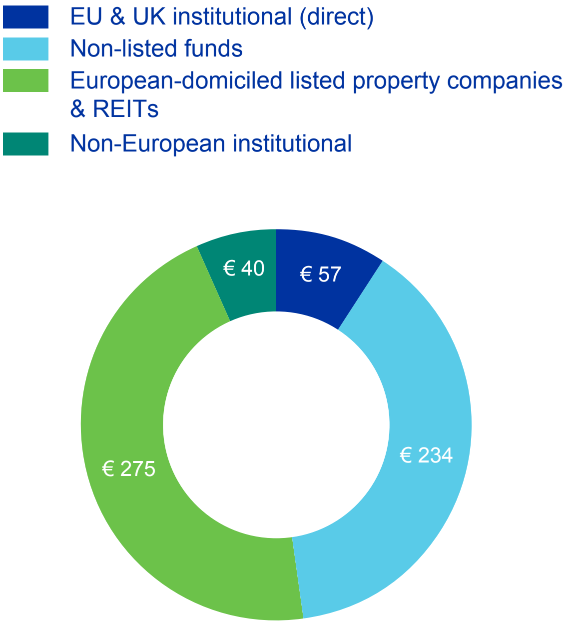
However, understanding the risk characteristics of the PRS requires investors to fully understand the range of the impact from structural change both within the sector specifically and in the context of the wider housing market.

The scale and structure of the PRS opportunity is strongly influenced by wider prevailing housing market structures and developments across other residential tenures in each country. The balance of each segment of a market – for example, social, cost-rental, intermediary, market rent and owner-occupation – contributes to overall demand and supply. This balance influences the equilibrium of both the housing market and indirectly, the PRS.

This paper represents the first of an intended series of INREV research papers addressing opportunities, challenges and solutions for institutional investment in European residential. As the first paper in the series, this research sets out the position of the PRS in the wider housing market landscape, exploring how housing market structures shape both the scale and scope of the PRS opportunity and their variation with socio-political structures.

It primarily focuses on the nine Northern European countries that have the strongest allocations to PRS, both absolutely and relative to market size. These are

Figure 1: EU and UK residential investment by investment mode



Source: INREV/ EPRA, 2022

Austria, Denmark, Finland, France, Germany, Ireland, Netherlands, Sweden and the UK.

The paper considers the changing role of intermediary PRS within the complexity of broader housing market structures. In particular, it explores the complexity of wider affordable housing segments. The degree to which public/subsidised housing extends across income groups is considered and how this impacts on the scope of the PRS sector, and therefore the capacity for institutional capital to participate.

The research also considers the current challenge of balancing affordability – and viability – with costs of production when it comes to the continued flow of institutional investment in the PRS. This challenge is also facing public and third-sector housing – or NFP – providers, with many governments providing some form of subsidy or indirect support to bridge the gap between costs and affordability.

In some countries, various forms of public supports are also extended to the PRS as a means of harnessing institutional capital to contribute to the delivery of annual targeted housing requirements through the cost-push inflationary period. The research considers a wider range of direct and indirect supports that are being – or may be – used to facilitate the deployment of institutional capital, for example funding models, tax breaks, land and site provision, and other planning considerations.

Chapter 2

Defining terminology for affordable residential and for affordability

> There is a plurality of meaning in the use of terms related to affordability and affordable housing that can vary across jurisdictions, between the housing and real estate industries and across different stakeholders.
> Definitions are set specifically for how terms are to be interpreted for the reading of this paper.
> Intermediary PRS sits within a spectrum of public and private affordable housing provision, alongside other housing segments.
> There is no accepted definition of an affordable rent and it should be considered as varying with total housing costs and income level.
> Affordable intermediary rents may represent the market rent, or may reflect a discount to market rent.

Housing market structures have evolved independently across countries. Although there is some common housing sector language across countries and between public, NFP and private sectors, the exact meaning and interpretation of terminology can vary. In particular, the term ‘affordable housing’ may be used to represent multiple housing segments and the scope of each segment varies across markets. Similarly, what constitutes an ‘affordable’ rent is often ill-defined.

This plurality in the meaning of terminology can create confusion. It is recognised that as the intermediary PRS investment opportunity and how it can be accessed differs across and within countries. Consequently, there are a range of definitions being used by investment managers to form and execute investment plans.

This report does not seek to replace definitions in use, but does set out a framework for the consistent interpretation of the terms used in this paper to refer to affordable rented housing segments. This is especially the case for ‘affordable’ housing targeted at middle-income households, which often has different meanings across jurisdictions and within public, NFP and private segments of the market. Equally, the concept and definitional scope of affordability is explained to ensure consistency of interpretation in the reading of this report.

“What constitutes an ‘affordable’ rent is often ill-defined.”

“This report sets out a framework for the consistent interpretation of the terms used in this paper to refer to affordable rented housing segments.”

2.1. Intermediary housing as a segment of affordable housing

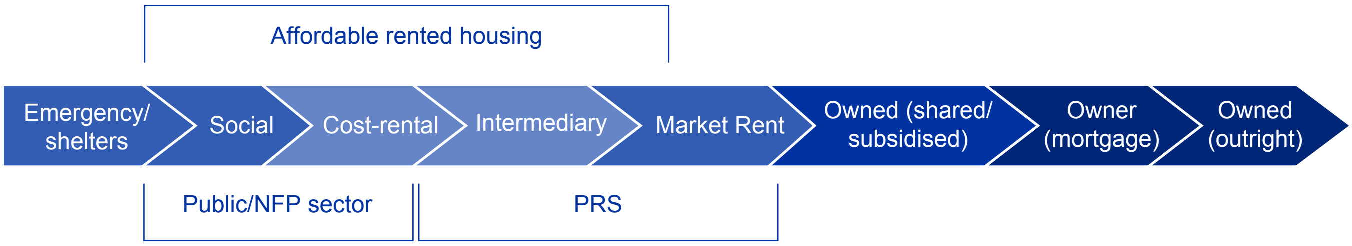
The housing market comprises a range of housing tenures that can be split between owner-occupied and leased, public and private markets, and affordable and market rent. Figure 2 illustrates the spectrum of affordable housing tenures available and shows how they span the public and private sectors.

The overriding objectives of housing policies, including the intended socio-economic reach of public housing varies across Europe. Universalist systems are favoured in some markets which extend the provision of public and/or not-for-profit housing across all income groups. At the other end of the spectrum, some countries have limited the provision of public and NFP housing to lower-income groups.

In this paper, the term ‘social’ is used to describe public housing provided to lower-income households at sub-market prices that is targeted and allocated according to specific rules[3]. ‘Cost-rental’ is used to represent housing provided to middle- as well as lower-income households, predominantly by NFP affordable housing bodies[4] (AHBs). Although there is variation in the models employed across countries,

3 OECD (2020), “Social housing: A key part of past and future housing policy”, Employment, Labour and Social Affairs Policy Briefs, OECD, Paris, http://oe.cd/social-housing-2020.

Figure 2: Housing market spectrum



Source: INREV.
Note that the market rent is driven by market forces which will determine its level of affordability. Where demand and supply are broadly in equilibrium, affordable and market rent housing sharing the same utility value/quality will demonstrate a duality in rental development.

cost-rental represents the most common financial framework employed to deliver this housing (Box 1).

The term 'intermediary' is used to capture PRS housing explicitly targeting the provision of affordable housing for middle-income households no longer able to access owner-occupied housing and unlikely to be allocated 'cost-rental' housing because – depending on the market – they don't qualify or due to scarcity of supply.

While the PRS comprises institutional and non-institutional investment segments, this paper focuses on institutional PRS. This represents a range of sub-segments, principally purpose-built multi- and single-family assets (Figure 3).

In markets with a long-established institutional residential investment market, assets may be existing or new developments. In countries where the institutional PRS is more embryonic, activity has been focused on developing new institutional grade products, with the institutional PRS sector often known as build-to-rent in these countries.

4 There is also variation in the terms used for not-for-profit housing organisations across countries which also include Housing Association, Limited Profit Housing Associations and non-profit Housing Companies

Box 1: Examples of cost-rental affordable models

Cost-rental affordable housing models are employed across many countries seeking to extend affordable housing to middle-income groups. Traditionally, rents are determined on the cost of delivery, including finance costs and ongoing management and maintenance of an asset, amortised over the lifetime of the asset, between 40 and 80 years depending on the specific framework. Initially, the approach requires the support of some form of government finance or intervention. Initial rents are usually linked to an index such as earnings growth or consumer price index (CPI).

In closed or semi-closed systems, where invested capital, loan repayments and housing stock is retained in the system, a revolving capital source gradually emerges over time as loans are repaid. Surpluses and/ or the equity of the stock enable a self-financing system to evolve. This reduces the need for direct capital support from public finances, although in many countries the government effectively acts as a loan guarantor/ lender of last resort enabling access to a lower cost of capital. Where the stock of such affordable housing is accessible to a wide section of society and grows to meet demand, it can smooth developments in market rate PRS rents. Restoring housing market equilibrium and providing housing options from a range of suppliers allows for a substitution effect across cost-rental and PRS housing options, fostering a unitary rental market[5].

Access for institutional investors has largely been limited to the provision of debt. However, as countries with relatively low levels of public and/or affordable housing and housing shortages seek to respond, opportunities for institutional capital to invest equity are emerging.

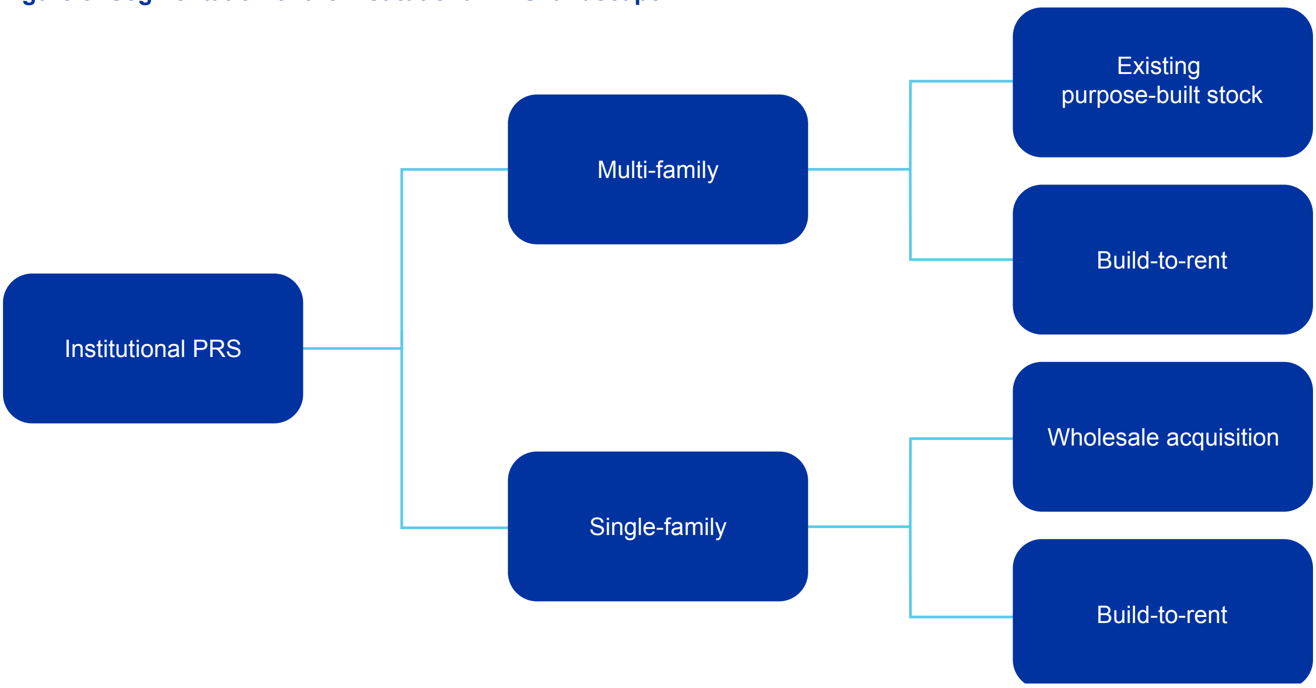
5 Michael Klien, Peter Huber, Peter Reschenhofer, Gerlinde Gutheil-Knopp-Kirchwald, Gerald Kössl (2023) The Price Dampening Effect of Non-profit Housing, Austrian Institute of Economic Research (WIFO), Austrian Federation of Non-Profit Housing Associations (GBV) WIFO Research Briefs 5/2023

Table 1: Comparison of selected cost-rental frameworks

	Austria	Denmark	Finland	Ireland (NFP)	Ireland (private)
Cost-based as % stock	17%	20%	11% (20% including stock with expired rent covenant)	Infancy (accelerating roll out)	Infancy (launched August 23)
Eligibility	Universalist (80% of population by income)	Universalist (priority categories)	Universalist (local restrictions in practice)	Middle income (up to €66k)	Middle income (up to €66k)
Funding	Public loans (subordinate) (30–40%)	Mortgage loans, underwritten by state (85–90%); State subsidised debt payments in excess of 2.8%	Private loans, underwritten by state (95%)	Government equity loan (up to 35%) and government equity investment (up to 20%)	Government equity loan (no interest, up to €200k per unit)
	Bank loans (30-40%)	Municipal loans (8–12%)	Equity (5%)	Private loan (40–50%)	Private loan
	Equity 10–20%)	Tenant equity/ deposit (2%)	Public grant	Equity (up to 10%)	Equity
	Tenant equity/ deposit (0–10%)				
	Public grant (5%)				
Cost-rent defined by/ applied at	Building/ asset level	Building/asset level	Social provider level	Building/asset level	Building/asset level
Cost-rent determination	Cost of delivery and management	Cost of delivery and management	Cost of delivery and management across portfolio	Cost of delivery and management, including financial return, and at least 25% discount to market rate	Cost of delivery and management and at least 25% discount to market rate
Maintenance & Improvements	Sinking fund wrapped into rent	Local disposition fund	Cross-subsidisation	Sinking fund wrapped into rent	Sinking fund wrapped into rent
Affordable rent	In perpetuity	In perpetuity	Usually 40 years	In perpetuity	50 years
Rent after loans repaid	Grundmiete, fixed price per square metre	Fixed nominal rent	Ceases to be cost-rental, rents set in line with cost-based principle	Rents set in line with cost-based principle	Extend, or exit cost-rental, repaying capital and return on equity share
Security of tenure	Very high	Very high	Very high	Very high	Very high

Source: Housing Europe (2021); Government of Ireland (Housing Agency) (2023)

Figure 3: Segmentation of the institutional PRS landscape



> **"The term 'intermediary' is used to capture PRS housing explicitly targeting the provision of affordable housing for middle-income households."**

This contrasts with the characteristics of non-institutional investment which vary across markets depending on the maturity and scale of the sector, but generally represents a large number of small-scale, non-specialist investors, often invested in non-institutional grade housing.

As countries seek to accelerate the delivery of housing supply, increasingly the lines between public, NFP and private sectors are blurring. As such, affordable housing represents a continuum providing housing solutions across a range of income profiles including social, cost-rental and intermediary housing as well as subsidised homes or low-cost homes to buy.

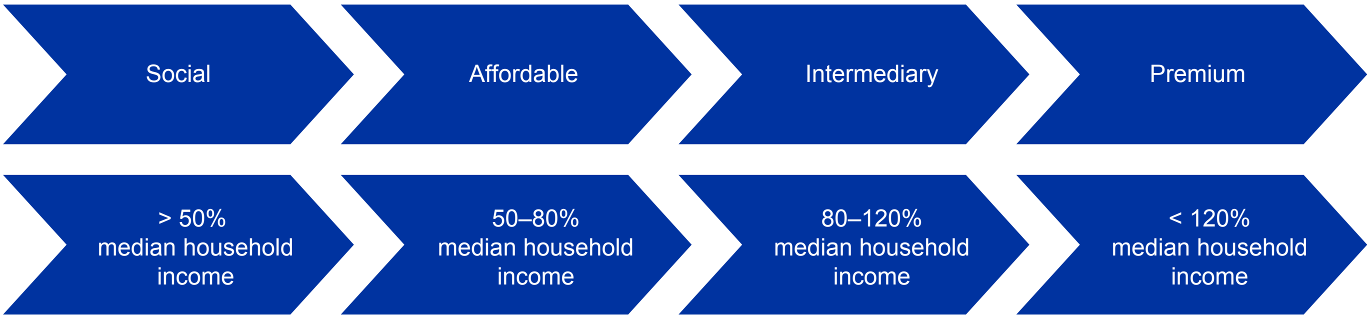
However, delivering a financial return remains a primary goal of the PRS and is an important differentiator. This contrasts with social and NFP affordable housing where the primary goal is to deliver affordable housing as part of wider socio-economic policy.

