UK Housing – What's the problem?

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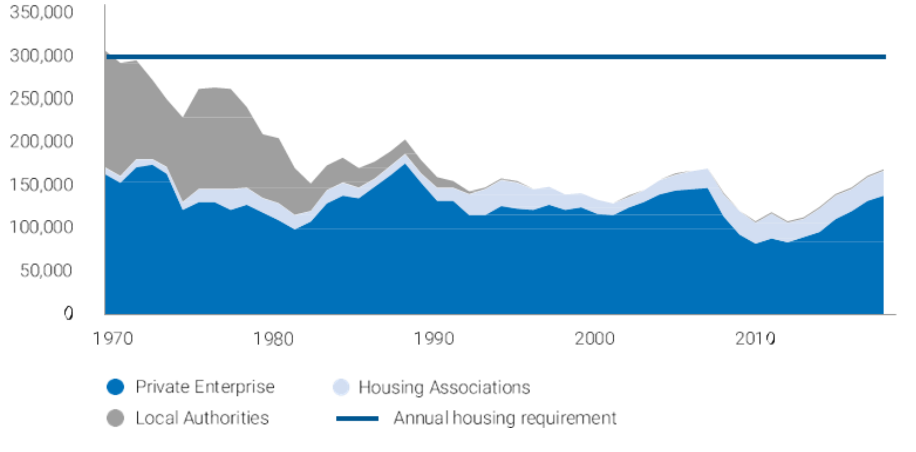
Discussing the UK housing market is something of a national pastime. The idea of owning your own home has become an unrealistic long-term goal for many. While issues of affordability are reasonably well understood, it's worth recapping what the scale of the problem is, why Private Rental Sector funds have come to the fore in recent years, and why in particular we believe a strategy focused on low to middle income earners can have the greatest social impact.

We're not building enough houses

According to the Government's Housing White Paper in 2017, the net annual housing requirement to keep pace with population and economic growth means we should be building 300,000 homes a year. We haven't built that many homes since 1970. Even a significant ramping up of the number we do build each year is not going to erase this 40-year cumulative deficit.

Completed Housing in England 1970-2018



Source: ONS October 2019, Table 213.

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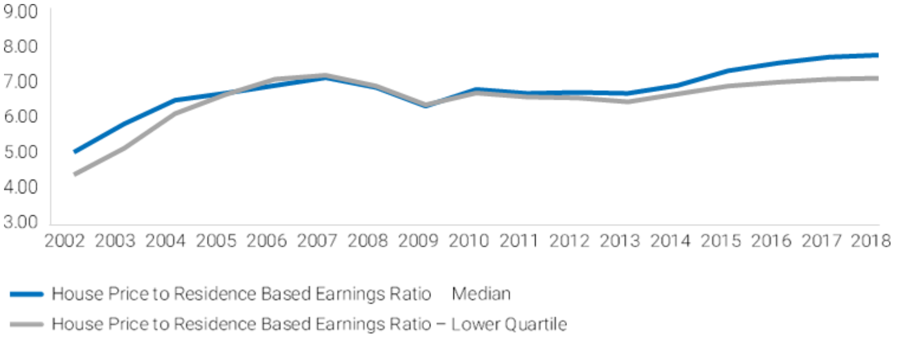
Affordability has declined

The fact that house price growth has outpaced earnings should be no surprise to anyone, however the picture is consistent across the distribution of earnings and house prices.

House prices to residence based earnings ratio



Source: ONS, 28 March 2019

The chart shows the house price to earnings ratio for England and Wales for the median and the lower quartile (higher is less affordable). For those on lower quartile incomes in England & Wales, back in 2002 house prices were 4.4x earnings. In 2018 that number has risen to 7.2x earnings. Unsurprisingly, tenure trends show the number of people buying with a mortgage declining.

OK, forget buying, just rent!

The private rented real estate sector in the UK is worth about £1.2trn, with only 3% of the market owned by institutional investors. The private rental sector is therefore dominated by small, unregulated landlords.

A recent study found that over 25% private rented homes were deemed unfit for human habitation (according to the Government's Decent Homes Standard). That's over 1 million homes.

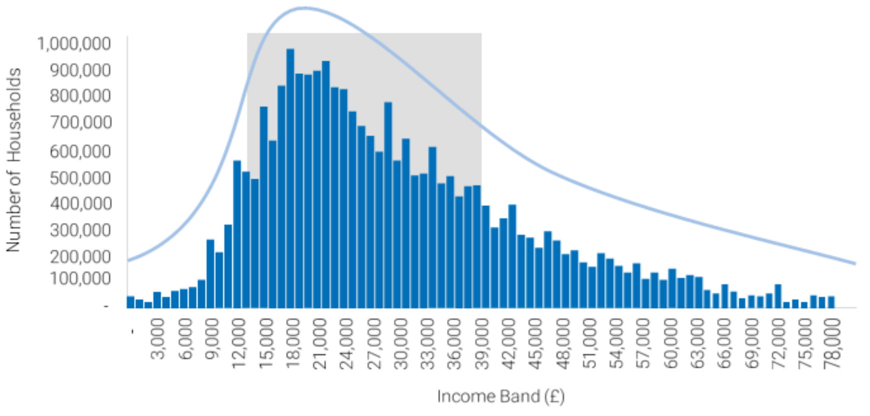
Added to inappropriate use of Section 21 notices (no-fault eviction notices) there is clearly a challenge for people to find a quality rental home offering security of tenure.

How can institutional investors have an impact?

Institutional investors bring a long-term outlook to the Private Rented Sector (PRS). This simply means that they value the cashflow and therefore plan to take actions in order to protect this income stream. This is why you will see PRS funds come in all shapes and sizes, some focusing on the most vulnerable in society (e.g. social housing, accommodation for the homeless or victims of domestic abuse being some examples) and some focusing on prime inner-city provision. Some buy existing stock while others develop.

In our view, targeting a rental product at the deepest part of the potential occupier market (economically active households on low to middle incomes) can have an enormous impact (see earnings distribution chart overleaf).

Distribution of UK Household Income 2017



Source: Office for National Statistics, Household disposable income and inequality in the UK 2017.

Delivering additional volumes of housing to this occupier group is the first step to impacting the housing shortfall and improving the PRS. Build to Rent funds bring forward homes that can be delivered irrespective of traditional housing market delivery drivers such as sales rates.

Accelerating the delivery of housing for low to middle income households nationally and innovating the way in which build to rent properties are operated are two of the BMO UK Housing Strategy's objectives.

In our next update, we'll consider what this kind of strategy can do in addition to delivery of new, quality rental stock to bring about measurable impact in the target demographic and their respective communities.

Key risks

Capital at risk and investors may not get back the original amount invested.

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

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