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UK living sector investment: Slipstream into the mainstream

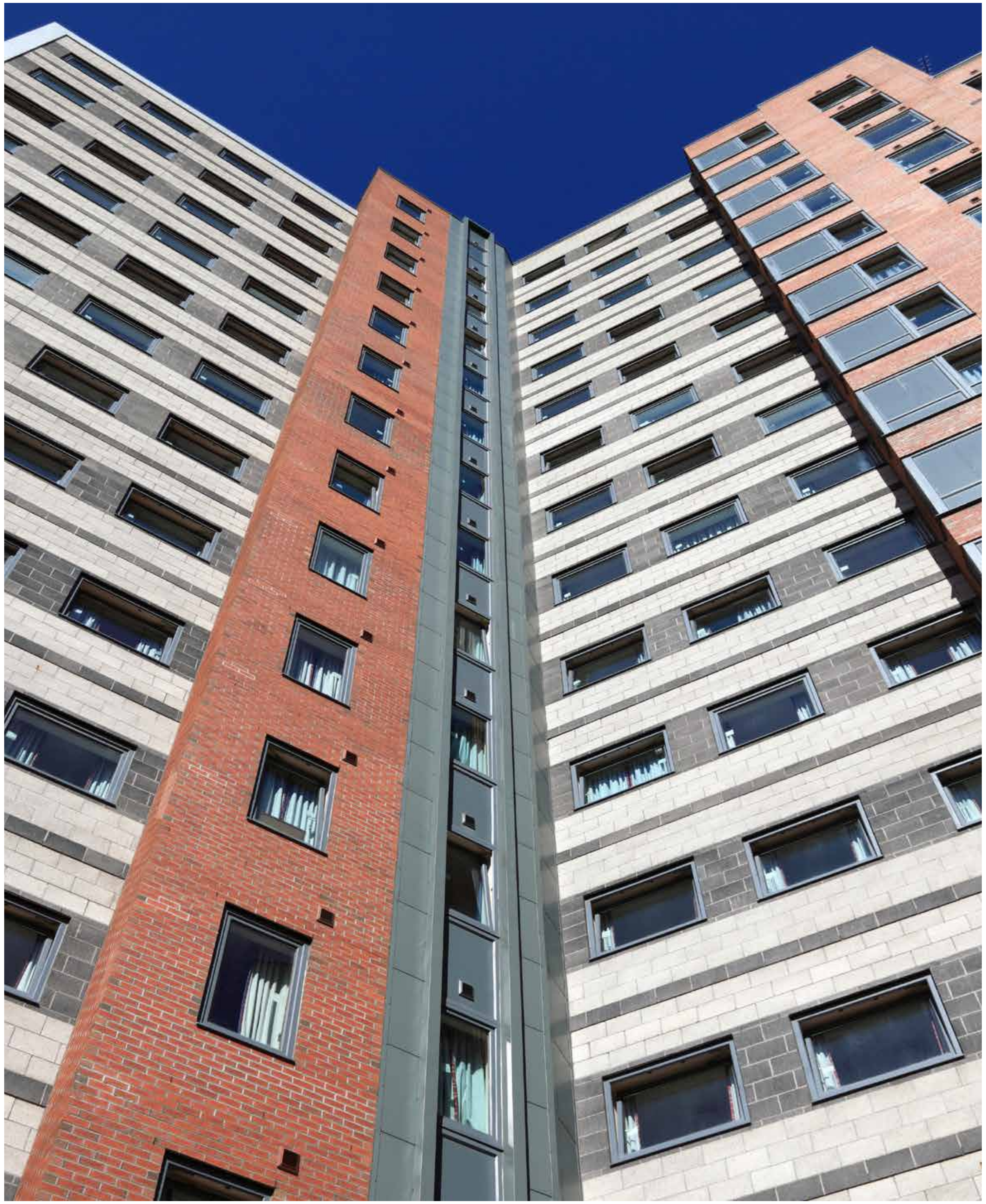
LGIM

Key messages

- Purpose Built Student Accommodation (PBSA) and Build to Rent (BTR) have been the main investible segments of UK residential, from the point of view of institutional investors, but new segments are emerging to meet occupier needs. These include Co-Living, Single Family Rental (SFR), Affordable Housing and Senior Living.
- These new segments are relatively immature with little institutional investor exposure and few liquid assets. Since 2020, transactions in these emerging sectors have accounted for less than 20% of UK residential investment volumes[1].
- We believe the fundamental underpins of strong household growth, an expensive home ownership market and rising urbanisation amid inelastic housing supply will support ongoing performance across residential segments.
- Over the long term, we expect returns, excluding yield shifts, across residential segments to range between 6% and 7% p.a. compared to an assumption for All Property of 5.1%.
- Two key risks are common: Affordability pressures limiting expected rental growth and political risk around residential regulations.
- This report examines the fundamental demand underpin for established and emerging residential sectors and concludes that the UK is well placed to provide investors with attractive risk-adjusted returns over the long term relative to both domestic commercial sectors and international residential markets. The fundamental underpin and regulatory environment in the UK relative to other global markets makes it an attractive opportunity for investors, in our view.