PRS intermediary housing seeks to deliver appropriate and affordable housing solutions to middle-income households, the profile of which varies by country and city (Figure 4). The affordable rent may represent a market rent, with the strategy for achieving the delivery of intermediary housing solely concerned with location, design and density.

Equally, affordable rents may represent a discount to prevailing market rents, perhaps supported through planning requirements, cross-subsidisation with market rents and sales, and/or through direct and indirect public subsidies. Defining target intermediary rents is central to the viability of a scheme and must be balanced against costs of delivery, access to subsidies and ongoing management. Of course, this begs the question of how to determine an affordable rent.

> **"Equally, affordable rents may represent a discount to prevailing market rents."**

Figure 4: Affordable housing segments and socio-economic profile



2.2. The importance of total housing costs and residual income to the concept of affordability

There is no accepted definition of what constitutes affordable housing for any rental tenure. The EU defines housing cost overburden as "where the total housing costs (net of housing allowances) represent more than 40% of household disposable income". Importantly, total housing costs refer to the monthly expenses associated with the right to live in a dwelling and in addition to rent, includes utilities, taxes and other mandatory charges, for example refuse collection[6]. A ratio of 30% rent to gross income is also commonly used as an acceptable level of affordability[7].

The degree to which these measures deliver a similar outcome for the quantification of an affordable rent differ with taxation levels and the extent to which rents are inclusive of other housing costs, including energy and/or heating.

This is important as institutional investors aligned with the ambitions of the Paris Agreement[8] will deliver housing to high environmental standards, reducing energy costs through sustainable, energy efficient buildings. This improves housing affordability and total housing costs should be considered in the assessment of an affordable rent.

Of course, what is affordable also depends on total net income and the extent to which income net of housing costs is sufficient to meet other essential expenditure. As well as varying with the scale of income, this also varies with household size and dependents. It also differs across similar socio-economic households across jurisdictions, given variation in costs of provision of services, for example healthcare, childcare and transport. Broadly, the capacity to bear higher rent-to-income ratios increases with net income.

There is no accepted definition of what constitutes affordable housing for any rental tenure. The EU defines housing cost overburden as "where the total housing costs (net of housing allowances) represent more than 40% of household disposable income"

"For both public and institutional investors, the capacity to provide a subsidised rent usually relies on the investment being supported by some form of incentive or subsidy."

The determination of an intermediary rent can be directly related to the income of the target audience, and this may be at the core of development strategy and drive location, density and design. Often, intermediary rents may not differ from prevailing market rents.

In countries or specific locations where competing land uses or restrictions on density may make it challenging to deliver intermediary housing at a rent that is affordable to the target audience, direct and indirect public supports may be extended to institutional investors, for example in France, Ireland and the UK. Often, models for affordable rent determination may be defined within these initiatives.

Generally, affordable rent determination is either anchored to an income-to-rent ratio, discount to market rate, utility-based or cost-based. These approaches are defined in Table 2 with examples of their application to the delivery of intermediary housing solutions in different countries. For both public and institutional investors, the capacity to provide a subsidised rent usually relies on the investment being supported by some form of incentive or subsidy.

6 https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Living_conditions_in_Europe_-_housing#Housing_affordability
7 OECD (2023) Overview of Affordable Housing Indicators, HC.1.5
8 International Treaty on Climate Change

Table 2: Approaches to determining affordable rents

Determining affordable rents	Definition	Application
Income based	Rents are determined based on a desired or targeted rent to income threshold	Employed in the US for institutional investment, especially preservation of affordable housing. In exchange for setting rents at 30% of area median income (AMI) and allocating 40% to tenants with incomes below 60%, and 40% to tenants with incomes between 60% and 80%, investors receive federal subsidy and low income tax credits.
Discount to market rate	Rents are set at a discount to market rent	Increasingly used as a target for intermediary affordable housing provision, with limitation that in markets where there is very low affordability, discounted rents may still be above a desired proportion of income. Examples of its use include policies specifically targeting the provision of affordable intermediary housing in France. The French government has implemented a financial framework encouraging institutional investors to create affordable rental housing, applying a reduced VAT rate of 10% and an exemption to property taxes on developed land for a maximum of 20 years in exchange for a minimum rental commitment of 15 years to rent at a 20% discount to market rent. In addition, investors may also access a lower cost of capital, particularly when pursuing wider environmental and sustainability strategies. In the UK, the Affordable Housing Programme awards capital grants to regulated housing associations in exchange for a commitment to rent at 80% of market rent.
Utility based	Rents are determined by housing unit characteristics, including location, size and amenities	Primarily used in more universalist systems, such as Sweden. In seeking to deliver housing-for-all, housing provision is designed to meet a range of needs in scale and quality. This is reflected in differential rents, and are also used to benchmark against rents within the area that are used to determine the appropriate rental rate.
Cost-rental	Rents are determined based on the costs of provision	Cost-based rental models are common to the universalist housing systems in Austria, Denmark and are also used as the primary social and affordable housing model in Finland. More recently, Ireland has adopted the model specifically for the provision of intermediary housing. Under cost-rental systems, rents are determined on the basis of the income required to service the associated costs of development and ongoing management. Cost-rental schemes are managed and implemented by regulated NFP entities and should deliver rents at a discount to market rents. Where subject to additional supports, for example preferential access to, or zoning of land, discounts may be substantial. In Ireland, a form of cost-rental housing has been extended to the private sector (Secure Tenancy Affordable Rental). The ability to deliver cost-rental at below market rents is dependent on the scale of the market and access to direct or indirect forms of subsidies. These differ considerably across the frameworks used by individual countries and as compared in Box 1 previously.

Source: INREV (2024); Source: OECD (2023); Housing Europe (2021); Various national housing reports;

Chapter 3

Strong rationale for institutional investment in intermediary PRS

- Over preceding decades, housing policy has failed to adequately anticipate and respond to strong and persistent socio-demographic change leading to a supply imbalance across all tenures, and particularly for affordable rented housing solutions for middle-income households.
- There is a natural alignment between the objectives of long-term income investors and intermediary PRS as it offers secure income, economic dislocation, strong opportunities to invest sustainably and a symmetry of purpose in respect of the underlying beneficiaries of both the investment return and the housing provision.
- Challenging market conditions and regulatory change create multiple headwinds for institutional investors seeking to deploy capital in the sector.
- Housing market structures and the maturity of the PRS varies across countries, impacting on market risk and opportunity, and in turn capital allocations.

The European PRS has potential to offer institutional investors a wide range of opportunities stemming from demand and supply imbalances across multiple segments of the market.

Accelerated urbanisation has caused strong population growth across Europe's prime cities that has out-paced residential supply. At the same time, socio-demographic trends are shifting the type of housing demand, with strong growth in single person households. For example, feminisation of the workplace, the delaying of significant life milestones including marriage and family formation, and increasing divorce rates have increased demand for smaller, centrally located housing units and/or co-living solutions.

The demand for rental tenures has also expanded as house price growth and lending requirements have constrained the option of owner-occupation, especially for younger middle-income households. Equally, many younger economically mobile households value the flexibility of leasing over ownership.

Long-income investors attracted to the PRS value the potential to develop and acquire long income streams from purpose-built multi-, and more recently, single-family assets that offer strong dislocation from economic cycles and the potential to manage risk through strong management.

> **"Long-income investors attracted to the PRS value the potential to develop and acquire long income streams that offer strong dislocation from economic cycles and the potential to manage risk through strong management."**

> **"There is also a strong alignment between the over-arching ambitions of institutions and policy-makers in respect of expanding affordable housing segments."**

In particular, the level of excess demand over supply reduces downside cyclical risk for development strategies. Essentially, the scale and velocity of unmet demand eliminates the potential risk of supply overhang associated with development timing. However, timing risks associated with wider financial market movements and regulatory change that effect the cost of development and asset pricing persist.

There is also a strong alignment between the over-arching ambitions of institutions and policy-makers in respect of expanding affordable housing segments. The scale, scope and longevity of pensions fund and insurance companies gives them the unique role of acting as universal investors.

In short, it is prudent for them to take a holistic, long-term view in their strategic planning and decision-making at an organisational level – considering how one trend, opportunity or decision might impact and ricochet across other areas through multi-decade

"The current cost of retrofitting older housing is substantive – averaging €50k to €70k – per unit and can usually not be supported by cashflow alone."

time horizons. Their scale and global reach also makes them conduits of knowledge across regions and borders, and sectors, and this cements their leadership role.

This is particularly evident in the pursuit of a more sustainable and just economy and society. Institutional investors were early signatories to the United Nations Principles of Responsible Investing (UN PRI) in 2004 and to the Sustainable Development Goals (SDGs) set out in Agenda 2030 in 2015. Environmental, social and governance considerations are embedded in every aspect of the real estate investment process, from inception, beyond disposal to repurposing of an asset beyond its anticipated lifespan. These requirements cascade not merely through their own organisations, but to investment managers, service providers and their wider supply chains.

PRS investment strategies offer strong opportunities to pursue sustainable investment strategies with the sector tied to multiple strands of the United Nations SDGs that are in sync with achieving financial objectives. As some 44% of housing stock in Europe was built before 1980, existing stock is also of varying quality, especially in respect of energy efficiency and requires investment[9]. The current cost of retrofitting older housing is substantive – averaging €50k to €70k – per unit and can usually not be supported by cashflow alone.

Current impediments to valuation practice inhibit its risk benefits being embedded in valuations appropriately[10]. Yet, institutional investors with a long-term investment horizon, are committed to aligning with the Paris commitments and understand that retrofitting to near net zero (NNZ) standards de-risks investments over the long term across a number of dimensions (Figure 5).

First, given the climate crisis and urgency to adapt, many investors anticipate that regulatory change will require all assets to transition to net zero, impacting

"Institutional investors with a long-term investment horizon understand that retrofitting de-risks investments over the long term."

Figure 5: Risk benefits of net zero

"Approximately 10.6% of all households in cities and 37.9% of households earning 60% or less of median income in the EU are overburdened by housing costs, with those in market rented housing in cities most exposed to housing cost overburden."

on value as the market for inefficient assets erodes and/or they are made obsolete by legislation restricting their use, and/or carbon pricing is used progressively to tax emissions.

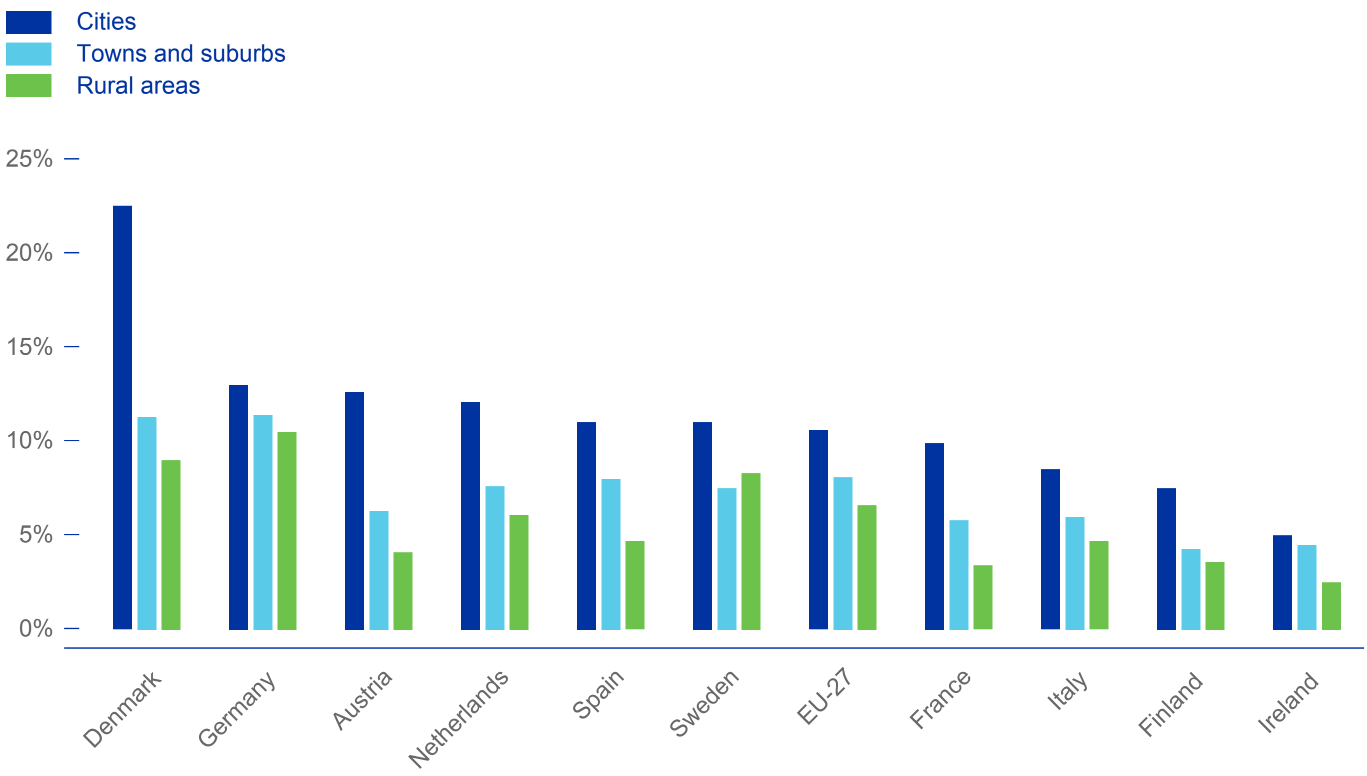
Second, energy efficient assets and renewable energy sources reduce both operational costs and costs of occupation. This enables rental levels to increase as a share of total occupation costs, without lowering rental affordability. Third, the transition to a low carbon economy and society presents a risk of potential economic disruption. As housing is a basic necessity, the risk of structural dislocation is lower than for alternative sectors – both real estate and economic.

In addition to an over-arching shortage of housing, approximately 10.6% of all households in cities and 37.9% of households earning 60% or less of median income in the EU are overburdened by housing costs (Figure 6)[11]. At 26.1%, renters are more likely to be overburdened than those owning their home, with those in market rented housing in cities most exposed to housing cost overburden[12].

For this reason, investing in intermediary housing provides an opportunity for institutional capital to greatly contribute to the housing crisis solution and at the same time, deliver on relevant SDGs. These include objectives that target poverty, inequality, sustainable and resilient built environments, access to clean and affordable energy and through strong governance, creating institutional frameworks that promote a more just economy and society.

9 https://ec.europa.eu/futurium/en/system/files/ged/folder_action_plan_of_the_euua_housing_partnership.pdf
10 ULI (2022) Breaking the value deadlock: enabling action on decarbonisation, October
11 Eurostat (2023) Housing in Europe
12 Eurostat (2021) EU 27 and UK

Figure 6: Housing cost overburden by degree of urbanisation



Source: Eurostat (2023) EU-SILC; ONS (2023)

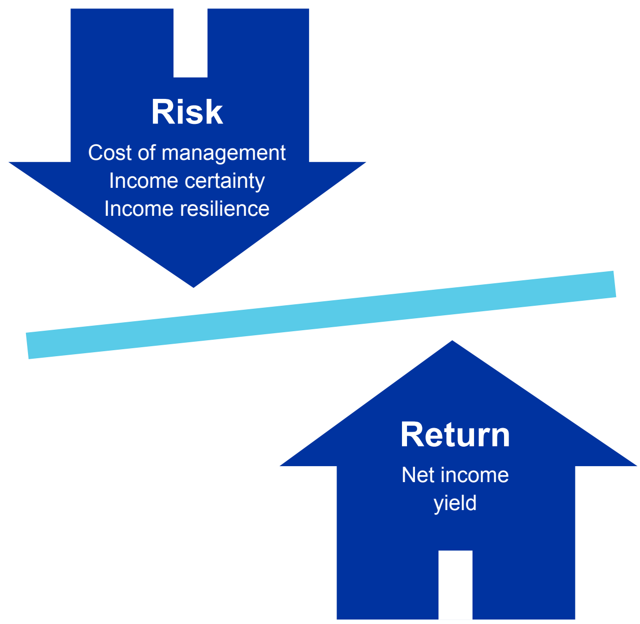
3.1. Intermediary PRS has a beneficial income risk profile

The investment profile of intermediary housing provides a range of risk benefits that enhance and protect net income (Figure 7). Given the strength of underlying demand for this product, lease-up periods are immediate, reducing income voids and associated marketing costs. Rental affordability also results in longer duration of tenancies, which in addition to delivering stable income also reduces management costs. Equally, the affordability of rents reduces non-payment risk and associated costs of recovery.

