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Mind the underinvestment gap: Shaping the UK's future through private markets investment

Decades of underinvestment has placed untenable pressure on UK social infrastructure – including housing, healthcare, infrastructure and other essential services – driving a need for aligned capital to support regeneration and growth across the country. The scale of investment required is vast; as is the opportunity for large scale investments by institutions (otherwise referred to as institutional capital) to create positive change and tap into what we see as an abundant landscape for holistic, private markets investing.

In this paper, we explore:

- The UK's investment need and the substantial opportunity set for institutional capital.
- Target areas that could generate positive social as well as environmental outcomes.
- How a diversified private markets approach could deliver best relative value.
- The potential for improved investment outcomes through access to hybrid transactions that can fall through the asset class gaps.

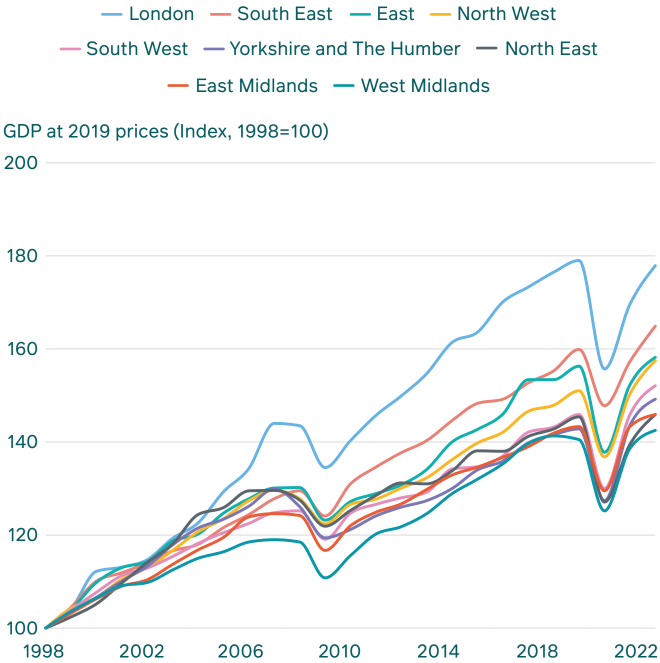
Structural challenges run deep

For generations, a disparity in wealth – and consequently living standards – has shaped the UK economy. An era of deindustrialisation combined with the deregulation of financial markets in the 1980s marked a defining chapter in the country's economic course, resulting in the UK's staggering regional income divide today, relative to its G7 peers. In terms of disposable income and productivity, the Institute of Public Policy Research named the UK as the most unbalanced nation of all advanced OECD economies of its size.[1]

The UK's transition to a services economy and the network effect of London's continual draw of workers from regional towns has concentrated high growth companies in the South East, in cities including London, Oxford and Cambridge. This has accelerated economic expansion in London, where real GDP (adjusted for inflation) grew by 2.4% pa between 1998 and 2022, versus 1.5% for the rest of the UK, according to ONS.

[1] Institute for Public Policy Research, '2023 State of the North 2023 – Looking out to level up: How the North and the UK measure up', January 2023.

London's economy grew by 30% more than the rest of the UK between 1998 and 2022



Source: ONS, Regional economic activity by Gross Domestic Product, UK: 1998 to 2021, March 2023.

Uneven investment levels have also resulted in mixed outcomes across the country, with the government responding to continued population growth, changing consumer needs and the need for a wholesale transformation of the country's transportation networks[2]. Between 2018/19 and 2022/23, transport spend per head was over double in London compared to England as a whole[3].

