

# The Investment Podcast



## Episode 30: The Investment Podcast: Catering to subtleties across the housing spectrum

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**Speaker 2:** This podcast is for investment professionals only.

**Romil Patel:** Hello and welcome to *The Investment Podcast*. My name is Romil Patel, and I'm delighted to be joined here in the heart of London by Alex Greaves, Head of UK and European Residential at M&G Real Estate. Welcome to the podcast, Alex. It's a pleasure to have you on the mic for today's episode.

**Alex Greaves:** Hi Romil, nice to join you.

**Romil:** The topic of discussion is the living sector, or housing, a fundamental human need yet one which poses extremely high barriers to ownership amongst the younger cohort due to higher borrowing costs, limited supply, and soaring prices over a period of years. In addition to the affordability constraints in major cities, the available housing stock doesn't necessarily reflect the way certain demographics live and work in a changing world. Alex, let's start by defining exactly what the evolving needs across the housing spectrum are, and how this varies across global markets.

**Alex:** Housing needs are really defined, in our view, by what age profile you sit in, and those needs are driven then by the activities that you are likely to pursue. We'll divide housing need into the five different demographics, and we are focused on housing that is rented by people as opposed to housing that is built for sale. We're trying to derive long-term income streams from this type of housing.

On a needs basis, we split housing into five different categories. The first one being learn, which is what we call student housing, and it's that phase of life typically 18 to 22. It's probably the first time in life that you are actually likely to move away from home. This is often the case in both UK and Europe, and we'll come back to some of the nuances a little bit later.

Learn is very much that first phase and your first exposure to rented housing. The second one that we call connect is typically demonstrated by 25 to 35-year-olds. Now the reason we call it connect is that's the phase in life that you are most focused – or most people are, not all – most people are most focused on trying to develop both their professional and their personal network.

They want to be as close to work as possible despite what's happened in the pandemic and people's working patterns. They want to be close to their social life because they want to develop what's going on at a personal basis. As people start to get a little bit older, we go into the third phase that we call grow, and grow is characterised by the search for space. Once you've developed and evolved both your personal and your professional network, the need to be close to those hubs starts to diminish in the prioritisation for space.

That might be due to families, that might be for education, that might need for more green space etc. Those desires outweigh those primary desires. As a result of that, people will often move on in the search for space into that growth phase. The fourth phase is one that we don't actually house currently, and we call it relax. Relax is for people who are either close to retirement, empty nesters, or have retired.

The reason we can't look after them is they tend to be quite equity rich in most of the European and the UK [markets] across the board, but what does happen is people then get beyond that stage and relax because they've got their mobility, they've got wealth and they tend to move around either domestically or internationally. As people age and get a little bit older, we then go into the reconnect phase, and this is the phase that we can house

people, and it's when the mobility has started to go and you start to see people occupying or under-occupying family homes where people have left that empty nest.

Those are the five different phases that we identify, four of which we then invest into.

**Romil:** Within those phases themselves, can you give us an example of how we cater to nuances across the European market? For example, the learn phase, how might we cater to student accommodation across Europe?

**Alex:** There's some really interesting nuances there where, for example, if you are in the Netherlands, you've got to put in very large amounts of bicycle parking spaces. We have a scheme in Bologna in Italy where we had to put in a significant amount of freezer storage space. The reason for that, as I learned, was because the Italian market or the domestic market will typically pack their children away to university at the start of the term with a year's worth of frozen food, and a standard fridge does not have enough space to cater for that. As a result of that, we had to put in storage rooms with large scale fridges in there.

I recently came back from a trip in Lisbon and we came back from a scheme and we saw communal kitchens and the idea of the communal kitchen was to deal with the local fire safety regulations where they didn't want people cooking in their own rooms, but actually, they had these huge floors and it looked like a bake-off tent or a MasterChef room where you had 30 or 40 different ovens and extractor fans and lots of people were cooking together, and food brings people together so trying to use that across other schemes is actually a really interesting thing.

**Romil:** That's a really interesting example. I think I could have done with a lot of freezer space at university as well. Looking ahead, what role do you think institutional investors can play in correcting this generational imbalance by meeting supply demand, and given that housing is a utility, how stable is it?

**Alex:** I'll deal with the last question first – how stable is it? When we looked at residential as a whole, you can plot it over a 30-year period, and you preferred to use the word utility, because of that utility nature, people have to live somewhere, and as a result of that, we tend to see less volatility in the returns, and we see it much more as a defensive play from an institutional point of view.

We've seen it in the last two downturns certainly with the UK cycles, we've seen it through the Covid period with rent collection rates where sadly we saw a number of commercial premises and the different types within commercial really struggling in rent collection, but residential remained really stable across the whole period. Again, from a UK perspective post-mini-budget, we've seen that stability then come through again.

What roles do the institutions, or what roles can they play? We see a really good opportunity to get long-term liability-driven income matches because wages tend to reflect what's going on from a rental point of view into rents and rental growth. Being able to actually build the product, bespoke product, that's specific and takes into account the nuances that I mentioned in students, you have the same within Build-to-Rent (BTR) as well. Being able to build that kind of product across various different cities and in suburban locations is something that institutions can fund.

**Romil:** Just to bring demographics into this a little bit, Alex, how do you see the needs varying for housing from market to market across Europe? Where do you see greater demand, for example, the connect phase or the learn phase?