The affordability characteristics also deliver income stream resilience through economic cycles. Although middle-income earners are not immune to economic swings, tenants are provided with some headroom where there is a gap between market rate and affordable rents, providing some anti-gravity qualities to income certainty.

Moreover, demand for affordable housing will increase further. Relatively, PRS intermediary housing should increase income certainty and reduce income volatility. Although requiring strong housing management, the tenant profile should also require less intensive housing support services and specialist expertise than social and cost-rental affordable housing segments.

Figure 7: Risk return of affordable intermediary housing (for rent)



"Intermediary housing provides a range of risk benefits that enhance and protect net income."

3.2. Current challenge of inflationary conditions

Despite the strength of underlying demand for the institutional PRS and in particular, intermediary housing strategies, there are signs that institutional capital is pausing investment. This is due to a perfect storm in market conditions that are eroding returns at the same time that real estate return requirements are increasing. Over the preceding five years, the market has experienced high cost of construction inflation which although plateauing, remains elevated.

Geopolitical events – combined with the legacy of loose monetary policy to manage economies first through the legacy of the global finance crisis and then through the disruption of the pandemic – has sharply raised inflation. Consequently, this led to a sharp rise in interest rates that both raise the cost of capital and the relative rate of return that long-term real estate investments are required to deliver over bonds. At the same time, a combination of rental affordability ceilings and rent regulation are capping income streams. These challenging market conditions create multiple headwinds for institutional investors seeking to deploy much needed capital in the sector, particularly where there is an associated timing risk with the delivery of new supply (Figure 8).

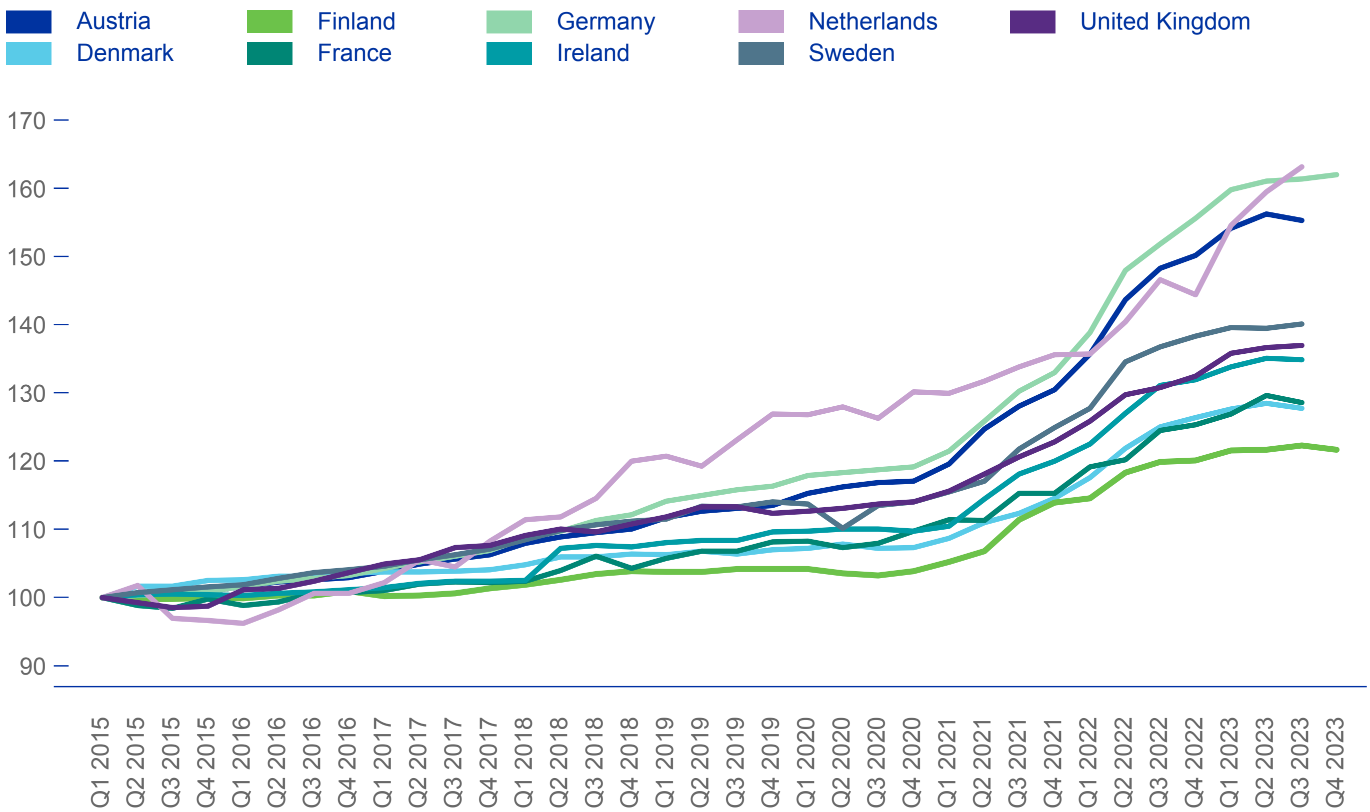
> **"Challenging market conditions create multiple headwinds for institutional investors seeking to deploy much needed capital in the sector."**

> **"Europe's housing crisis persists and will deepen further if supply tapers off until market conditions improve."**

Essentially, downward pressure on revenues and upwards pressure on costs are eroding returns. As competition for standing investments is increasing, the decline in new residential building permits indicates that the supply pipeline is shrinking (Figure 9).

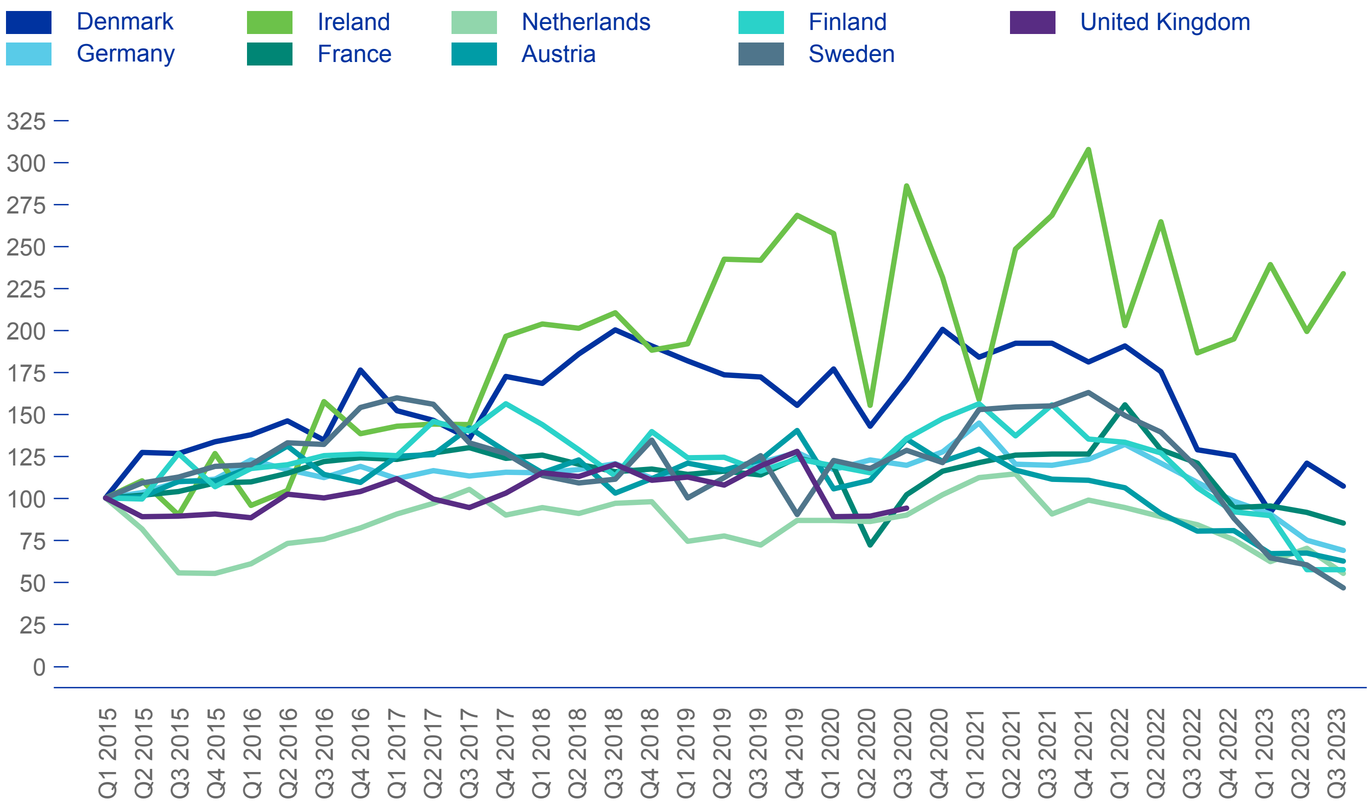
Although decarbonisation of the built environment has led to both policy instruments and investment strategies that emphasise the need to renew and retrofit existing buildings rather than develop, in many countries the expansion of housing supply requires the development of new stock. Yet, Europe's housing crisis persists and will deepen further if supply tapers off until market conditions improve.

Figure 8: Index of construction costs for new residential buildings Q1 2015 to Q4 2023 by selected countries



Source Eurostat, ONS, 2023
**UK is Housing Cost Price Output for New Construction*

Figure 9: Index of growth of residential building permits by sqm of useable floor area (excluding community residences), Q1 2015 to Q3 2023



Source: Eurostat, 2023
** excluding community residences*

Table 3: Rent regulation by country

Country	Degree of tenant protection	Rent regulation generation	Intensity and form	Rent regulation initial rent, new build
Austria	Very high	Second generation	High, index linked, with introduction of cap for regulated	None (unregulated PRS)
Denmark	Very high	Second generation	Mid, index linked and capped	None
Finland	High	Third generation	Mid, index linked	None
France	High	Second generation	High	Mid (rent controls in selected cities)
Germany	Very high	Second generation	High, rental reference index; rental brake	None
Ireland	High	Second generation (rent pressure zones)	High, index linked and capped	None
Netherlands	Very high	Second generation	Mid, utility/quality points	Mid
Sweden	Very high	Second generation	High, utility/quality points and collective bargaining	High
UK (England)	Low	None	None	None

Source: Catella Residential Investment Management (2023); https://www.oecd.org/els/family/PH6-1-Rental-regulation.pdf; Various local market reports.
Note: The above table references the tone of the market. The application of regulation can vary in some markets according to the date of the contract and type of dwelling. For example, in markets such as Austria where there is a high degree of integration between regulated and non-regulated stock, the non-regulated PRS has different inflation rate thresholds/caps applied to the regulated for-profit and not-for-profit sectors.

3.3. The importance of rental and regulatory certainty for pricing

Inflationary conditions have also impacted on rental markets. Housing policy development underestimated the scale and impact of shifting demographic trends and has resulted in excess, unmet demand amid supply constraints, in turn fuelling a period of strong rental growth. The impact on rental affordability has been further exacerbated by geopolitical events that have led to cost-push inflation and a cost-of-living crisis.

However, given housing is a basic need, competition for scarce housing resource persists and to avoid rental levels becoming deeply unaffordable, most markets have introduced some form of rent regulation to control rents. Indeed, of the selected countries in Table 3, the UK is unique in maintaining a free market approach having no form of rental regulation and weak security of tenure.

The purpose of rent regulation measures is to balance the interests of landlords and tenants given the asymmetric power of landlords, especially where there is a housing shortfall. Protecting tenants from excessive and deeply unaffordable rent increases should avoid reducing residential mobility or increasing evictions in markets with low security of tenure, and be balanced against the landlord's requirement to generate a reasonable return and not inhibit new supply.

Most investors recognise that current rent regulations are distinct from the hard rental freezes and caps associated with first generation rent controls introduced in post-war decades of the last century. This approach tended to generate many of the negative consequences associated with rent controls in the private sector and they are not currently employed in Europe, although an attempt to introduce them in Berlin in 2021 was later deemed unlawful.

In most markets, the introduction of rent regulations is through second and third generation controls and are intended to be temporary. Second generation rent controls apply to existing and new tenancies and third generation rent regulation measures only apply to existing tenancies. The strength of security of tenure is often a differentiating factor as in countries with low security of tenure, landlords may terminate existing tenancies to secure open market rents if rent regulations do not extend to new tenancies. Regulations may also differentiate between new tenancies in existing dwellings and those from new supply, with the initial rent for the latter often unregulated.

"Many investors do not consider second and third generation rent controls to be an issue in themselves as such options can be priced. The issue is one of timing, predictability and certainty."

Most take a cap and collar approach to rental growth, familiar to many rental agreements for long-income products that protect investors from deflation and tenants on index linked contracts from rental spikes.

Many investors do not consider second and third generation rent controls to be an issue in themselves as such options can be priced. The issue is one of timing, predictability and certainty. For institutional investors seeking a long-term income stream, rent regulations are not an impediment if they provide for a reasonable return on an investment and can be priced at acquisition. Where regulated rents are below the market price, net income also benefits from lower void costs as vacancy and churn reduce and income volatility decreases given the headroom between the regulated and market rent[13].

However, uncertainty as to the future progression of rental regulations increases risk and is particularly problematic where there is timing risk related to development as the pricing of land acquisition occurs at the outset. The price paid for land is usually a residual value of the expected development value less costs and an appropriate return on risk. Changes negatively impacting on value subsequent to land acquisition erode the return. This can stall development plans. It can also lead to land hoarding with landowners – often private individuals – waiting for price recovery and curtailing the availability of appropriate sites for institutional investors, developers, public and NFP housing providers.

Under the current challenging market dynamics, rent regulations are contributing to the challenges facing institutions on their capacity to execute their PRS investment strategies. Indeed, a recent study of rent controls in Europe suggests that rent control policies that restrict rental price increases without introducing policy measures to encourage new supply will exacerbate housing shortages in the PRS as private capital withdraws[14]. Yet, there is a critical need for an expansion of housing supply to resolve the housing crisis – and in turn, the underlying affordability challenge. In some markets, including France, Ireland and the UK, state agencies have tailored specific housing policy initiatives to support institutional and other long-term investors' affordable housing activity (see section 6).

13 Catella Residential Investment Management (2023) European Residential Vision
14 JLL (2023) Uncertainty in times of changing rent regulation, JLL the Netherlands

3.4. Current allocations indicate dynamics of housing market structure underpin investment strategy

European residential real estate has a long history as a component of institutional real estate portfolios in certain countries including France, Germany, the Netherlands and the Nordics. Both the scale and range of investment activity across evolving institutional grade segments have expanded over the past decade and institutional residential activity has also extended to other countries such as the UK and Ireland.

A country's socio-political culture defines the role of housing policies in economy and society. This context informs on market stability and the degree of public oversight, regulation and intervention, which are important considerations for institutional investors. The variation in the maturity of the PRS across countries and the diversity of housing market structures influence the risk characteristics of markets, including the range and depth of market opportunities and anticipated return prospects.