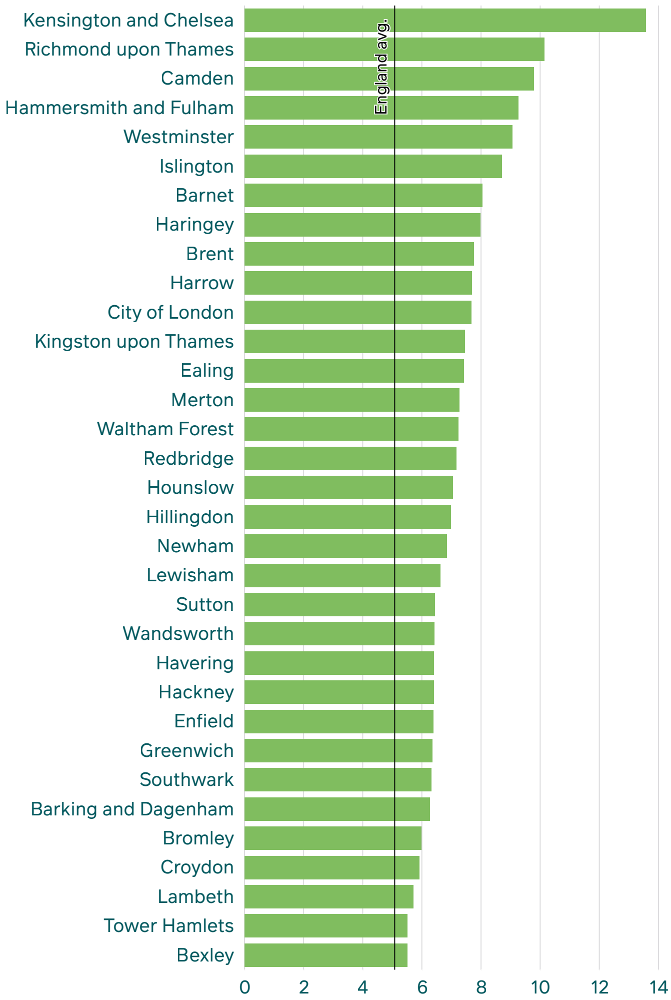
The UK National Infrastructure Commission has stressed the importance of prioritising transport network investment in Birmingham, Bristol, Leeds and Manchester, in the face of growing passenger numbers. Without an increase in capacity, employment growth in these cities is likely to be constrained over the next 20-30 years, according to its Second National Infrastructure Assessment[4].

However, challenges remain even in cities that have attracted higher infrastructure spend. In London, like other cities, there are stark inequalities across boroughs; food bank usage has soared and the cost of living is high. Unemployment rates were also higher in London than in any other region in the third quarter of 2024, at 6% versus 4.3% for the UK overall[5].

What's more, the city is at the centre of the country's housing affordability crisis. House price to earnings ratios remain elevated across London compared to the rest of the England and average London rents have significantly outpaced earnings growth in recent years.

Housing affordability more stretched than England average in all London boroughs

Mean household HPE ratio (July 2024)



Source: M&G Real Estate, based on ONS and Nomis data; HPE in maps represents mean house price compared with mean gross household income; average house price data as at July 2024; average earnings as at 2023. Household income is proxied by taking 1.4x full-time salary for residents in each local authority.

The impact of housing pressures on lower income households has been particularly acute in the capital, with 17.6 households per 1,000 in temporary accommodation compared to 4.7 in the rest of England as of the second quarter of 2024[6].

Pressure on housing supply and other essential infrastructure and services continues to mount with a rising urban population – echoed in key cities across the country.

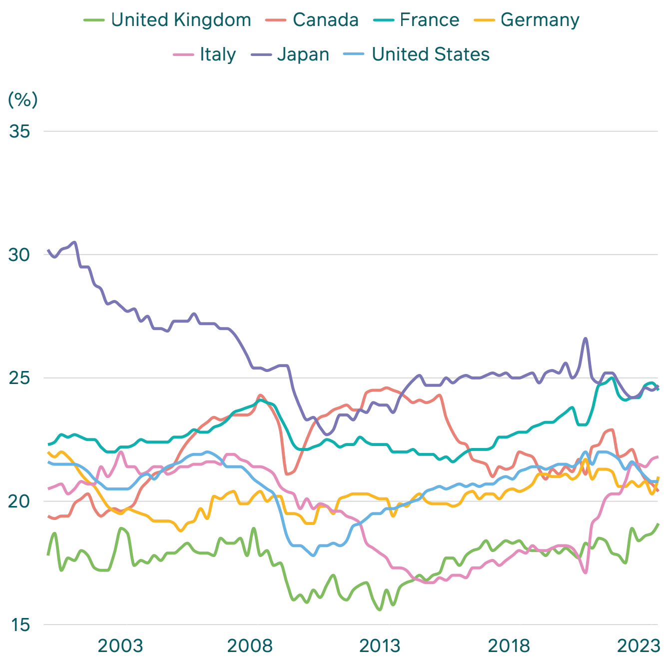
[2] IFS Green Budget, October 2020.
[3] HM Treasury, National Statistics, December 2023.
[4] National infrastructure Commission, March 2025.
[5] ONS, December 2024.
[6] Source: DLUHC, November 2024.