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

1. CBRE & Knight Frank as at Mar 2024



Introduction

Institutional exposure to the UK residential sector remains low but is growing quickly. In 2023, residential assets accounted for 9% of institutional real estate capital value, up from 3% in 2008[2]. This is likely to grow further; residential consistently tops investor preference surveys supporting the view of rapidly increased allocations. In the UK, allocation to residential remains significantly below markets like Germany, the US and the Netherlands with 12%, 29% and 59% of real estate capital value, respectively[3].

The cashflow profile of the sector is supporting conviction. Since 1987, residential assets recorded robust real rental growth of 1.1% p.a. compared with -0.3% for traditional commercial assets[4].

In our view, structural headwinds in the retail and office sectors have also encouraged institutional capital to rotate to alternative real estate assets. PMA forecast average residential rental growth of 3.6% p.a. in the UK over the next 5 years[5]. Across eight developed markets measured this is behind only the US and Germany.

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2. MSCI UK Annual Property Index as at Dec 2023
3. MSCI Global Annual Property Index as at Dec 2023
4. OECD Housing Prices, MSCI UK Property Index, ONS as at April 2024
5. PMA Global Multifamily Forecast Data as at April 2024

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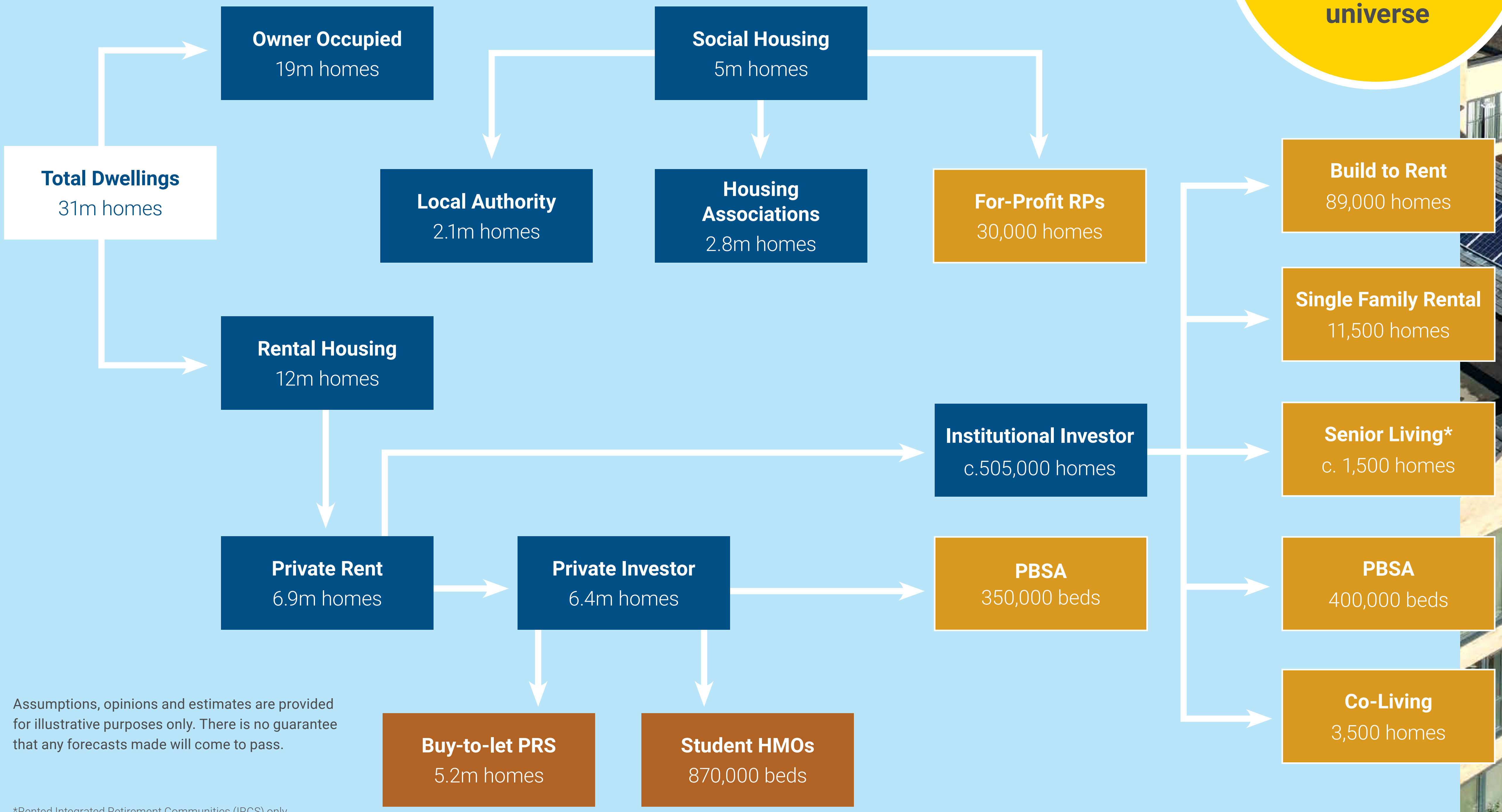
UK residential universe