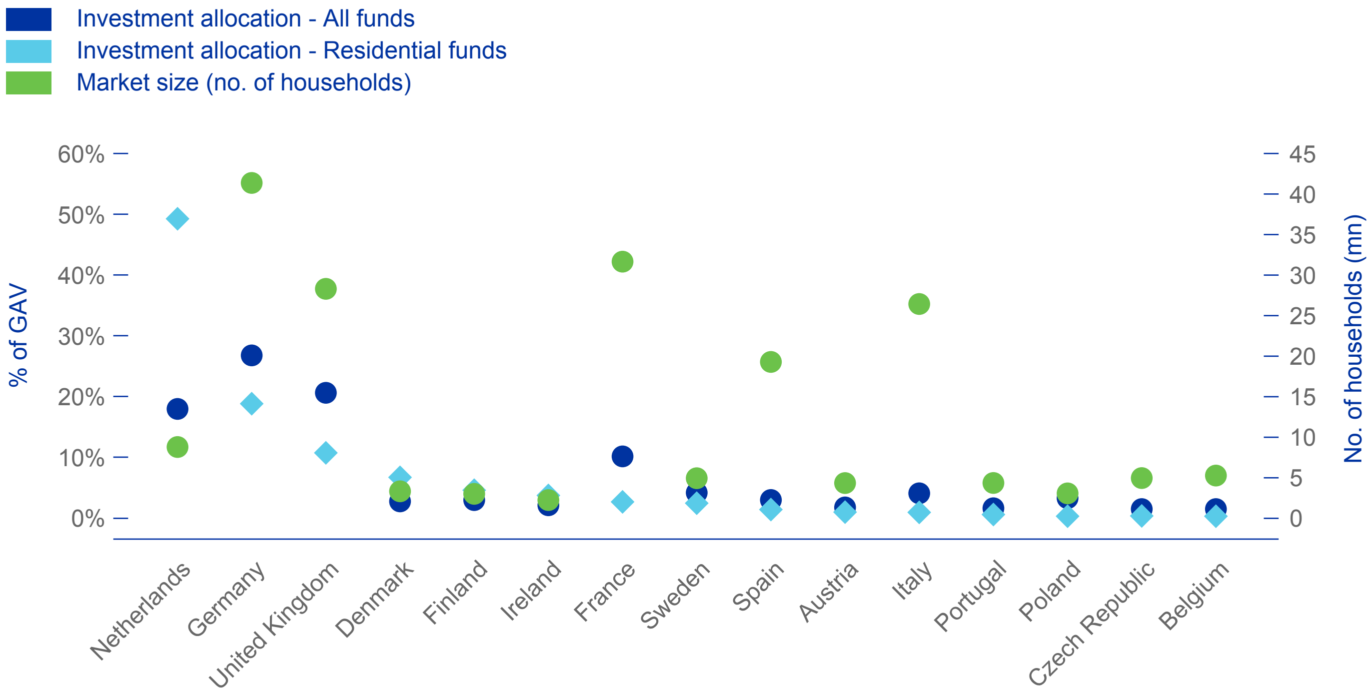
These structural risks are somewhat dislocated from more cyclical risk characteristics, including economic prospects and other considerations driving commercial real estate strategies. As a result, the pattern of allocations to the residential sector within the universe of the INREV Quarterly Index vary from those observed across all funds (Figure 10).

Although Germany, the Netherlands, and the UK account for the three largest percentage allocations, Germany and the UK are underweighted relative to the universe, alongside France. In contrast, there is a marked overweighting of residential relative to the total INREV universe in the Netherlands. Allocations to Denmark, Finland and Ireland also represent an over-weighting, which is particularly pronounced given their smaller relative market size.

These differences in allocations within the INREV universe are due to a number of factors. Some markets may appear to be underweighted because of a long-established residential listed/REIT market such as Germany and the Nordics or because there are opportunities to invest directly or through some form of public/private partnership, for example France. Similarly, other markets provide frameworks for institutional capital to debt finance public or third sector housing, although such opportunities may not be readily accessible to non-domestic institutions.

This socio-political culture also points to the scale of the opportunity in the PRS for institutional investors and importantly, the degree of change it represents to housing market structures at a country level. Where this includes a significant recalibration of existing housing tenures and an extended range of purpose for the PRS, the capacity for existing landlord and tenant legal frameworks to easily accommodate such change can also be of interest to investors.

Figure 10: Tilts to residential fund allocations v all fund allocations and market size (no. of households)



Source: INREV Quarterly Index, Q2 2023; Eurostat (20230; ONS (2023)

Chapter 4

The PRS opportunity for institutional investors

> - The structure of Europe's housing markets is diverse and shapes the scale and profile of unmet housing need.
> - The demand for intermediary housing solutions is not merely about scale, but also represents a recalibration of prevailing tenure structures.
> - Institutional activity in the sector has the potential to significantly improve housing affordability, standards and living conditions.
> - The impact of socio-demographic trends points to a generational shift in housing demand and preferred and/or attainable housing solutions.
> - Intermediary PRS assists by establishing a new rung on the housing ladder targeting middle-income households seeking longer term leased housing solutions.
> - Beyond the scale of demand there is a need for the provision of PRS intermediary to expand its range of purpose.
> - Investors seeking to deliver intermediary PRS should consider how existing landlord and tenant law impacts on risk and viability.

A country's socio-political culture defines the role of housing policies across a spectrum of 'housing as a basic need' through to 'housing as a market good'. This context shapes the scale and scope of the institutional investment opportunity within the PRS alongside the underlying demand and unmet housing need. It also informs as to the degree of change an expansion of the PRS could represent within housing market structures of individual countries.

In some countries, there is potential for a significant recalibration of existing housing tenures and an extended range of purpose for the PRS. In these cases, the capacity for existing landlord and tenant legal frameworks to easily accommodate such change is important for investors.

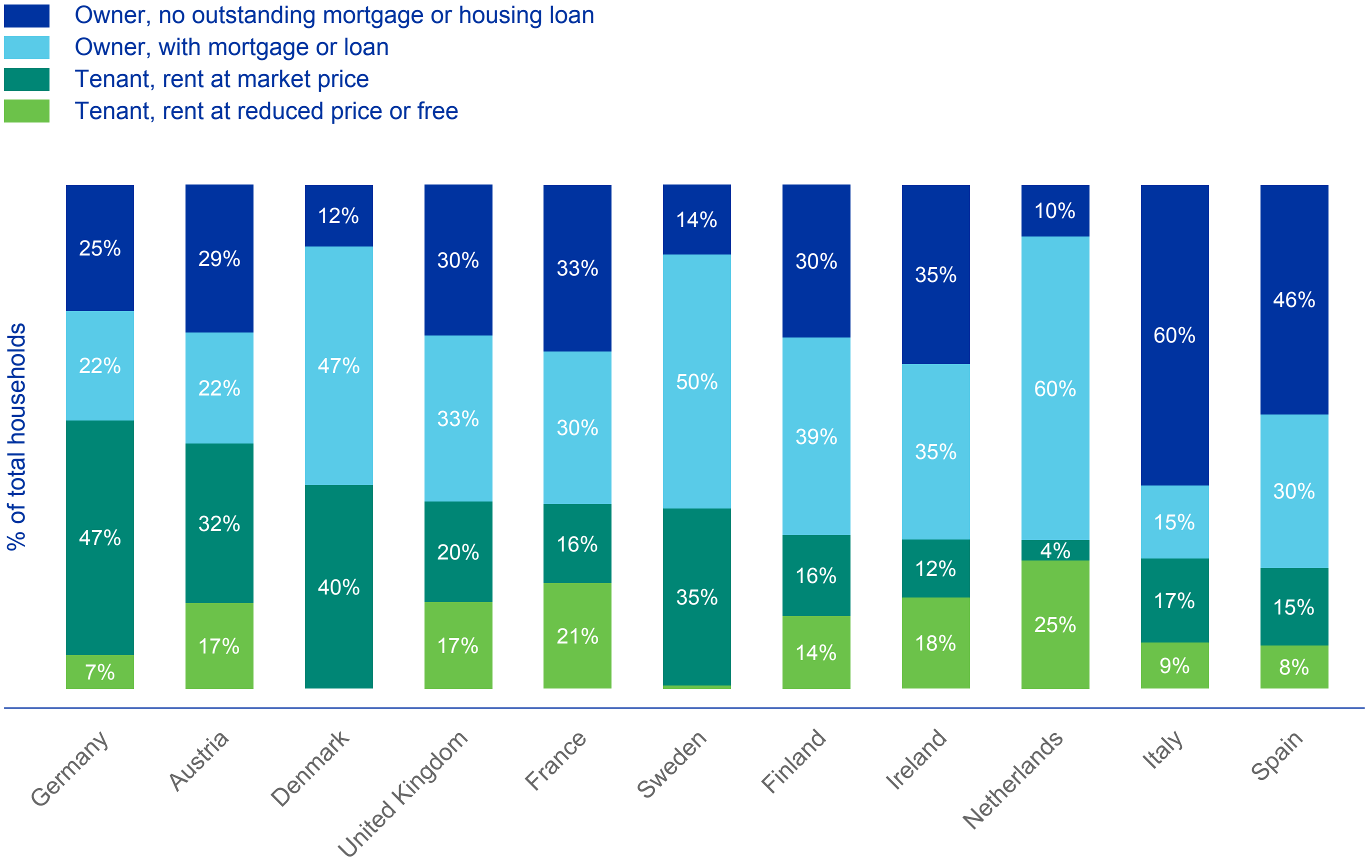
4.1. How tenure and housing need contribute to the PRS opportunity for investors

Housing market structures vary widely by tenure in Europe and influence the scale and conventional purpose of the PRS in each market (Figure 11). Different socio-cultural norms have evolved distinctly across countries and are embedded in ownership patterns and lease structures. Crucially, developments in the scale, quality and regulation of any one tenure type will impact on the structure and demand for other forms of tenure in each country. In turn, this influences the capacity for institutional investors to access and participate in the PRS intermediary investment opportunity.

At first glance the structure of housing markets appears straightforward. Owner-occupation, with or without a mortgage, is the preferred tenure in all markets, apart from Austria and Germany. In these countries the decision to rent or buy is more balanced as lifelong renting is considered an alternative option to acquiring a home, rather than a temporary stepping stone.

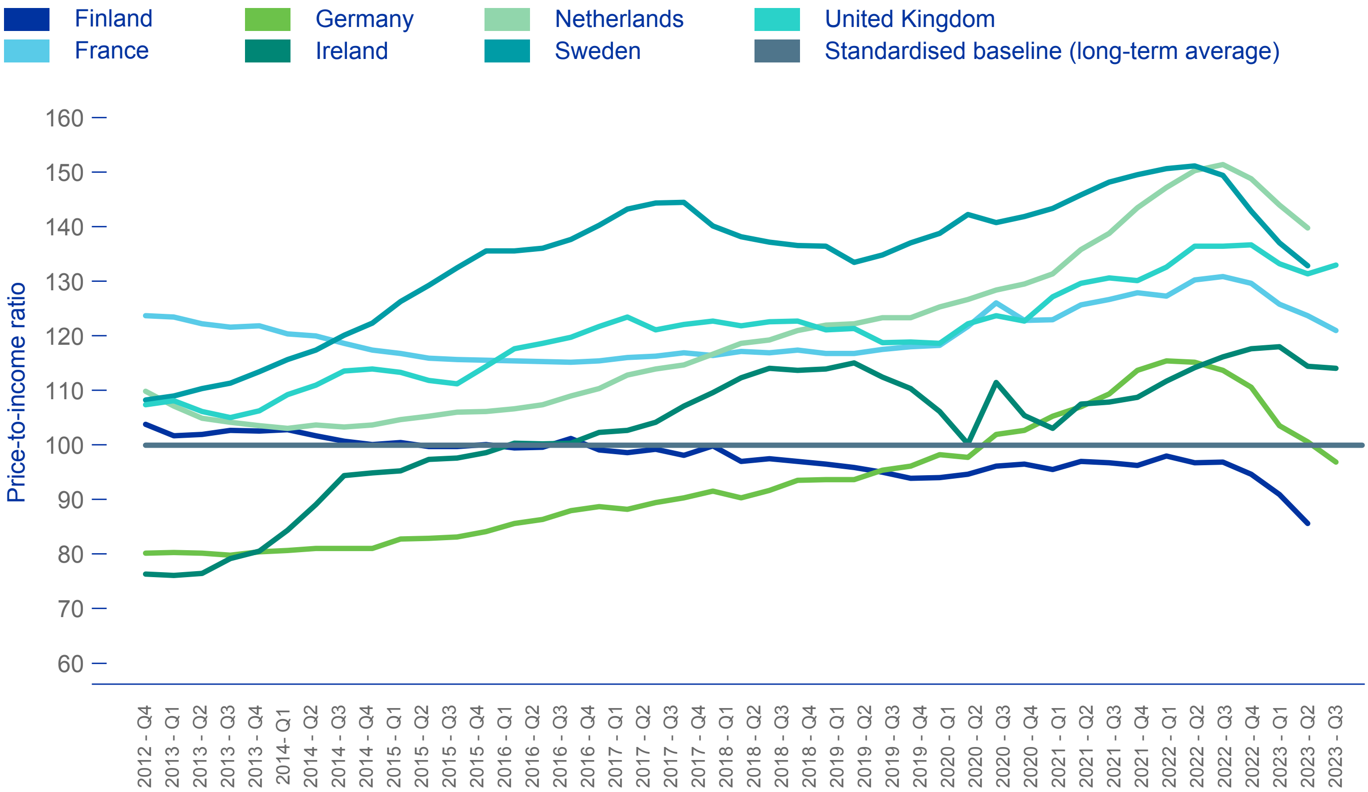
In many markets, the financialisaton of housing means that the decision to rent or buy is not cost-neutral, with expectations of future wealth accumulation through house price growth. However, house price growth has outstripped earnings growth over the past decade, decreasing affordability and often putting home ownership out of reach for new and evolving middle-income households (Figure 12).

Figure 11: Household distribution by housing tenure (end 2022)



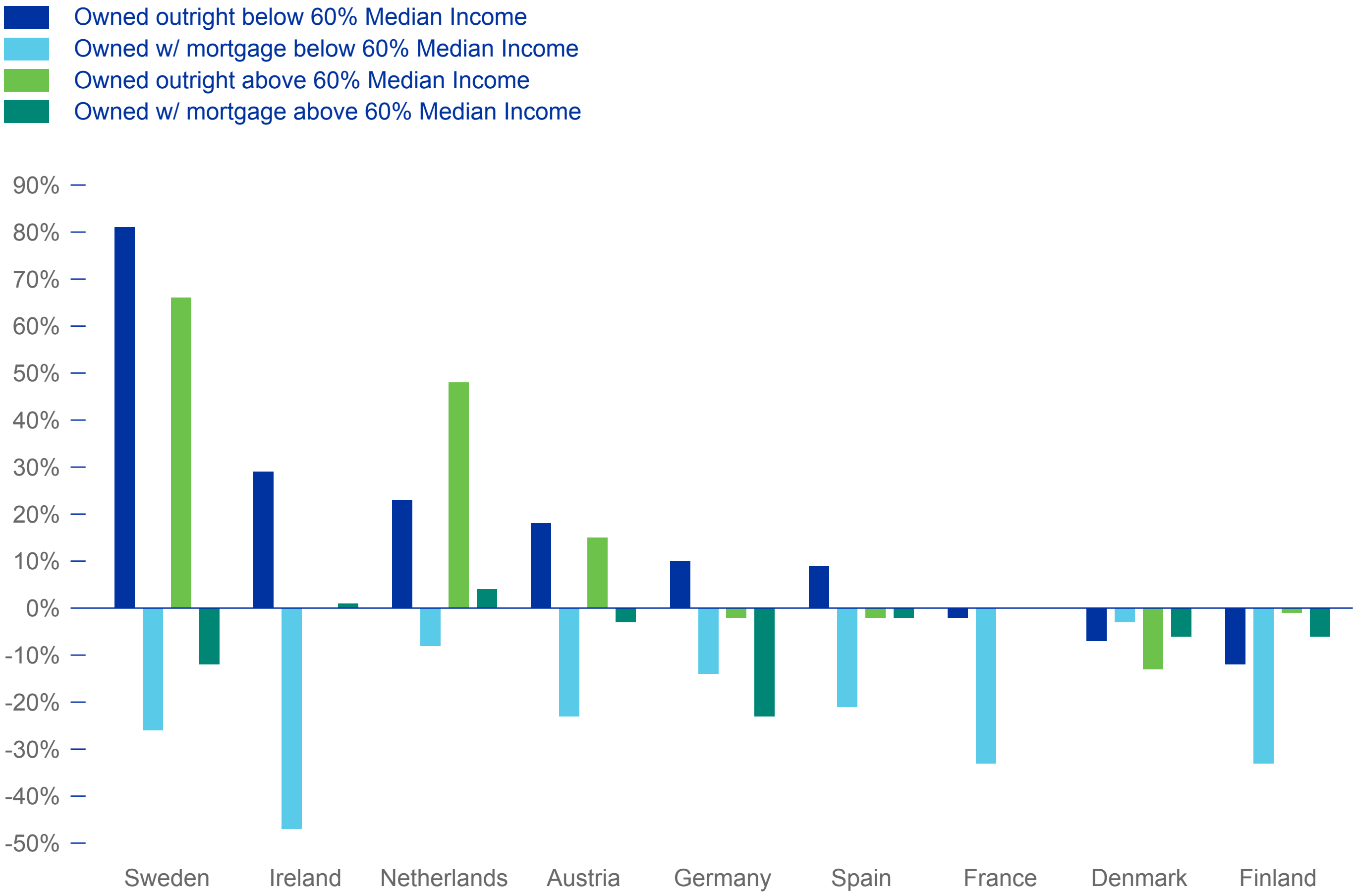
Source: Eurostat, ONS, 2023
**UK data 2021*

Figure 12: Standardised price-to-income ratio



Source: OECD Affordable Housing Database, 2023

Figure 13: Change in proportion of households having owner-occupation tenure by income profile (end 2012 to end 2022*)



Source: Eurostat EU-SILC survey, ONS, 2023
** UK end 2012 to end 2021*

As a result, owner-occupation rates have declined in many markets. This decline is most marked in ‘owners with mortgage or loan’, especially younger households and/or those earning less than the median net household income (Figure 13).