The UK's growing investment need

The UK's structural challenges have been exacerbated by a lack of investment overall. As a proportion of GDP, total investment – both public and private – has consistently lagged other G7 economies.

Increased levels of investment in UK real assets, including housing, healthcare, infrastructure and other essential services – supported by strong cross-party political backing – therefore has the potential to accelerate productivity and growth across the UK.

UK investment as a proportion of GDP remains lower than other G7 economies



Source: ONS 2023, whole economy investment (Gross Fixed Capital Formation, public and private sectors).

Key target areas for investment include housing, given the UK's overall 4.3 million homes backlog versus the average European country[7]. New housing starts have consistently lagged government targets, and a large-scale, long-term solution is now required in conjunction with more innovative funding solutions from the private sector. The government has committed to tackling this problem through measures such as planning reforms to expedite housing projects reaching an investible stage sooner.

[7] Centre for Cities, February 2023.
[8] NHS England, Estates Returns Information Collection Summary data for 2023/24, October 2024.
[9] PWC, Unlocking investment for Net Zero infrastructure, November 2020.
[10] Offshore Energies UK, "Business outlook 2023: The comprehensive outlook for the UK's offshore energy resources", 2023, accessed July 2023.

Another priority area for investment is healthcare, given a growing and ageing population, combined with the long-term deterioration of the NHS estate. Backlog maintenance costs have now risen to £13.8 billion, according to NHS data for 2023/24[8] – more than the total cost of running the entire NHS estate. Clinical services are therefore at high risk of major disruption or failure, meaning the requirement for fit-for-purpose healthcare facilities is paramount. Other public sector buildings, including schools and prisons, are similarly in need of significant CapEx.

Across the country, the need for regeneration continues to intensify. To meet the UK's net zero target by 2050, £40 billion of investment in low carbon and digital infrastructure is required every year for the next decade[9]. Private sector investment will be essential to meet the UK's energy transition commitments, with the Office for Budget Responsibility estimating that over 70% of UK clean energy investment will have to come from the private sector[10].

Institutional capital alone cannot resolve the problem, but it has an integral role to play in realising projects that raise living standards, reduce health inequalities, improve public services and contribute to decarbonisation.

Putting capital to work where it's needed

Key to driving economic growth across the country is the provision of funding for high-growth companies – often university research spin-outs – such that they can establish roots in regional locations.

If institutional capital is put to work effectively, the benefit for people and places can be profound. Thriving high streets with an abundance of local and regional businesses are the lifeblood of regional towns and partnering with local authorities to create an environment in which these retailers can flourish is a tried and tested model for enabling councils to fulfil their ambitions to support local people and businesses. Likewise, funding the development of healthcare facilities can help to support better health outcomes for local people, particularly in underserved areas.

Institutional capital can also be deployed to support the need for more housing where it is needed most across the UK. Amplified by widening commuter belts, the social and economic potential this can harness can be consequential.

Institutional capital at work:

Decarbonising transport infrastructure

Financing infrastructure that contributes to the UK's decarbonisation targets is a key priority for institutional capital; which is why our investment in sustainable transport is an important focus.

As a joint-majority investor in **Zenobē Energy**, one of the UK's leading owner/operators of electric bus fleets and battery storage, our Infracapital business has been able to support carbon reduction as well as the transition to renewable energy systems.

The ability to scale up infrastructure platforms also supports Zenobē's growth ambitions to accelerate the take up of electric bus fleets in the UK and internationally.

In turn, we are able to contribute to national decarbonisation targets, while also targeting long-term contracted cash flows for investors.

Supporting regional growth and job creation

Funding the growth of innovative businesses can be an impactful way to unlock growth in regional locations.

Investing in **Northern Gritstone** – an investment vehicle set up to fund intellectual property (IP) and research companies from the Universities of Leeds, Manchester and Sheffield – has the potential to promote economic growth through the creation of new industries and high quality jobs.

It also helps to position the North of England as an innovation leader, in turn encouraging more investment in the region.

Importantly, institutional capital has enabled the commercialisation of IP relating to health and life sciences, advanced manufacturing, and technological innovation, whilst retaining it within the UK economy.

The second-order effects of broadening access to these advancements also have the potential to make a positive difference to people's lives, as well as the environment.