Expected income growth over the long term is similar across residential segments with relative outperformance driven by higher net initial yields in emerging sectors. Nuances in overall return are likely to come from differing operational and regulatory risks that impact cashflow.

The UK residential universe structure

Largest sector in the built environment but little institutional exposure



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*Rented Integrated Retirement Communities (IRCS) only

Source: LGIM Research as at Q2 2023

2%

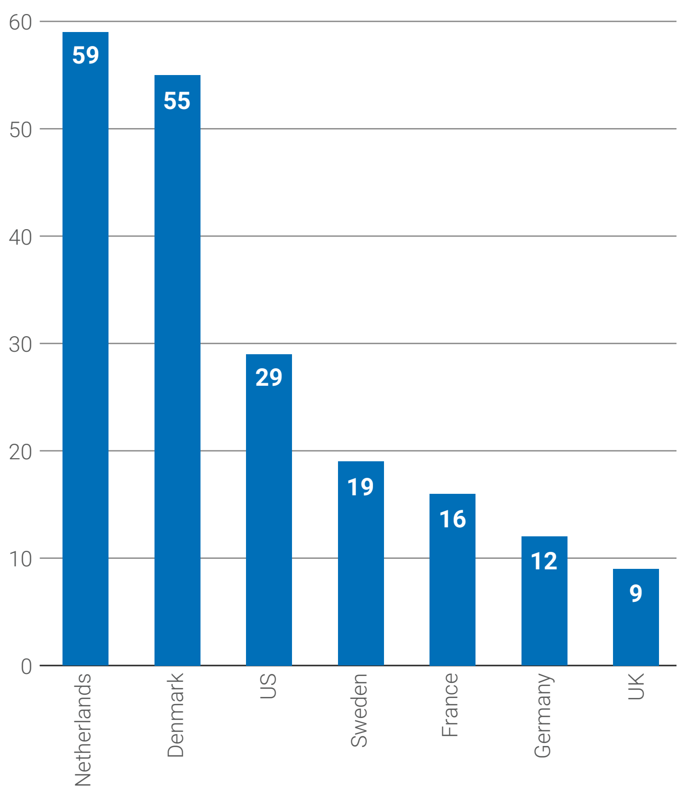
Institutional ownership of total UK residential universe

Why residential now?

For decades prior to the 2008 Global Financial Crisis, institutional real estate investors in the UK viewed the residential sector as a niche asset class, unlike their counterparts in other developed European real estate markets. It is likely that this was partly due to the high participation of private buy-to-let investors, given a combination of favourable tax treatment and specialist mortgage credit. Over the last decade, supported in part by increasing residential property risk premiums as UK gilts yield fell post 2008, to 9% in 2023[6]. Meanwhile, several of the advantages enjoyed by individual investors have been eroded.