In contrast, the percentage owning their own home outright has increased in some markets. Indeed, as the baby-boomer generation pays off its remaining outstanding mortgage, the share of owners without a mortgage in higher-income households is increasing.

This signals a generational issue, especially for middle-income younger professionals who – particularly in countries where housing policy is skewed towards viewing housing as a commodity – are finding their aspirations for home ownership are unachievable without substantive financial support from family. In turn, this contributes to further wealth polarisation and presents a challenge for social inclusion and cohesion. Equally, younger professionals may not qualify for, or may face long wait times of 5-10 years for cost-rental housing.

Indeed, given the larger debt burden and more limited prospects afforded to younger generations, the aspiration for home ownership is also lower, with a higher value placed on maintaining mobility.

The distribution of tenure data also masks two further aspects of housing market structures.

First, it is important to understand how social and cost-rental housing is provided in each country. For example, as cost-rental housing providers are private companies in Denmark and Sweden, albeit operating NFP housing models subject to public regulatory frameworks, they do not meet the statistical criteria employed for this dataset to be defined as subsidised.

As a result, cost-rental housing is included within the market rent category, of which it has a majority share (see section 5.2). Similarly, in some countries the structure of social and cost-rental provision can include a time-limited obligation to offer subsidised or below-market rents and the data only includes those still under obligation to offer a subsidy, regardless of whether the subsidy persists.

>page 25

Table 4: Outline of scale of housing need

	Context	Estimated shortfall
France	The supply of housing defined by financial law annually, including defined targets for social – and affordable – housing production. The SRU law requires 25% of housing to be affordable to lower-income households by 2025 and Paris has increased this target to 40% by 2035. Ambitions for social housing decreased per annum from 120k in 2016 to 95k in 2021, but new targets of 250k introduced to catch up and meet the needs of 2.4 million awaiting allocation of social and affordable housing, the majority of which are low-income households. Current financial conditions including housing costs and finance costs weighing on new construction.	Around 500k units pa required, of which at least 25% should be social and majority should be targeting affordable.
Germany	Govt has policy objective to build 400k new dwellings pa of which 25% should be subsidised social housing. However, targets not being met. In 2022, an estimated 280k units were completed and expected pipeline decline (242k 2023 and 214k 2021). The National Federation of Germany housing and real estate companies (GdW) constructed about 30k pa, but costs of construction and rising finance costs causing affordable housing to collapse. Impact on members is about a third less affordable units – or 10k less pa.	GDW estimates 320k pa required, of which 25% need to be social and affordable.
Ireland	No official estimates for social housing, but in June 2019 just under 70k households on a waiting list – and excludes those seeking to relocate in social housing and those in private rented but receiving direct govt payments to landlords. In 2019, there were 57.7k households receiving Housing Assistance Payment (HAP). Around 35% of households leaving HAP go to social housing. Around 9k homeless. Capital funding increased from €500 million to €2 billion in 2022 on 2021 budget and has been revised further in 2023 in recognition of cost pressures and changed financial market environment.	Central Bank est. 34k new homes needed pa 2020 to 2030 to keep up with population growth. In 2020 and 2021 shortfall of 50%. Estimated around 80k social housing units needed, without considering the 110k young working people (25 to 34) still living with parents.
Netherlands	Estimated that housing shortage of 331k dwellings or 4.2% of total stock. Concentrated in cities, where deficit of 6% is estimated. Shortage expected to escalate to 419k by 2025 and then edge down. In Amsterdam, waiting time to get a social/ affordable housing unit where demand/supply imbalance most acute is 5.5 years. Proposed rent regulation would effectively extend the reach of regulated housing sector into mid-market private sector housing.	Around 800k new homes required between 2021 and 2030, of which 250k new social homes and 50k 'intermediate' homes.
Sweden	Universalist approach to provision of housing. Public housing represents 16% of housing stock and cooperative housing a further 24%, with all residents qualifying regardless of income/ wealth.	Estimate shortfall of 160k units and estimated that 640k new additions required 2018 to 2027, of which 75% need to be in Stockholm or Gothenburg.
UK (England)	National Housing Federation (NHF) estimate in its report that there are approx 8 million with unmet housing need in UK – of these 3.6 million require social/affordable housing representing 1.6 million households – yet only 1.16 million are on official housing wait lists. Gap includes those in overcrowded/ unsuitable housing and 'concealed' – those adult households/ individuals living with parents	Around 340k new housing units required pa to 2030, of which 90,000 should be social and 33k 'intermediate' affordable, with a further provision of 28k for shared ownership housing.

Source: Housing Europe (2023); Housing Europe (2021); National Housing Federation, UK (2022); Housing Agency, Ireland (2023); UN Habitat (2023)

"Assessments of housing need across jurisdictions lack consistency and often accuracy."

The second aspect the data masks is the scale of housing needs that remain unmet. Most countries are currently experiencing a supply/demand imbalance for housing overall but more specifically when it comes to certain segments, notably social and cost-rental. For some markets, this shortfall spills over into demand for the PRS, especially from middle-income households, which can potentially be met by institutional investors delivering intermediary housing. Table 4 provides an overview of the estimated shortfall of housing in the context of the wider market.

Moreover, assessments of housing need across jurisdictions lack consistency and often accuracy as what is included in housing demand estimates varies across jurisdictions. For example, definitions of 'homeless' vary as to whether they include those without shelter, those in temporary and emergency accommodation and those seeking accommodation who are currently residing in private households.

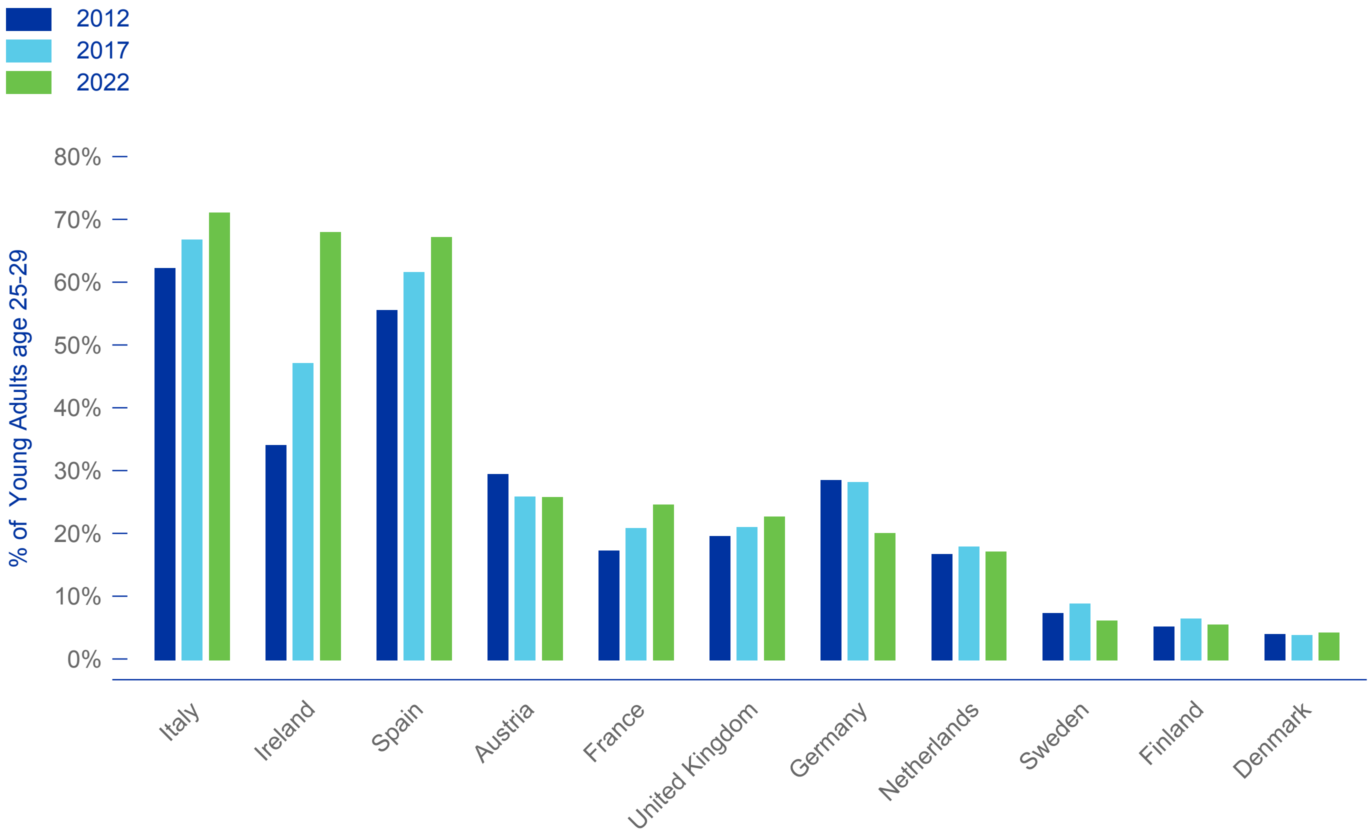
This 'hidden' – and often unaccounted – demand may also extend to young adults living in their family homes because they are unable to secure alternative accommodation due to low availability and/or prohibitive costs.

It is difficult to compare rates across countries as inter-generational living is a socio-cultural norm in some markets, notably Southern European countries. However, even within these countries rates are rising (Figure 14). In Ireland, the rates of young people aged 25 to 29 living at home have doubled over the past decade to 68% and are contributing to an uptick in emigration among young people arguably as a result of a housing crisis, rather than a lack of economic opportunity.

In other countries such as Denmark and Finland, young people are included specifically in supply and priority listings for social and cost-rental housing as greater weight is given to the impact of housing

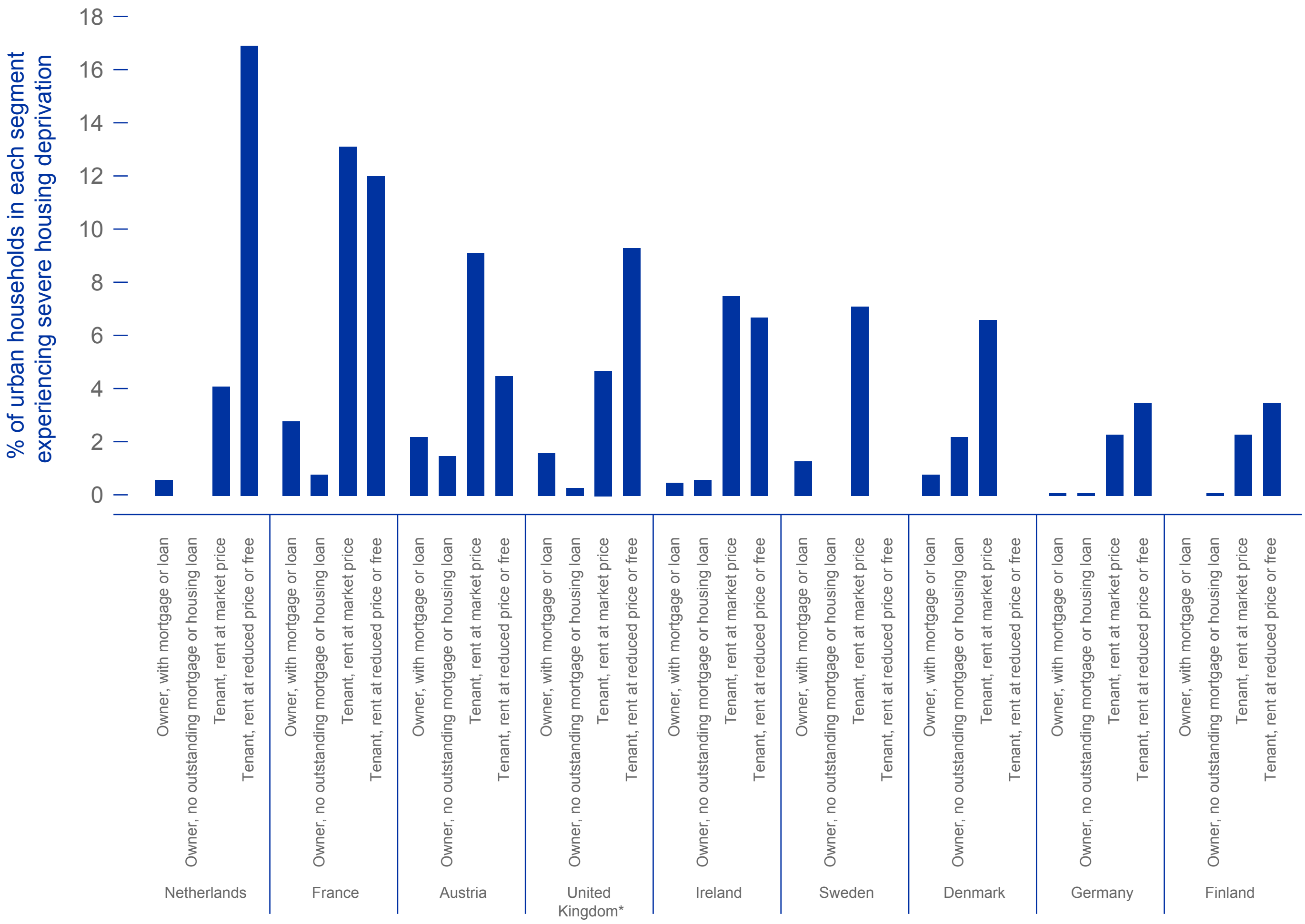
'Hidden' demand may also extend to young adults living in their family homes."

Figure 14: Young adults (25-29) living in family home*



Source: Eurostat (2023) EU-SILC; ONS (2023)
** % of that age group*

Figure 15: Severe urban household deprivation rate by tenure status (2020)



Source: Eurostat (2023); Last available data for UK is 2018

on future life choices and progression. In Germany, the number of 25 to 29 year-olds living in the family home has fallen, reflecting changes in underlying demographics. As the number of young adults is shrinking in Germany, the underlying population in this category is now more weighted towards the oldest.

Housing need in the PRS is also not solely concerned with the number of housing units required. There is also a need to increase the suitability and quality of housing in the sector. Figure 15 shows the percentage of the population living with severe housing deprivation by tenure[15]. Although housing quality clearly varies across countries, leased tenures have higher rates of severe housing deprivation, which are intensified in urban areas where demand is greatest. Institutional activity in the sector has the potential to significantly improve housing standards and living conditions through investment in new and existing housing and ongoing professional management.

As housing needs change in different countries, this is expanding the size and role of the PRS across many European markets. This presents an emerging market for institutional investors, which requires product innovation of new and existing stock that can be better tailored to meet the needs of increased demand from population growth in major urban centres and the spill-over from unmet demand from other forms of tenure, particularly for middle-income households.

15 Severe housing deprivation is defined as those living in dwellings which are considered as overcrowded, while also exhibiting at least one of the housing amenity deprivation measures (households with a leaking roof, no bath/shower and no indoor toilet, or a dwelling considered too dark (Eurostat, EU SILC).

4.2. How structural shifts change the purpose of the PRS

The PRS has traditionally accounted for a relatively small component of housing tenures in Europe, with some notable exceptions. In Austria and Germany, the decision to rent a home is considered a choice of long-term occupation style, whereas in many other countries renting is considered either transitory or short-term until circumstances enable acquisition of a home or allocation of subsidised affordable housing.