NORTHERN GRITSTONE
THE VALUE OF IDEAS

Transforming local economies

Institutional capital can, in many cases, deliver projects which make a material difference to local economies, such as M&G's funding of the Rochdale Riverside development in Greater Manchester.

Funding the £80 million retail and leisure development through a 35-year inflation-linked lease to Rochdale Borough Council has helped to reverse a long-term downward spiral of reduced footfall and consumer spending in the town centre.

Following its completion in April 2020, the council has estimated that the development will bring in an extra 2.1 million visitors and £150 million in retail expenditure each year.

Overall, the development has created 1,450 local jobs and an estimated net additional £22 million gross value added (GVA) over a five-year period for the local economy. Furthermore, around 40% of construction labour was sourced from the local borough.

Institutional capital at work:

Helping to improve health outcomes

M&G's funding of The Harborne Hospital adjacent to the Queen Elizabeth Hospital in Birmingham is a clear example of how institutional sector capital can be used to unlock innovation and help improve health outcomes.

The hospital provides the people of Birmingham and the West Midlands access to outstanding private and NHS care in a world-class facility, while also helping to attract and retain NHS talent.

In addition to 72 NHS beds and 66 private beds, the hospital features a new radiotherapy unit, and the latest technology to provide some of the most complex surgical and medical procedures across multiple specialisms.

The hospital's construction was funded on a 40-year inflation-linked lease, backed by University Hospitals Birmingham NHS Foundation Trust, allowing the healthcare provider to raise long-term funds against the asset, while retaining ownership of the freehold when the lease ends.

Funding of this nature benefits healthcare providers and patients, as well as retirement savers, through sustainable, long-term cash flows.

Supporting regeneration through collaboration

M&G's £61 million investment in two affordable housing developments by not-for-profit community benefit society, Tirion, demonstrates the power of successful private and public sector collaboration.

The debt financing provided will help to deliver over 600 much-needed affordable and private homes through the redevelopment of a former Cardiff paper mill and a decommissioned steel works in Newport.

Significant regeneration of these derelict sites, close to city centres, brings both social and economic benefits for local areas, creating new, sustainable neighbourhoods.

The homes are being built to the highest energy ratings in the UK – EPC A or B – with 30% of the energy required to heat and power homes generated by renewable sources.

Institutional capital has been integral to the project's implementation, given local authorities continue to face pressure on finances.

In place of a funding grant, land was provided by the Welsh government, which also subsidised decontamination costs for the sites.

Given the long-term nature of institutional capital, collaboration between M&G, the Welsh government and Tirion met collective requirements.

We see this model continuing to gain traction as a way to fund more affordable housing projects.

Why now?

We believe the clear funding gap for social infrastructure in all its forms offers a compelling opportunity for institutional investors to drive substantial change and generate attractive potential returns.

However, there is a shortage of appropriate risk capital to meet this requirement, given mainstay corporate defined benefit pension schemes are de-risking and insurers, while growing, are likely to remain heavily restricted by solvency rules.

This heightens an already steep requirement. Hence, the need to channel capital more effectively in the UK, to support regeneration and growth, is widely recognised. Ongoing engagement with the likes of the newly established National Wealth Fund – designed to encourage investment by de-risking infrastructure projects, in particular – will be key to unlocking private-public sector collaboration.

> **"Targeting investment through multiple private market asset types and locations can maximise social outcomes by unlocking larger, more ambitious projects that can often fall between the asset class gaps."**

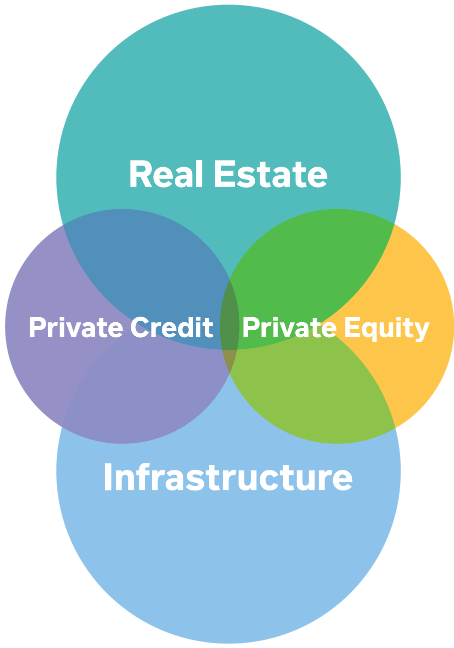
Long-term investors, including local government (LGPS) and defined contribution (DC) pension schemes, as well as international capital, could be well positioned owing to the nature of their risk/reward requirements, as well as their commitment to creating positive social outcomes. The ability to invest across private markets, underpinned by predictable cash flows and/or strong growth potential, means these investors are well-positioned to undertake investments that target some of the UK's multi-faceted structural challenges.