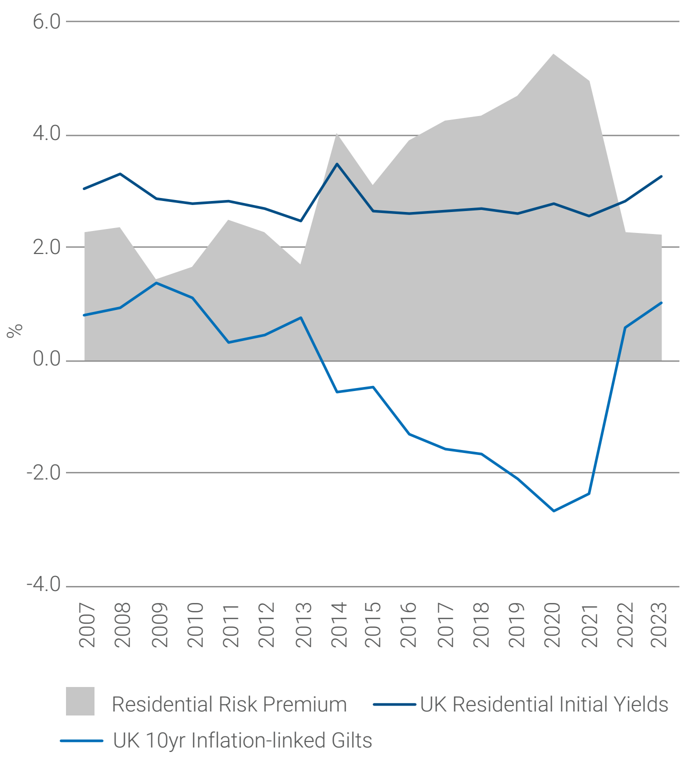
We believe allocations are likely to grow further as investors recognise the opportunities available. Residential asset classes have consistently topped investor sentiment surveys since Q2 2020, as measured by the PMA survey of investor preference[7].

% of Institutional RE Investment in Residential, 2023



Source: MSCI Global Annual Property Index as at April 2024

Residential Property Risk Premium



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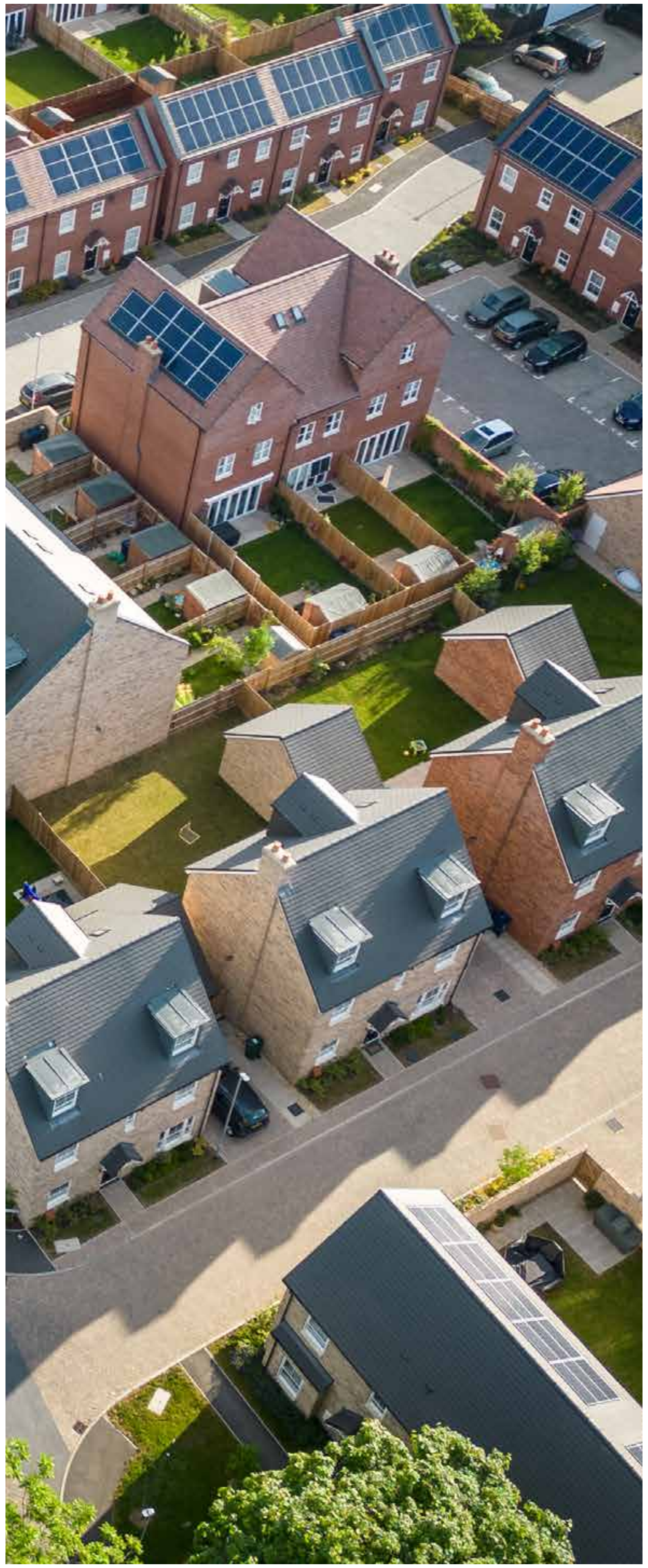
6. MSCI UK Annual Property Index as at December 2023
7. PMA Survey of Investor Preference as at Q1 2024
8. DLUHC, Housing Supply: Net Additional Dwellings as at May 2024
9. ONS House Price to Workplace-based earnings ratio as at March 2024
10. DLUHC English Housing Survey 2022/23
11. Nationwide House Price Index

