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Why investment in residential rentals is making a return **Bill Nowlan**

Changed landscape means residential property in favour again with institutional investors

Investment in residential property in Ireland was abandoned by institutional investors in the 1970s because returns were inferior to those from commercial property. Photograph: Yui Mok/PA Wire

Investment in residential property in Ireland was abandoned by institutional investors in the 1970s because returns were inferior to those from commercial property.

Irish Life, for example, sold its significant residential holdings during that period and up to the 1990s as the returns from the sector were about 3 per cent lower than from its commercial portfolio, even after taking capital appreciation into account. The cause of that underperformance was that the owner-occupier sector was heavily subsidised by the State, with cash grants and tax reliefs. One researcher estimated

that these subsidies – ones not available to the professional investor – accounted for 30 per cent of the price of a house.
The landscape has dramatically changed over the past decade with the withdrawal of mortgage tax relief and grants. The removal of this bias has not happened in Ireland alone, but is a worldwide phenomenon. It has resulted in institutions becoming investors again in the residential rental sector. Residential investment is now a standalone asset class, ranking alongside offices, retail, and so on.

Flotation and acquisition

We have an excellent example of that trend in Ireland, in the recent flotation of I-Res REIT plc and its acquisition of almost 2,000 residential rental units. Other institutional investors have also acquired significant residential portfolios in Dublin, including Kennedy Wilson, and overseas investors are looking at the sector.
Institutional investors are typically pension funds, life assurance companies and others who seek a safe long-term berth for their funds, usually based on yield rather than simple capital appreciation. But is institutional investment in residential property a good idea? Unquestionably yes. Not only does it provide a reliable supply of much-needed accommodation, but also the nature of the investment favours long-term, secure, stable tenancies. A balanced housing market requires a strong, viable private rented sector to provide choice and flexibility, and to provide a counterbalance to shortages, spikes and bubbles in other housing sectors.
At first look, however, the net income returns from residential property, at 4 to 5 per cent a year, still seem to be lower than those available on commercial property by at least 1 or 2 per cent. So why the renewed interest by professional investors? There are number of reasons.
First, residential rents rise over the long term in line with wages and salaries (and pension funds need to track wages), whereas commercial rents follow, and often lag behind, inflation.
Second, the demand for residential rental accommodation is growing significantly. The number of households renting privately in Ireland almost doubled between 2006 and 2011. Internationally, the growth in home rental can be attributed to many factors, including urban growth, the reversal of suburbanising trends, social changes (including smaller households), and less focus on ownership and more on flexibility and convenience. In general, the English-speaking world is becoming more "European" in its choice of rental housing.
The third reason for the renewed investment interest is that residential properties tend to physically depreciate less rapidly, with lower obsolescence. In well-managed

portfolios, vacant properties are refurbished and relet in weeks, whereas a commercial property can take a year to refurbish and as long again to relet.

Disappearing landlords

In Ireland, it's probably just as well that institutions are showing a renewed interest in the private rental sector, as it is currently being abandoned by its former mainstay, the one-off small-time landlord. In Ireland, more than 80 per cent of landlords own either one or two properties. According to work carried out by Mark FitzGerald and his researchers at Sherry FitzGerald, the loss of buy-to-let homes in the private rental market in 2014 was around 12,000 homes, or 250 a week.

Moreover, it is clear that this loss of units is more prevalent in Dublin and in the lower price ranges. But it is in this sector that the State currently pays the rent on just under 100,000 units, and where it expects to find further supply. It is no wonder that rents are rising rapidly as available supply declines. This end of the market is of little interest to institutional investors, largely for management and location reasons. In other countries, state supports are in place to attract institutional investors into this sector, but none of these currently exist in Ireland.

Finally, a word of caution to the Government in regard to possible rent controls. The emerging interest in investment in the residential sector could be easily stifled if this is not approached correctly. I note that Minister for the Environment Alan Kelly was careful to describe his aim as "rent certainty", not rent control. There are sophisticated structures in place in other countries to soften the short-term impact of rapidly rising rents on tenants, and these should be considered as a way of doing this without dampening institutional demand.

Bill Nowlan is chairman of WK Nowlan Property and a director of Hibernia REIT Plc. The views expressed here are personal and are not those of either organisation