A holistic approach to local investment

We believe a holistic approach to local investment is the optimum way to add value – for both investors and local stakeholders.

Providing holistic, single-source funding through an array of private assets capabilities can maximise the benefits of institutional capital and unlock larger, more ambitious projects which can all too often fall between the asset class gaps.

Combining private markets expertise



Source: Illustration by M&G Investments, March 2025

This model has distinct benefits. It can play a fundamental role in de-risking often complex, place-based investments (whereby resources target specific locations to drive local economic growth and social benefit) versus traditional, single asset class strategies.

Exposure to multiple private asset classes allows for relative value judgements to be made in real-time when comparing projects, providing the potential for attractive risk-adjusted returns throughout the cycle. Furthermore, it can also offer improved potential outcomes and increased investment opportunities for investors through access to hybrid and unique off-market transactions.

Institutional capital at work:

Maximising outcomes

The enhanced ability to boost the benefits of institutional capital by tapping into multiple private assets capabilities is evident through M&G's investment in **Greencore Construction**.

Our acquisition of a majority stake in the sustainable housebuilder has enabled Greencore to scale its operations, providing carbon positive homes that harness cutting edge building methods and materials to lock up more carbon than is emitted both during construction and over the course of a property's lifetime.

M&G has also partnered with Greencore to fund sustainable new developments of private and affordable housing, such as Greencore's Springfield Meadows development in Oxfordshire.

Utilising M&G's full private markets capabilities – in this case private equity and real estate – allows for compelling opportunities to be identified, structured and financed.

Maximising capital

For investment managers with the right expertise and track record, bringing together private assets capabilities into a diversified strategy can be an effective way to meet investors' objectives, we believe, allowing for real-time assessment of relative value and positive social outcomes across asset classes and transaction types. Access to both equity and credit expertise offers the potential to optimise market dynamics, while the benefit of deep private assets origination and management expertise can further support the ability to adapt quickly to evolving requirements.

"No silver bullets are available for the scale and complexity of investment required in the UK – but when accessed in an optimal way, we believe a significant opportunity awaits institutional investors willing to embrace current market dynamics."

As experienced private assets investors, we see value in targeting a strategy that considers both financial and social outcomes to determine the best use of capital. As part of this, a clear ESG framework is necessary to assess, monitor and measure ESG credentials across asset classes, meeting investors' requirements whilst also maximising the opportunity set and providing a clear basis for comparison.

Working alongside public bodies, expert developers and operators to understand the intricacies of local needs, we believe it is possible to drill down further to determine where capital can be deployed to achieve long-term, sustainable benefits. This could mean creating affordable homes and local jobs, funding healthcare facilities and upgrading transport systems, or investing in renewable infrastructure.

Deploying capital to achieve maximum, long-term benefit

- Local economic growth
- Improved health outcomes
- Decarbonisation
- Access to homes where they're needed
- Access to services and essential infrastructure

Source: Illustration by M&G Investments, March 2025

Tapping into a significant opportunity

The need to tackle the UK's structural challenges and improve social and economic inequality is an enduring task, and institutional capital is necessary alongside public sector funding and innovative long-term solutions to help achieve these goals. This requirement is supported by cross-party political backing, a shortage of available private capital, and an ambitious investment pipeline, creating what we see as an abundant landscape for holistic, private asset investing.

Since innovative, hybrid solutions are often required to bring schemes to fruition, we believe accessing investments in a way that optimises capital and the benefits that institutional capital can have on the social, environmental and economic fabric of the UK, is fundamental. Scale and breadth of private assets capabilities allows M&G to approach essential infrastructure investment in this way, with the ability to balance positive outcomes and attractive risk-adjusted return potential through real-time relative value and benefit decisions.

No silver bullets are available for the scale and complexity of investment required in the UK – but when accessed in an optimal way, we believe a significant opportunity awaits aligned investors willing to embrace current market dynamics, whilst creating tangible and lasting positive social and economic outcomes for the country.

M&G Investments