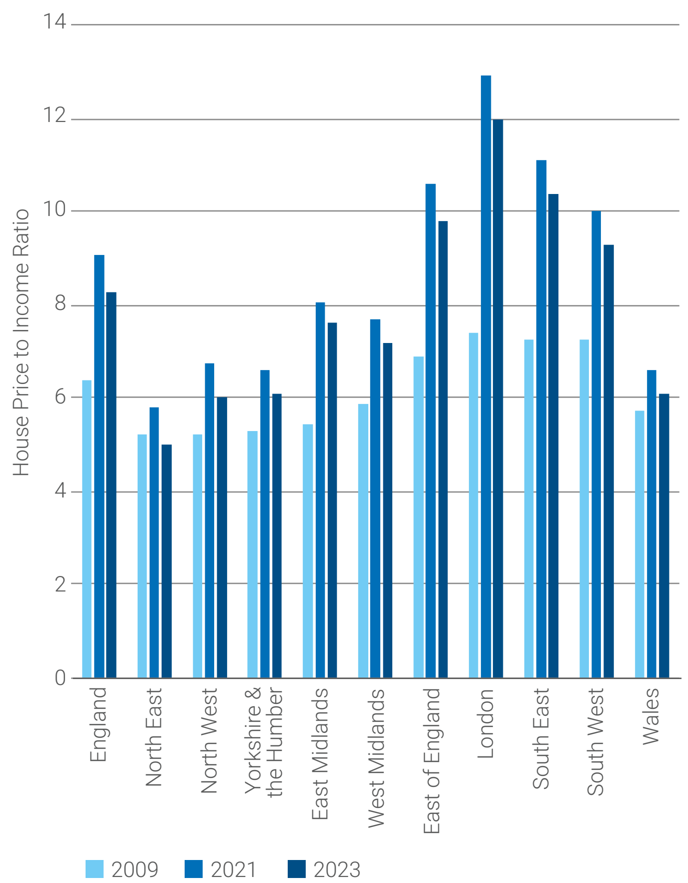


Fundamental to this performance is the structural undersupply of housing. The new UK Labour Government has set a target of 370,000 new homes p.a. to meet the historical undersupply and needs of a growing population. But, on average, only 230,000 new homes per year have been built[8].

This has contributed to rising house prices with the median house price-to-income ratio rising from 7.0 in 2008 to 8.3 in 2023[9]. As a result, households have spent longer in the privately rented sector. Indeed, the proportion of renters living in a rented home for three years or longer grew from 33% in 2009 to 50% in 2022[10].