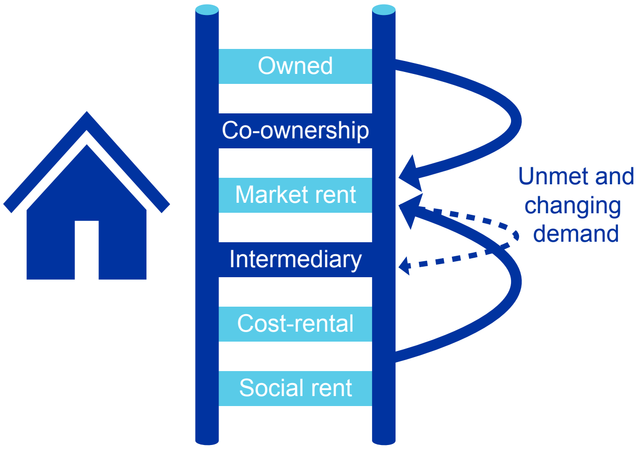
However, the PRS is under pressure to evolve to meet both the expansion of demand from within its traditional base and importantly, to meet the longer-term housing needs of spillover demand. This includes both those who can no longer afford to, or who no longer have the aspiration to buy, as well as those who can no longer afford market rent housing but cannot access social or cost-rental housing either due to the scarcity of supply or because they do not qualify (Figure 16). The emergence of intermediary housing within the PRS assists by establishing a new rung on the housing ladder targeting middle-income households seeking longer term leased housing solutions.

Over the past decade, the share of PRS as a tenure has been expanding as social and cost-rental housing provision has failed to keep pace with increased housing need, and in many markets access to finance and the affordability of home ownership has deteriorated. As a result, the market rented sector has come under increasing pressure, resulting in an escalation of rents that challenges affordability for lower- and middle-income households.

As this causes a structural shift in demand for intermediary housing as part of the PRS, there are several dimensions that shape the investment opportunity for institutional investors. First, the scale of the additional displaced demand from those individuals whose needs might previously be met by some form of social, cost-rental or ownership tiers of the housing ladder.

Beyond the scale of demand there is a need for the provision of PRS intermediary to expand the range of purposes it serves. The range of housing provided needs to respond to a wider – and changing – socio-demographic, including the increasing number of single person households, families, seniors, and an expanded younger demographic across an extended range of income groups.

Figure 16: Expansion of private rented sector rungs on housing ladder



"Intermediary housing within the PRS assists by establishing a new rung on the housing ladder targeting middle-income households seeking longer term leased housing solutions."

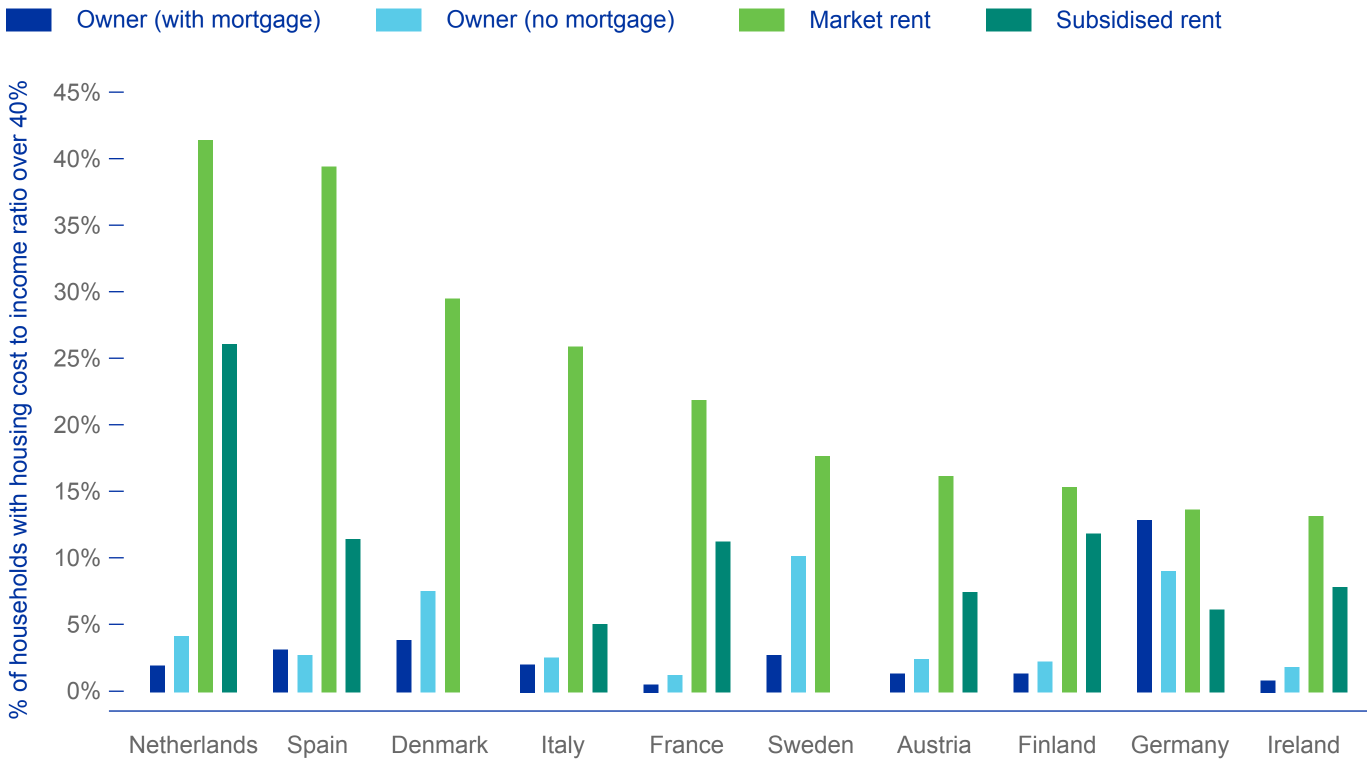
Second – and importantly – the purpose of the PRS is expanding. In markets previously skewed towards owner-occupation, the PRS primarily catered for more economically mobile and transient tenants, either in terms of more temporary duration in a location or in respect of life stage. Now, as either home ownership is delayed or extends out of reach, or the provision of PRS intermediary substitutes for social or cost-rental, it may also need to adapt to provide longer-term security and certainty to occupants. Many new and evolving households including younger generations and households reconstituting into single adult households (with or without children) no longer aspire to home ownership.

4.3. Impact of demand on rental affordability

The shortfall in housing supply against housing need has resulted in market disequilibrium, with scarcity leading to rent escalation. Household income growth over the last five years has been slower than rental growth and cost-push inflation has put further pressure on household budgets. This is experienced across all tenures, but in most markets housing cost overburden is more acute in the PRS sector given the funnelling of spillover demand to this segment of the market (Figure 17).

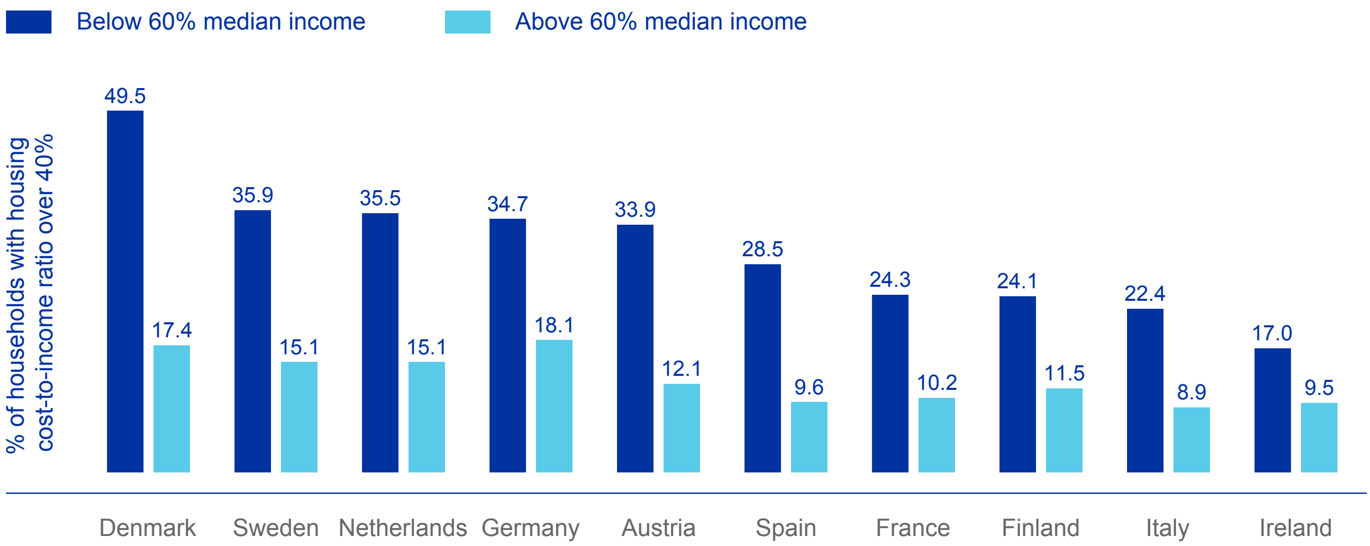
Unsurprisingly, the housing cost overburden is more acute for households earning less than 60% of median income. Middle-income households are particularly impacted as they represent a large proportion of spillover demand to PRS from unmet need across other tenures (Figure 18).

Figure 17: Housing cost overburden by tenure



Source: Eurostat (2023) EU SILC

Figure 18: Housing overburden rate by income



Source: Eurostat (2023) EU SILC

This underlines the institutional investment opportunity to expand intermediary PRS housing. In addition to contributing to the restoration of housing market equilibrium, institutional investment in PRS has the potential to transform both affordability and quality of the sector through innovating to provide appropriate and affordable housing solutions for middle-income households.

Importantly, institutional commitment to sustainability will include building and retrofitting to net zero, with the resulting improved energy efficiency also reducing total housing costs and improving affordability, in turn protecting net income. Regardless of rent regulation measures, there is a ceiling to rental levels based on the capacity of household income to absorb further increases in housing costs. However, measures that lower associated costs of occupation expand headroom for the rental component of total costs.

PRS rental movements are also influenced by the scale of provision of other market segments as this impacts demand levels. The size and reach of the regulated social and cost-rental housing market can moderate market rate rental volatility when the demand and supply of housing is broadly in equilibrium.

4.4. Adjusting PRS to lifelong renting and lease terms

In markets other than Germany, Austria and to a lesser extent France, market rented housing has conventionally been used as a bridge to more permanent accommodation. However, this is changing as many middle-income households, including key workers in education, health, emergency and other public services, younger generations and other newly formed households are now anticipating lifelong renting.

Institutional investors along with the state are responding to this growing demand from ‘generation rent’ with a range of solutions including intermediary housing. However, in some markets they are doing so in the context of lease arrangements originally designed for a more transitory role of market rent housing. This means that landlord and tenant law is not aligned with the expanded purpose of PRS, especially in regard to longer-term tenancy durations.

From an investor perspective, markets with landlord and tenant law that is aligned with longer-term tenancies increase certainty and lower risk.

> **“In some markets landlord and tenant law is not aligned to longer-term tenancy durations.”**

The gap between housing purpose and legal considerations is particularly acute in liberal housing markets, where landlord and tenant law tends to weight tenancy rights in favour of the landlord. For example, in the UK the introduction of legal reform to outlaw ‘no fault’ evictions has been much discussed, however its introduction in law is subject to an unspecified delay. As a result, private landlords can give notice to an existing tenant without due cause to begin a new tenancy at a higher rent.

> **“Consideration of leasing law and practices in Austria and Germany where lifelong renting is a tenure option of choice identifies important enabling factors.”**

This leads to considerable insecurity for occupiers, not merely as to the duration they will be able to reside in their current accommodation, but given the scarcity of accommodation, whether they can be certain of securing alternative housing and at an affordable price.

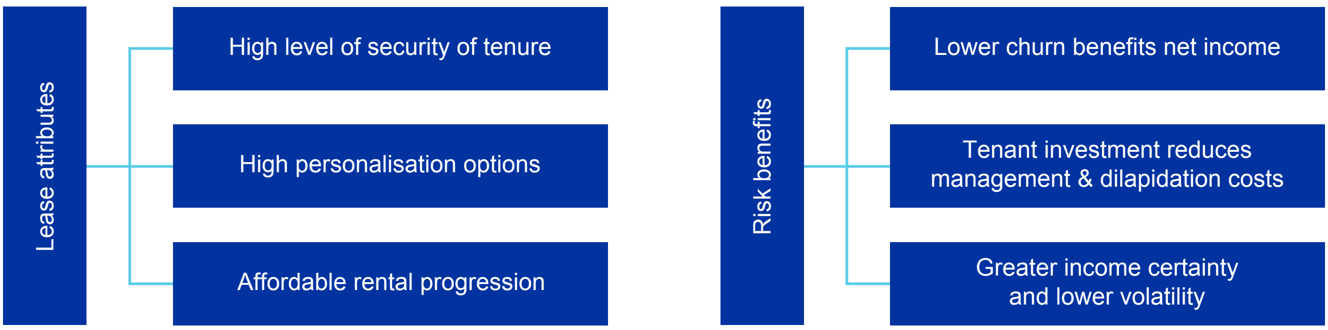
Indeed, a recent study of the UK housing market indicates that gentrification of central locations is leading to displacement of longer-term tenants to cheaper locations in distant suburbs. This trend of ‘surburbanisation of poverty’ that not merely removes an occupier from their home, but from their community and institutions including schools and workplaces is enabled by the absence of security of tenure[16].

It is estimated that between 2012 and 2020, one in nine lower-income market rent PRS households have been displaced in the UK. In a housing environment that requires a cultural shift from owner-occupation towards a leased tenure as a viable alternative, existing landlord and tenant relationships – and law – require revision.

In contrast, consideration of leasing law and practices in Austria and Germany where lifelong renting is a tenure option of choice identifies important enabling factors (Figure 19). First, tenants have a high degree of certainty in respect of security of tenure. If the tenant is fulfilling their contract, the tenancy may only be terminated under a limited set of circumstances. In Germany, this includes the landlord requiring the accommodation for a family member.

However, lease termination is a very rare circumstance as the history of private sector

Figure 19: Lease attributes and risk benefits of lifelong leasing frameworks



16 Bailey, N, Livingstone, M and Chi, B (2023) Housing and welfare reform and the suburbanisation of poverty in UK cities 2011-20 Housing Studies involvement in the sector – including the provision of social housing in the 1970s and 1980s – means that in addition to private individuals with significant portfolios, institutions and other larger organisations hold a significant share of the PRS. This is an important attribute of institutional activity in the sector that, in addition to professional management, is often understated.

> **"Investors seeking to deliver intermediary PRS should consider how existing landlord and tenant law impacts on risk and viability."**

Second, this permanency enables tenants to have the confidence to invest both financially and emotionally in their homes. Indeed, in Austria and Germany it is common for housing units to be let in shell condition with tenants responsible for the installation of kitchens and they may also be permitted to make non-structural changes. This allows for a greater degree of personalisation which is appropriate to long-term renting tenures.

Third, rent regulations provides for a high degree of certainty as to the long-term rental affordability of the housing, especially in periods where there is a housing shortfall. Despite changes over recent decades in the new and retained supply of social housing stock in Germany, both it and Austria have largely maintained a unitary rental market in terms of cost-rental and PRS rent levels being similar for housing units of comparable location, quality and utility value[17].

> **"Re-weighting security of tenure to enable tenants to feel greater security over their home delivers a number of risk benefits for long-term intermediary PRS strategies."**

Investors seeking to deliver intermediary PRS should consider how existing landlord and tenant law impacts on risk and viability. Conventionally landlord-weighted regulatory frameworks that include low security of tenure to tenants are considered to reduce risk as they provide greater control. However, re-weighting security of tenure to enable tenants to feel greater security over their home delivers a number of risk benefits for long-term intermediary PRS strategies.

First, net income benefits from lower churn rates. Second, tenants have a vested interest in managing and maintaining their home, reducing management costs and dilapidations. Third, there is greater certainty and lower volatility of projected income over the long-term horizon. Indeed, uncertainty of potential duration for tenants may act as a barrier where investors are seeking to provide intermediary PRS as a long-term housing solution of choice.

Ideally, landlord and tenant arrangements should be tailored to provide an appropriate balance of rights that reflect the purpose of PRS segments, for example whether for short-term, transitory or long-term housing requirements.

17 Mark Stephens (2020) How Housing Systems are Changing and Why: A Critique of Kemeny's Theory of Housing Regimes, Housing, Theory and Society, 37:5, 521-547, DOI: 10.1080/14036096.2020.1814404

Chapter 5

Social and cost-rental housing structures and PRS investment risk and opportunity

- There are significant differences across countries in the definition, size, scope, target population and type of provider of social and cost rental housing.
- In many countries, there is a blurring of the boundaries between the public, cost-rental and intermediary PRS.
- Some countries harness institutional capital to finance social and cost-rental housing, while others also invite equity participation.
- A large social housing stock that is addressing the housing needs of a wide section of society can impact on private market rents.
- Most countries have fallen behind in their housing targets, with surplus demand from social and cost-rental housing directed towards the PRS.