**Alex:** That's very specific and it depends on the different countries, and different cities within the different countries. Without fail, almost all cities have the same challenge which is, there's not enough new rental products that's well managed across the board, that goes without saying. From an opportunistic point of view, it comes down to which of those cities has got a greater evolution, or greater time has gone past for the different asset bases that have been built.

In Europe, we tend to see student being less evolved in comparison to the UK. The UK's got the most evolved and mature student sector I'd argue globally and has been evolved between 25 and 30 years. The European countries tend to be much less focused on that. I had a discussion earlier with someone today on Australia, and Australia student is more evolved than their BTR yet in the UK it's the opposite way around. In the US we see BTR being very, very mature student being very immature. It's very, very country and city-specific.

**Romil:** That must take a lot of cultural awareness from market to market to be aware of what the needs are, not just from a housing perspective but also catering to the amenities and the way that people live their lives as well.

**Alex:** It does and that's really important to have people not only sitting in a London office looking after both UK and European, but actually having people on the ground on a day-to-day basis who actually really understand the nuances that take into account the freezer example or the bicycle example, or how people might share particular housing together because as costs go up and demand increases, we tend to see more and more people sharing accommodations. Taking into account those nuances are really critical at an operational level as well.

**Romil:** Alex, if we just focus on the intersection between real estate and the environment, there are a number of countries in Europe which still have pre and post-war housing that hasn't been modernised, and the stock is often inefficient. Given that real estate drives approximately 40% of global carbon emissions, it's a key priority area in the pursuit of net zero. While there is clearly an opportunity to increase supply, how can this be done without emitting huge amounts of carbon into the atmosphere?

**Alex:** It's a really good question. The UK has the oldest housing stock in Europe and so is probably the worst culprit. There's the net zero and then there's the carbon that's embedded in the physical building so there's the operation of the asset, and we are moving closer towards that with air source, ground source heat pumps, better use of PV [photovoltaics], moving away from fossil fuels.

There are some – and it's really quite early days still – solutions that are being presented. Using modern methods of construction, there's one particular business I'm thinking of that produces panelised items that are built together, so panelised panels which have got hemp inside them, and they've been built using timber that's been sourced on a sustainable basis. Now, the combination of the hemp and the timber are carbon negative.

They've been using up carbon in the growth of those particular products. As a result of that, together with the way that the buildings are put together and the air-source heat pumps and the PV and using battery storage for electricity, those buildings are actually carbon negative. We are seeing solutions on a low-rise basis. We have yet to see them on a high-rise basis because it's quite hard to build in high-rise using timber and complying to what is different national fire regulations.

**Romil:** If we were to take that carbon-negative example and extrapolate a bit further, this could have a positive knock-on effect on scope two and three emissions?

**Alex:** Absolutely. It would be a real change for the industry. The irony, there's a bit of chicken and egg here because occupiers aren't necessarily driving that change. As a result of that, the house builders aren't necessarily following that driven change yet. There's an element of, if you build it then people will then purchase it, but because they haven't been built in scale yet, which is something that we are beginning to start that evolutionary journey, which will come in time.

**Romil:** Well, Alex, affordability is a key blocker. What are we doing to make housing more accessible?

**Alex:** The challenge here is all about supply. You're right, affordability has been a real challenge and continues to be a real challenge and we monitor this actually on a very regular basis. To give you the idea of the 6,000 occupiers that we've got, they're spending about 24% of their gross income on housing. Now, whilst that's our experience, that isn't the experience of everybody, and I recognise completely that the amount of supply is absolutely not keeping up with demand. The only way to change that is by finding a different way in order to actually put more housing back into the system, especially where it's needed.

A review at both government level and at a local level has to change it. Looking at things like, and I know it's a popular thing to do from an occupier point of view of rent controls, that is likely to reduce the amount of supply. We look across various different countries, it has a negative impact on new supplies. The way to do it is to find a way that incentivises both the institutions, the investors, and the developers to produce more products that comes in at a price point that is appropriate for the occupier base. Whether that's at a private level or at a social level, both of those need to be looked at.

**Romil:** Unfortunately time eludes us, but before we go, Alex, I'd like to ask you for your concluding thoughts. Over to you.

**Alex:** Housing is a fascinating debate and gets talked about by everybody, whether it's privately or in my world, professionally. I'd say there are three things really that are important to take away. The first one is, it's an institutional product and that should grow over a period of time. The downside protection, the defensive nature of residential is something that should really appeal to investors to help diversify their portfolios and exposures in real estate.

The social impact that you can have on people on their everyday lives, these are their homes and that's an absolutely key attribute and a key part to both investing and operating this type of product.

Then environmentally, as you mentioned earlier, Romil, of the 40% carbon emissions from residential – we can make a real difference here by finding new technologies, thinking about modern methods of construction, and focusing on how we can build new homes that people can live in operationally and through the development cycle. Carbon negative or zero is something that is a real opportunity here for both investors and for occupiers in the way that we live.

**Romil:** Well sadly, we must leave it there. Alex, it's been a real pleasure to sit beside you and discuss this. Thanks indeed for sharing your insights.

**Alex:** Thank you for having me.

**Romil:** Thanks to you, our audience as ever for tuning in. We look forward to seeing you on the next episode of *The Investment Podcast*, but it's goodbye for now.

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