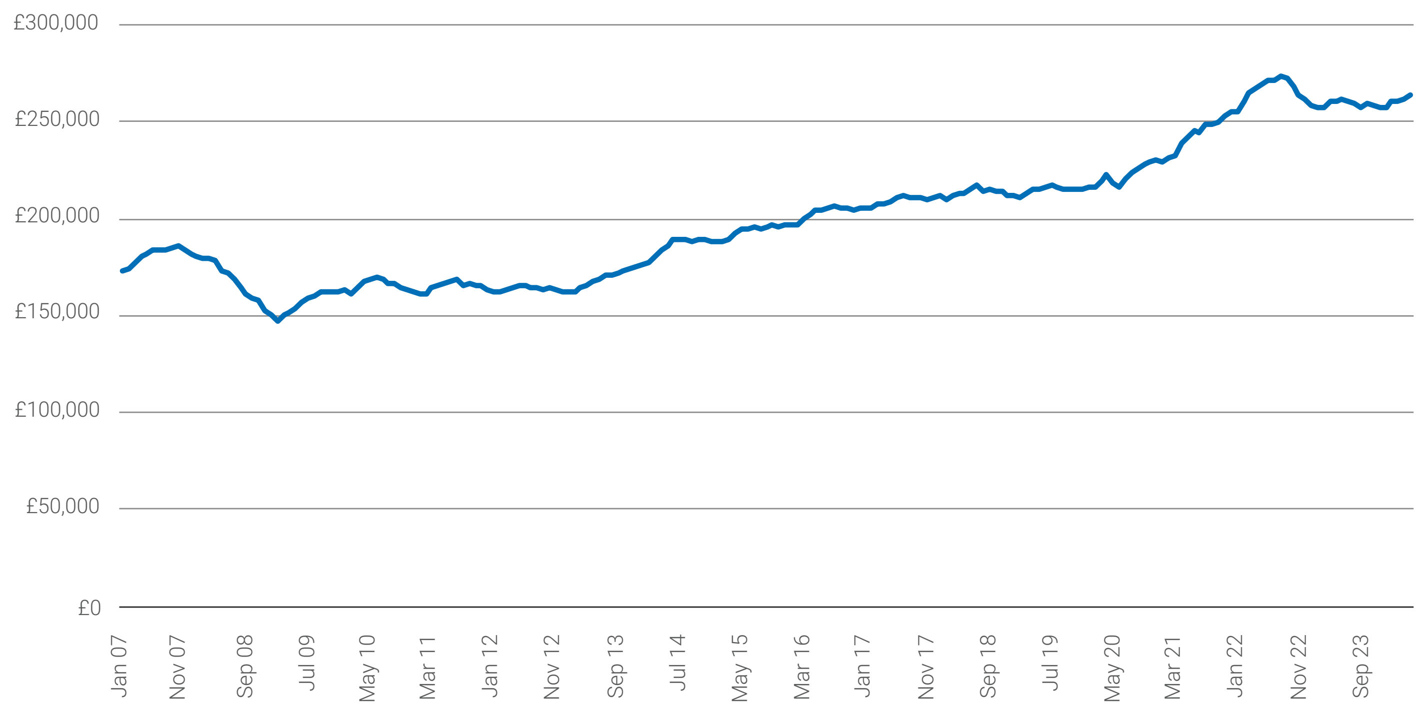
Affordability pressures are now entrenched in the owner occupier market with few signs of them easing enough to reverse the growing reliance on the rental market, in our view. Higher mortgage rates since 2022 led to house prices seeing their most notable decline since the GFC: since their peak in Q3 2022, house prices saw a peak to trough fall of -5.0% to the end of 2023. Despite this reduction, price-to-income ratios remained high across all regions and house prices have increased again; by 2.6% between December 2023 and May 2024[11].

Median Affordability Ratio, UK Regions



Source: ONS Ratio of House Price to Workplace Based Earnings as at Dec 2023

UK Average House Price



Source: Nationwide House Price Index as at May 2024

For investors, this environment has resulted in attractive performance. Since 1987, residential assets recorded robust rental growth of 1.1% p.a. in real terms, compared with -0.3% for traditional commercial assets[12]. The sector has also recorded higher occupancy than the commercial sector; occupancy rates averaged 97% over the long term, compared with 92% for commercial assets[13]. Additionally, sector returns have historically been less correlated to other commercial assets, providing a degree of diversification from the wider real estate cycle.

Residential Returns: Correlation to Commercial Real Estate Sectors (2001 – 2023)[14]

	Retail	Office	Industrial	Residential
Retail	1.00	0.78	0.66	0.68
Office	0.78	1.00	0.74	0.60
Industrial	0.66	0.74	1.00	0.32
Residential	0.68	0.60	0.32	1.00

Source: MSCI Annual Digest, LGIM Real Assets calculations

The retail sector has faced significant headwinds from the growth of e-commerce and the office sector now faces its own headwinds with the adoption of remote and hybrid working models and structurally higher capital expenditure requirements. It's our view that these structural headwinds have encouraged investors to reduce their allocations to those sectors and rotate to alternative real estate.