The fact that the structure of social and cost-rental housing systems varies widely across Europe has an important bearing on risk and the depth of the opportunity for institutional investors. Equally, the stability of housing policy and its impact on housing market structure affects risk and uncertainty.

The scope and scale of social and cost-rental housing shapes the PRS opportunity. In some countries, there is a blurring of the boundaries between the public, cost-rental and intermediary PRS. In others, regulated housing has – at least, until very recently – been limited to social housing for low-income households.

Equally, there is considerable variation in the consistency of housing market structures and the objectives of supporting policies. In countries such as Austria, Denmark, Finland and Sweden, the relationship between the public, NFP and private sectors has been relatively stable over multiple decades. In other countries such as the Netherlands and the UK, housing policy shifts have resulted in significant swings in the structure and profile of housing tenures.

There is further variation in the role of institutional capital within the provision of social and cost-rental housing as well as in the provision of PRS (Box 2).

"In some countries, there is a blurring of the boundaries between the public, cost-rental and intermediary PRS."

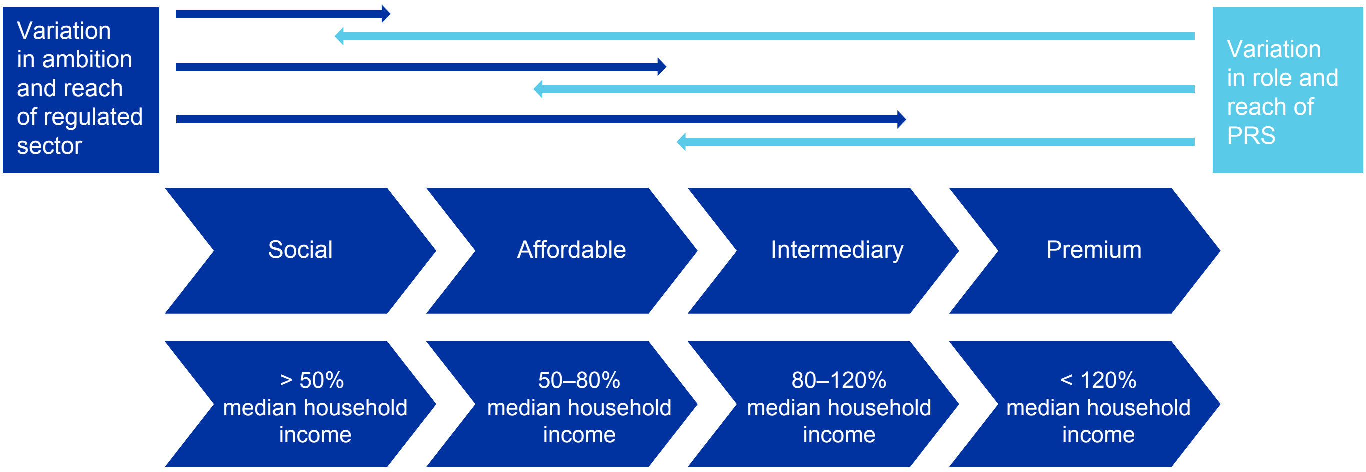
A number of countries, including Austria, Denmark and Finland harness institutional capital to finance social and cost-rental housing, while others, for example Germany, also invite equity participation.

It is not merely the scale and quality of social and cost-rental housing against underlying housing demand that is important to the scope of the intermediary PRS opportunity, but also the ambition of each country's housing policy regarding the sector's reach across socio-economic groups (Figure 20).

In some countries, for example Austria, Denmark and Sweden regulated social and cost-rental housing is open to all – or a very high proportion of the population. Such universalist housing policies acknowledge the diversity of households in the range of housing provision. Other markets operate a more selective approach, using income thresholds and qualifying criteria to access social and cost-rental housing. The degree to which provision is narrowed also varies, with many countries adopting a 'generalist' policy scope that covers a wide range of lower- and middle-income groups, for example, Finland, France and the Netherlands, while others narrow on the lowest income groups operating a 'safety net' policy approach, for example the UK.

Where housing demand and supply are in equilibrium, a large social housing stock that is addressing the housing needs of a wide section of society – even when targeted – has the capacity to influence and moderate private market rent levels. In turn, this provides a viable alternative to home ownership and creating a more unitary housing system.

Figure 20: Variation in the range of scope of social and cost-rental housing systems



"A large social housing stock has the capacity to influence and moderate private market rent levels. In turn, this provides a viable alternative to home ownership and creating a more unitary housing system."

However, the delivery of social and cost-rental housing slowed during the Covid-19 pandemic and most countries are failing to meet underlying housing need and have fallen behind in their housing targets, with surplus demand from social and cost-rental housing directed towards the PRS.

Institutional capital is well-positioned to assist in expanding affordable housing solutions through expanding the intermediary segment of the housing market. This assists in accelerating housing solutions for middle-income households. In doing so, it also frees up public and NFP capital and resource to increase the delivery of social and cost-rental housing addressing the needs of lower- to middle-income households.

5.1. Scope of social and cost-rental housing structures

Across countries, the spectrum of socio-political culture from liberal to social democratic informs the welfare regime for housing. Essentially, the degree to which housing is viewed as a social right or a market good form the bell-ends of established housing regimes. There are significant differences across countries in the definition, size, scope, target population and type of provider of social and cost rental housing.

In some markets, regulation of housing also extends to affordable housing for middle-income, or in universalist systems, all income groups. These housing systems may be divided into universal and selective, with the latter being further split into 'general' and 'safety net' (Table 5). Broadly, universalist and many generalist targeted systems offer social rent housing for low-income groups and cost-rental housing solutions for middle-income groups, whereas until recently, safety net selective systems have focused solely on social rent for low-income groups.

"There are significant differences across countries in the definition, size, scope, target population and type of provider of social and cost rental housing."

Table 5: Social rental housing regimes by country

Country	Housing regime	Eligibility	Social Housing Stock	Approach
Austria	Universalist (almost)	80% of households eligible	Large	Cost-rental model
Denmark	Universalist	All households eligible; priority criteria	Large	Cost-rental model
Finland	Targeted (broad)	Theoretically universal, but in practice targeted	Moderate	Cost-rental model
France	Targeted (broad)	Lower- and middle-income households with over 60% eligible.	Moderate	Public subsidy
Germany	Targeted (generalist)	Lower-income households	Moderate	Public subsidy
Ireland	Targeted (generalist, safety net)	Lower- and middle-income households	Moderate	Public subsidy (low income); Cost rental model (lower to middle income)
Netherlands	Targeted (Generalist)	c. 50% + of households eligible	Large	Cost-rental model
Spain	Targeted (safety net)	Low income and vulnerable households	Small	Varies; subsidy
Sweden	Universalist	All households	Large	Cost-rental model
UK	Targeted (safety net)	Low income and vulnerable households	Moderate	Subsidy

Source: Housing Europe (2023), The state of housing; OECD (2020); https://www.oecd.org/social/social-housing-policy-brief-2020.pdf; OECD (2020), "Social housing: A key part of past and future housing policy", Employment, Labour and Social Affairs Policy Briefs, OECD, Paris.

5.2. Scale of social and cost-rental housing provision

Bearing in mind the differences in definition, the size of the social housing stock differs considerably from one country to another. Figure 21 illustrates the effective public housing provision as a percentage of housing stock. Importantly, it differs markedly from the 'subsidised rent' presented in Figure 11 (page 22) due to definitional issues of what constitutes a private company and whether there is an obligation to lease at a subsidised rent.

Specifically, in Figure 21 social and cost-rental housing represent a larger share of all leased housing than PRS in Sweden and Denmark, but in Figure 11 (Section 4.0) there appears to be an absence of social and/or subsidised housing. This inconsistency reflects the universality of their housing regimes which adopt a 'housing for all' approach, rather than an absence of affordable housing.

At one end of the spectrum, social housing represents over 20% of all dwellings in three countries (the Netherlands, Denmark and Austria), and, by design, has historically been home to a relatively broad cross-section of low- and middle-income households. While social and cost-rental housing accounts for between 10% and 19% of the total housing stock in five countries (Finland, France, Germany, Sweden and the UK). In most EU countries including Ireland and Spain, it accounts for less than 10% of the total stock.

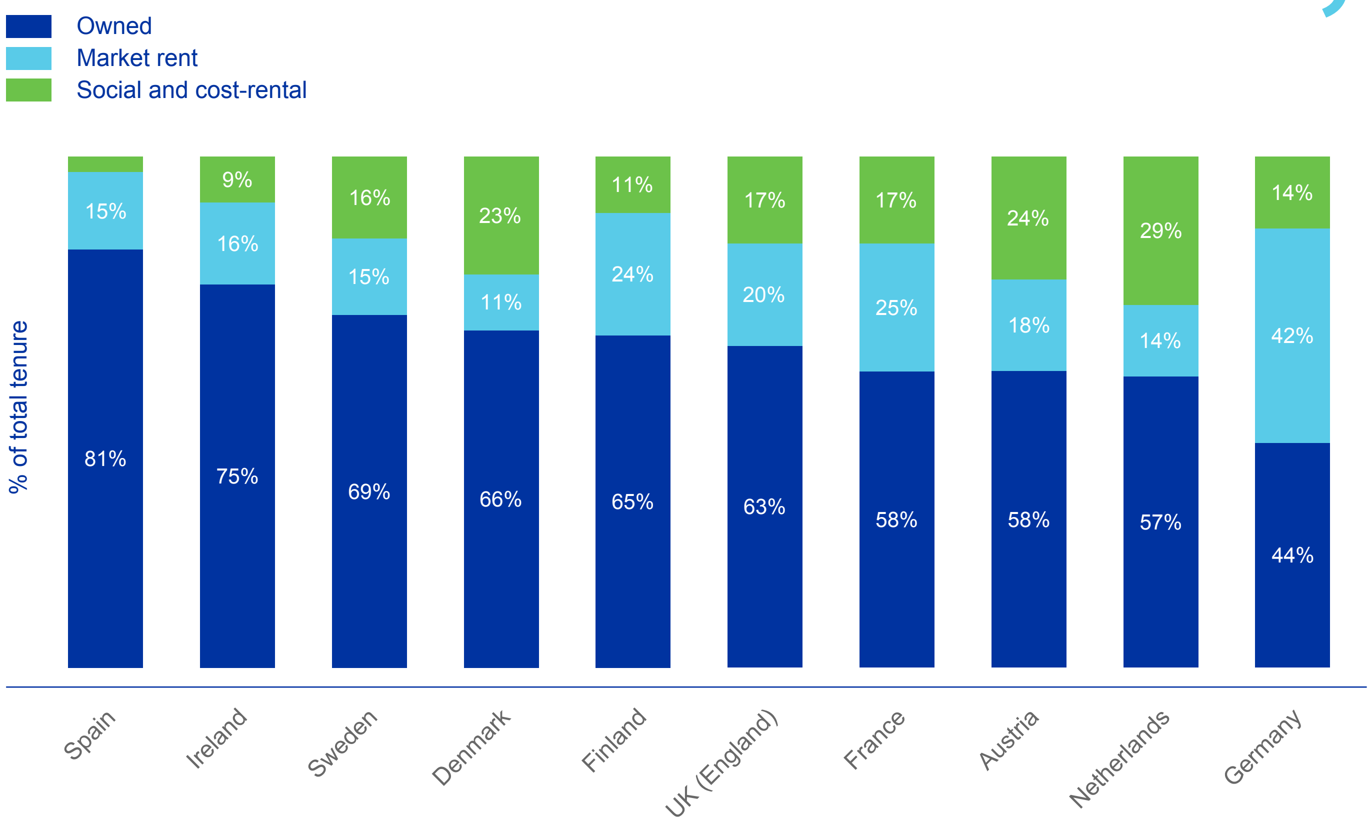
The example of Germany illustrates the depth of understanding that is required to assess market risk.

In Germany, the delivery of social and cost-rental housing is often supported by lower cost of capital government loans. In return, borrowers are required to subsidise rents for the duration of the loan period, usually thirty years.

After the end of the loan term, rent subsidies are no longer a requirement, however where owners are municipalities or NFP operators, the prevailing rental affordability is usually maintained. Matured, but publicly/NFP owned social housing stock is included in the data for Germany in Figure 21[18]. This provides a clearer picture of the proportion of tenure that benefit from some form of social or affordable regulated rent, which is not included in the data for 'subsidised rent' in Figure 11.

> **"This impacts on the financial stability of NFP housing operators and on their capacity to invest in their housing stock."**

Figure 21: Public housing as proportion of tenure



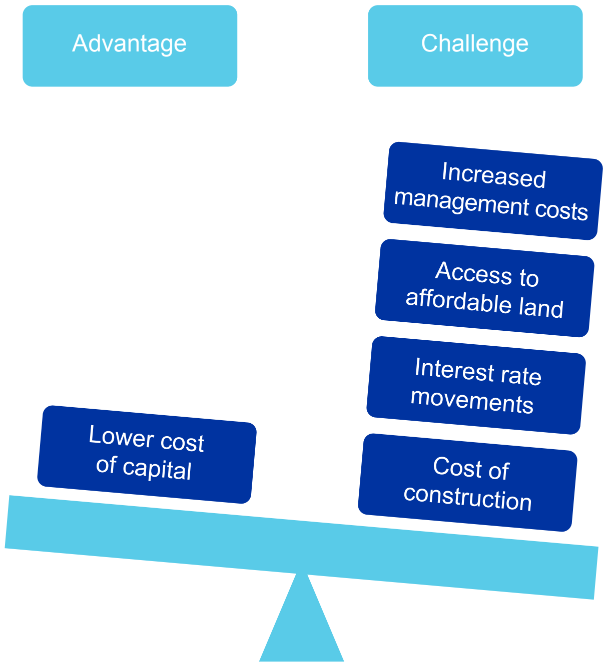
Source: Housing Europe (2023) State of Housing; Housing Europe (2021) State of Housing

18 Housing Europe (2023), The state of housing

"The scale and socio-cultural provision of social and cost-rental housing is an important component of understanding the structure and risk profile of the wider housing market."

In line with the wider real estate market, the dual impact of inflationary costs of construction, rising interest rates amid capacity constraints across the construction industry are currently impacting on delivery. This is particularly pronounced for cost-rental models that are not closed systems and where surplus income can be recalled into public finances, or in closed systems that involve no additional subsidy beyond access to a lower cost of capital (Figure 22). Indeed, this impacts on the financial stability of NFP housing operators and on their capacity to invest in their housing stock, including maintenance, upgrading and retrofitting to NNZ.

Figure 22: The current cost-rental challenge in a closed system



The scale and socio-cultural provision of social and cost-rental housing is an important component of understanding the structure and risk profile of the wider housing market in any country. Institutional investors are rarely directly involved in its operational management, and the social objectives of local authorities and regulated NFP housing bodies that are responsible for its delivery, including its financial management extend beyond bricks and mortar. However, its financial viability is often reliant on direct and indirect supports. These may also be of assistance in expanding intermediary housing within the PRS.

Box 2: Modes of institutional investment in social and cost-rental housing

Generally, there are four different models that traditionally enable institutional capital to invest in social and cost-rental housing.

First, the provision of income subsidies and/or discounted finance to investors in exchange for securing social and cost- rental covenants for the period of the loan agreement, usually thirty years. This is common in Germany and open to public, NFP and private investors. As income subsidies reduced in favour of individual social/housing support payments to individual tenants, private sector participation has declined.

Second, state-controlled agencies create a conduit for institutional investors to provide debt finance at sub-market rates to NFP housing agencies. In return, investors benefit from a state-backed guarantee that lowers risk to that of government bonds and tax breaks are also employed to incentivise lenders.

Third, in many countries the low interest rate environment of the previous decade encouraged many NFPs to acquire debt funding from institutional investors directly, often with accompanying state-backed guarantees.

Fourthly, in some countries, public and NFP housing providers may take a long-term lease on assets owned by institutional investors. These may be market-based, part of a public-private partnership as build to suit, be connected to securing development rights over public land or be embedded in planning considerations and/or national housing policy.

These structures create different risk/opportunity sets for investors in comparison to PRS and are beyond the scope of this paper, except where they blur with the intermediary PRS investment opportunity.

Chapter 6

Harnessing institutional capital through public intervention

- Only an expansion of new supply can address the long-term shortage of housing to meet underlying, unmet demand.
- Direct and indirect public supports could enable the continued flow of institutional capital to deliver intermediary housing supply through challenging market conditions as part of a long-term solution.
- There is a large toolbox of supports at policy-makers' disposal including access to a lower cost of capital, tax incentives, increasing land availability and reducing the risk and costs associated with planning considerations and timing.
- A number of markets including Ireland, France and the UK have developed frameworks to harness institutional capital to accelerate the delivery of cost rental and intermediary housing.