12. OECD Housing Prices, MSCI UK Property Index, ONS as at April 2024
13. MSCI UK Annual Property Index as at December 2023
14. PMA as at April 2024

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What is the UK residential living sector?

The challenges resulting from the UK's housing demand and supply imbalance percolate through all housing models, across all different age groups and at all different price points. We believe it is unlikely that simply building one type of housing will solve these challenges. The investible UK residential universe is now expanding to introduce the following segments:

- **Purpose Built Student Accommodation (PBSA)** provides homes for domestic and international students supporting various higher education institutions in the UK.
- **Build to Rent (BTR)** caters to predominantly young urban professionals[15] who value flexibility and community living in locations close to major employment hubs.
- **Co-Living** caters to predominantly young urban professionals. Homes are generally studio bedroom units with a large amount of shared communal spaces. It is typically a value proposition to BTR, with the trade off being small personal units.
- **Single Family Rental (SFR)** caters predominantly to middle-aged households and families in suburban locations.
- **For-Profit Affordable Housing** addresses the needs of lower-income households requiring quality housing at a reasonable cost. This is a government regulated sector with strict policies governing rents and lease structures. This spans the Social and Affordable Rented tenures, where rents are at least 20% below local market rents, and Shared Ownership tenure, where occupiers own a proportion of the home (typically between 25% - 75%) and pay rent on the remainder. While dominated by non-profit housing associations, institutional can access the sector through the growing number of For-Profit Registered Providers.
- **Senior Living** offers tailored living solutions for those aged 65+, typically looking to downsize, with accessibility and healthcare services as priorities.

15. While the target demographic is younger households, many different age groups also occupy the units

The PBSA and BTR segments are the most recognised areas for institutional investment with other segments relatively niche. Since 2020, BTR and PBSA transactions have accounted for 82% of transaction volumes in the residential sector[16].

The following details each segment and the practical means to access them:

Investment Segment Overview

	PBSA	Co-Living	Urban BTR	Single Family Rental	For Profit Affordable Housing	Rented Senior Living
Target Market	Full-time students (domestic & international)	Individuals in the private rented sector	Households in the private rented sector	Households in the private rented sector	Lower/middle-income households	Retiree households
Target Age Group	18 - 21	18 – 35	18 – 35	35 – 55	18+	65+
Current Market Size (# of homes/beds)	400,000 beds	< 3,500 homes	89,000 homes	11,500 homes	30,000 homes	1,500 homes
Typical Occupier Length of Residence	10 – 11 months	<1 year	1 – 2 years	3 – 5 years	10+ years	2 – 3 years
Institutional Share of Total Market	9%	<1%	1%	<1%	<1%	<1%
Sector Maturity[17] (1: Low; 5: High)	4	1	2	1	1	1

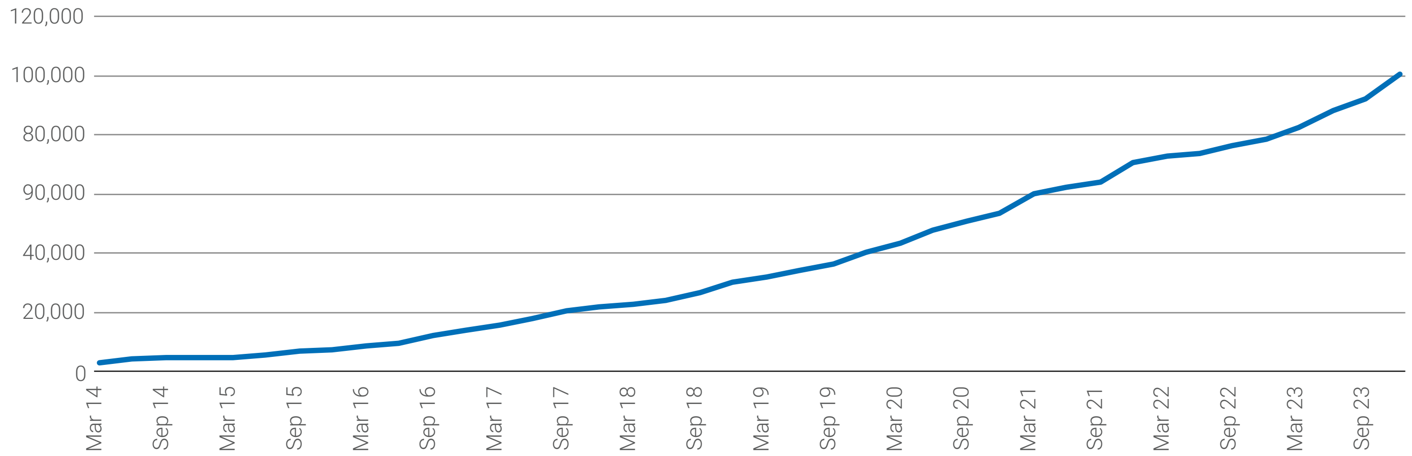
Sources: LGIM Research, DLUHC English Housing Survey, British Property Federation, Knight Frank, Cushman & Wakefield as at Q2 2024