Institutional investors have a fiduciary duty to deliver optimised risk-adjusted returns to their underlying savers and policy holders, which could be met through investment in intermediary PRS. In doing so, institutional capital also has the opportunity to contribute to solving Europe's housing crisis over the coming decades to meet the long-term, persistent wave of unmet housing demand.

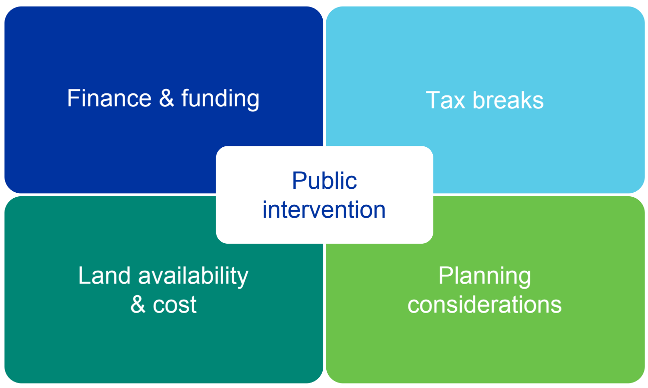
Recently, policy initiatives attempting to maintain an affordable supply of rental housing in Europe's cities have focused on regulation to moderate rental developments. Although this may alleviate immediate rent pressures, only an expansion of new supply can address the long-term shortage of housing to meet underlying, unmet demand. However, current financial market conditions are impeding the continued expansion of institutional investment in PRS.

Public stimuli – at least through prevailing market conditions – could facilitate institutional participation and assist in expanding the supply of intermediary housing as part of a long-term solution. At the public sector's disposal is a large toolbox of direct and indirect supports that can be employed in isolation, or in combination to support the financial viability of investment in intermediary PRS.

> **"Only an expansion of new supply can address the long-term shortage of housing to meet underlying, unmet demand."**

Supply-side supports and policy frameworks may incentivise investment by directly or indirectly reducing the required capital commitment, the cost of capital or the cost of land. They include finance and funding arrangements, tax breaks and incentives, planning considerations and land availability/readiness (Figure 23). Their application, particularly when combined in a well-considered framework can assist in ensuring that institutional capital can continue to contribute much needed supply to assist in remedying the housing crisis. Moreover, it provides an opportunity to align institutional activity with policy priorities.

Figure 23: The public intervention toolbox



6.1. Finance and funding

Most frameworks for the delivery of social and cost-rental – and often intermediary PRS housing – provide access to a lower cost of capital. Often this is provided by a state agency either directly, often drawing on funds from the European Investment Bank and/or the European Green Deal, or indirectly by acting as an aggregator for institutional finance.

Traditionally, institutional investors exposure to social and cost-rental housing has been through such debt finance. Institutional investors often benefit from a state guarantee giving the investment the quality of a government bond and usually receive some form of tax incentive. During the previous long, low interest rate period such schemes were less advantageous to borrowers and sometimes housing providers arranged finance directly with providers including institutions. This is expected to reverse in the context of higher interest rates.

Often, the provision of some form of government-backed debt is available for a proportion of total cost and must be paired with a commercial loan or other funding source, including equity. The government funding is usually offered as subordinate to other finance, facilitating more competitive rates on commercial loans.

> **"Public bodies may also pair debt finance with grants, or other forms of bullet no/low interest long-term loans. These are not usually extended to intermediate housing."**

Equally, public bodies may also pair debt finance with grants, or other forms of bullet no/low interest long-term loans. These are not usually extended to intermediate housing. However, the current high cost of debt and construction considered against housing need have seen this extended to private investors in some markets.

In Ireland, the Secured Tenancy Affordable Rental (STAR) scheme extends some aspects of the cost-rental affordable housing model to private investors (see Box 1, page 9)[19]. This is a time limited policy that provides state bearing equity funding per unit up to a maximum of €150,000 to €200,000 per unit, depending on location and environmental standards. This is in exchange for guaranteeing an affordable rent for a minimum of fifty years, defined as being at a minimum 25% discount to market rent. Security of tenure is also strengthened. The approach represents a form of value capture finance. The equity investment is non-interest bearing and no return is sought on income revenue, however a profit share pro-rata with the proportion of state equity funding at the end of the period is payable together with the original equity sum invested.

In the UK, for-profit investors are permitted to access grant funding if they register as For-profit Regulated Providers (FPRP). Although institutional investors represent approximately a fifth of FPRPs by number, they account for 90% of stock[20]. Some institutional investors have set up their own FPRPs and often work in joint venture arrangements with NFP housing providers, particularly in respect of management. Equally, there is a high allocation of funding to those awarded strategic partner status with Homes England, with a strong focus on large-scale multi-sector regeneration with new homes acting as a catalyst (see planning consideration and land assembly below).

> **"Tax break and incentives are also common to frameworks employed to expand the delivery of intermediary housing."**

6.2. Tax breaks and incentives

For social and cost-rental housing, tax break and incentives for private debt capital are often used to secure the provision of a lower cost of capital for the provision of affordable housing[21]. They are also common to frameworks employed to expand the delivery of intermediary housing. Tax breaks and incentives may include tax credits, capital gains, income tax and VAT discounts or exemptions. The provision of tax breaks increases the rate of return to compensate for lower rental rates, there by incentivising the provision of affordable housing.

In France, tax instruments are a central component of the framework established in the 2017 Finance Law to stimulate and employ institutional capital as both a source of debt funding and as a long-term investor of affordable intermediary rental assets. CDC Habitat established affordable housing funds through its subsidiary Ampere Gestion.

Institutional investors benefit from investing alongside public sector capital and receive tax breaks in return

19 Government of Ireland (2023) Secure Tenancy Affordable Rental, 1 August

20 Savills (2022) Equity investment in affordable housing, Spotlight UK Affordable Housing, Summer
21 ULI (2020) Promoting Housing Affordability – best practices to deliver affordable housing at scale, February

for offering rents at 20% lower than market prices for a minimum of 15 years[22]. These include a reduced VAT rate of 10% and property tax exemptions on developed land for a maximum of 20 years. The development strategy increases the stock of intermediary rental housing investment assets.

6.3. Land availability and cost

The availability, cost of land (and land remediation) and its connectivity to infrastructure ultimately underpin the affordability of housing. Finance and tax arrangements are often used to assist in equalising the rate of return from competing uses of land, particularly between market rent or ownership forms of housing and affordable housing. However, the public sector could also stimulate more institutional investment through assisting in the identification and supply of appropriate land, particularly site-ready land. Equally, providing greater certainty over planning consideration can lower risks of timing and inactive capital, and support returns.

Public land may be identified for development and allocated for specific tenures of social, cost-rental and sometimes intermediary PRS, for rent or sale. In some countries, public land may be sold at a discount to social and cost-rental housing providers, for example Finland and the Netherlands, while in others NFPs must compete with for-profit providers, for example, Sweden. In Vienna, zoning policy within planning can specify social, affordable and in the Netherlands also intermediary housing. In addition to creating certainty, it also assists in determining the land price with maximum land prices and rent levels per square metre largely pre-determined[23].

"The public sector could also stimulate more institutional investment through assisting in the identification and supply of appropriate land, particularly site-ready land. Equally, providing greater certainty over planning consideration can lower risks of timing and inactive capital, and support returns."

Land assembly and allocations to forms of affordable and market price housing are often a key component of wider strategic regeneration initiatives as well as smaller, specific redevelopment opportunities[24]. For example, the large-scale urban regeneration of Hamburg's docklands at Hafen City clearly defined their parameters with a third of housing allocations to social and affordable (including intermediary housing) to ensure an inclusive and sustainable community. On a smaller scale, the regeneration of the former barracks at Caserne de Reuilly in Paris created a mixed tenure of 50% social and student housing, with 20% allocated to affordable intermediate and 30% to private rent controlled units. In part this was enabled by a law which permits public land to be sold below market value to support subsidised housing[25].

In the UK, Homes England is using its public land, land assembly powers and funding, and working with strategic partners across the public, NFP and private sectors to deliver homes and sustainable development, with the aim of acting as a catalyst for economic growth in deprived areas. This approach coordinates infrastructure investment that assists in unlocking development land. The agency will enter into specific partnerships with private sector partners to deliver particular strategies and includes the English Cities Fund, a regeneration company comprising Homes England, institutional investment manager LGIM and place-making company MUSE.

22 European Investment Bank (2023)
23 Van Deursen, Hanneke (2023) The People's Housing: Woningcorporaties and the Dutch Social Housing System Part 2: The Mechanics, JCHS Harvard University
24 ULI (2020) Promoting Housing Affordability – best practices to deliver affordable housing at scale, February
25 SHAPE EU (2023) Delivering Affordable Lighthouse Districts in Europe, European Affordable Housing Consortium

6.4. Planning considerations

"Planning systems and policies are also an important driver of affordable housing delivery. Planning systems are very diverse across countries, as is the ownership of the land and accompanying development rights."

Other initiatives to assist with land availability include reducing or removing development levy charges associated with connecting sites to infrastructure. For example, in Ireland the government has introduced a development fee waiver for charges for connecting sites to local infrastructure and utility networks, although this is not specific to social, affordable or intermediary housing.

Planning systems and policies are also an important driver of affordable housing delivery. Planning systems are very diverse across countries, as is the ownership of the land and accompanying development rights. Many countries including Austria, France, Finland, Germany, the Netherlands and Sweden use a zoning system that specifies development rights by sector, scale and density. This affords landowners with development rights and provides certainty in terms of permitted development, land values and reduces risks associated with the costs of pre-development.

In some markets, including the UK and Ireland, planning systems set out frameworks and guidelines as to the type of development that may be acceptable, however, planning permission is granted for individual development proposals at a local level. These systems recognise the value of development rights being transferred to developers and seek to clawback a proportion of this value in developer contributions. This increases the risk and uncertainty associated with viability as land acquisition and pre-development costs are incurred prior to finalisation of planning. There is also a lack of certainty as to timing as these planning systems are a judicial process and may be subject to considerable delays.

"In some markets, including the UK and Ireland, there is also a lack of certainty as to timing as these planning systems are a judicial process and may be subject to considerable delays."

Chapter 7

Solving the affordable intermediate housing conundrum with institutional capital

- There is a clear need – and opportunity – for institutional capital to greatly contribute to Europe's housing solution.
- By expanding the intermediary PRS sector, institutional investors can assist in restoring housing market equilibrium and in turn, housing affordability.
- Harnessing institutional capital to focus on intermediary housing frees up public and NFP capital and expertise to focus on where it is most needed and most effective.
- Institutional investors need to understand differences in the structure of housing markets across countries and how these differences shape the intermediary PRS opportunity and impact on risk.
- Amid rising unmet need, affordability will remain under pressure until supply accelerates faster than demand and begins to erode the housing shortfall.
- Keeping the supply tap of institutional capital for intermediary PRS on through the current market conditions is prudent, but may require public sector support to bridge the viability gap.

There is a clear need – and opportunity – for institutional capital to greatly contribute to Europe's housing solution. In particular, by expanding a rapidly evolving institutional intermediary PRS sector, institutional investors can assist in restoring housing market equilibrium and in turn, and as scarcity value recedes, housing affordability.

Europe's housing crisis is not merely concerned with the volume of housing required. It also represents a structural shift in housing tenure demand across a range of longer-term rented housing solutions. Within the PRS, a rapid expansion of intermediary housing is required to satisfy the unmet needs of middle-income households seeking appropriate, affordable and secure homes.

Institutional investors seeking long-term income streams to match their underlying commitments to policy holders have a strong natural alignment with the intermediary PRS opportunity. This requires patient capital, often institutional proprietary capital and public sector pension plans. There is a symmetry to the investment purpose. These plans are over-weighted to public sector workers including education, health and emergency service professionals, which represent a significant proportion of the households that the development of affordable intermediary housing is targeting.

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> **"By leading the intermediary PRS, institutional investors free up public and NFP capital and expertise to focus on where it is most needed and most effective."**

In addition to the primary investment objective of delivering the required risk adjusted return to match assets with liabilities of future payments, the investment strategy is also serving the current interests of policy holders.

Institutional participation in the PRS will also deliver professional management, raising standards across the sector, including the quality of housing. Importantly, middle-income households require less additional social supports and programmes that form an important component of social and often cost-rental housing provision. By leading the intermediary PRS, institutional investors free up public and NFP capital and expertise to focus on where it is most needed and most effective.

The scale and nature of the opportunity varies across individual housing market structures. Institutional real

“Institutional real estate is by its nature a marriage of global and local capital and expertise.”

estate is by its nature a marriage of global and local capital and expertise. For residential, as European policy-makers seek to develop innovative solutions for Europe’s housing crisis both global capital, expertise and experience of best practice across jurisdictions is extremely beneficial, while the requirement for deep local knowledge and expertise is essential.

Institutional investors need to understand differences in the structure of housing markets across countries and how these differences shape the intermediary PRS opportunity and impact on risk. In particular, the scale, purpose and target audience for intermediary PRS will vary with the scale and intended socio-economic reach of social and cost-rental market segments, as well as house price affordability of the owner-occupied market.

Prevailing housing policies are an important driver in the evolution of housing markets structures. Developments in the scale, quality and regulation of any one tenure type will impact on the structure and demand for other forms of tenure. In turn, this influences the capacity for institutional investors to access and participate in residential investment opportunities.

Overarching socio-political intent of housing policy varies widely across countries from housing being considered as a social right to housing as a market good. Equally, the stability and consistency of housing policies across multiple timeframes varies widely across countries, impacting on investment risk and uncertainty. Investors should consider investment risk in the context of current policy and have regard to the volatility of housing policy, especially in the direction of policy, over preceding decades.

Regulation, landlord and tenant law, and best practice have evolved alongside housing market structures in each country. In some markets, long-term renting within the PRS is a socio-cultural shift, particularly for middle-income households, whereas in others, long-term renting within the PRS sector has long been considered a matter of tenure choice for middle-income households.

As housing markets develop and change, particularly those markets seeking to positively encourage life-long renting as an acceptable alternative housing tenure to owner-occupation, governments and institutional investors should review prevailing regulation, law and best practice and compare with markets that have large and long established rented sectors. This may assist in making life-long leasing an option of choice, rather than default.

Without this institutional activity, supply imbalances across European housing markets will persist into the long term. As it is, existing housing policies recognise the scale of the issue requires a multi-decade response. Amid rising unmet need, affordability will remain under pressure until supply accelerates faster than demand and begins to erode the housing shortfall.

However, geopolitical events have led to cost-push inflation, higher interest rates, higher bond yields with corresponding movements in real estate yields depressing values. This has resulted in a perfect storm for the viability of existing and planned developments, however there is no impact on unmet housing needs.

“Investors should consider investment risk in the context of current policy and have regard to the volatility of housing policy, especially in the direction of policy, over preceding decades.”

Keeping the supply tap of institutional capital for intermediary PRS on through the current market conditions is prudent. This may require public sector support to bridge the viability gap, requiring alignment between private, public and NFP sectors that creates additionality in supply levels at affordable rents.

The provision of grants, subsidies, access to a lower cost of capital, tax breaks and/or other interventions that lower costs, risk and increase certainty are common to public or state supported NFP social and cost-rental housing. It is less common for these to be extended to the private sector, although some markets including France, Ireland and the UK have introduced frameworks to enable the private sector to specifically deliver affordable intermediary housing. These approaches differ considerably, in part reflecting differences in their respective housing systems. Institutional investors should assess investment opportunities and associated risk in the context of these public private partnership frameworks.

Although there is unlikely to be a one-size-fits all solution, public policies and/or supports should be based on recognising the capacity for institutional capital to contribute to housing solutions, understanding institutional investor requirements and their over-riding fiduciary duty to policy-holders and savers, and how to best meet societal needs.

Institutional investors are seeking an appropriate, relative return for the risk incurred. Frameworks that increase certainty, including state-backed guarantees that provide government bond-like qualities to the investment, assist in lowering absolute return requirements in favour of enhancing risk adjusted returns.

By creating models that harness institutional capital, through debt, equity or both, governments can expand the delivery of social, affordable and intermediate housing and at the same time, expand the supply of investment product for institutional investment. Short-term public intervention has the potential to ensure that overall housing targets are met, the continued growth in the supply of institutionally managed, high quality sustainable intermediary housing and create frameworks that enable the sector to be self-sustaining – and affordable – over the long term.

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