Investment Accessibility of Segment Transaction Market

Route to Market	PBSA	Co-Living	Urban BTR	Single Family Rental	Affordable Housing	Senior Living
Stabilised Assets	Green	Red	Amber	Amber	Amber	Red
Sale & Leaseback	Amber	Red	Red	Red	Green	Red
Forward Fund	Amber	Amber	Green	Green	Green	Amber
Direct Development	Amber	Amber	Green	Green	Green	Green

Red, amber, green indicate difficulty of sourcing opportunities from the point of view of institutional investors as at Q2 2024

BTR Complete Units (Operational): UK



Source British Property Federation as at Feb 2024

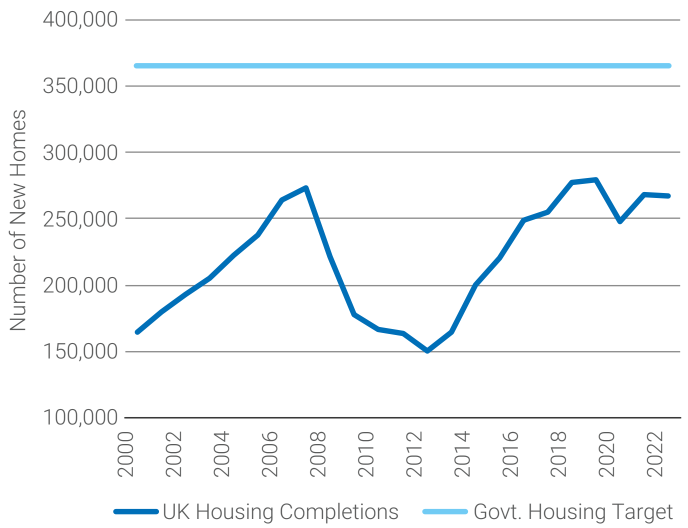
17. LGIM Research Qualitative judgement based on existing size of the market and transaction volumes

What is the investment case for the broad residential sector?

Across all residential segments the fundamental case is the need for housing. Strong population growth, coupled with shrinking average household size, and an expensive home ownership market have all driven demand for rental product. Meanwhile, below-target housebuilding, driven by a rigid planning system with lengthy planning delays, has resulted in inelastic housing supply.

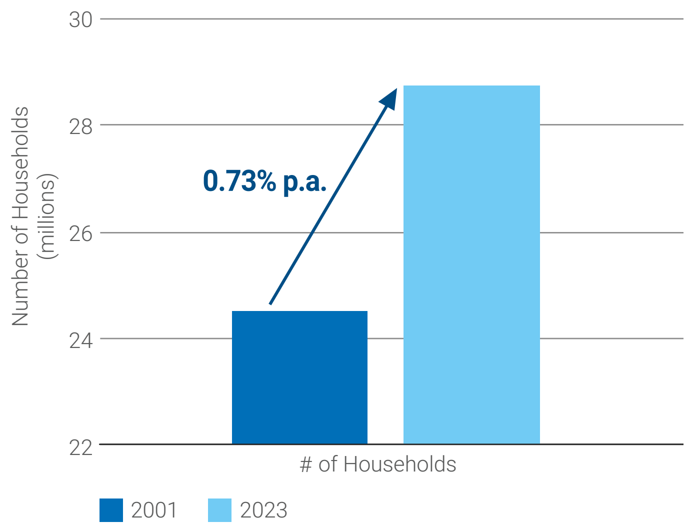
Together, this supported rental growth with positive financial outcomes for investors in residential assets, alongside clear social benefits. We believe that these trends are thematic, rather than cyclical, and long term.

UK New Housing Supply



Source: UK DLUHC Net Additional Dwellings as at Apr 2024

UK Household Growth

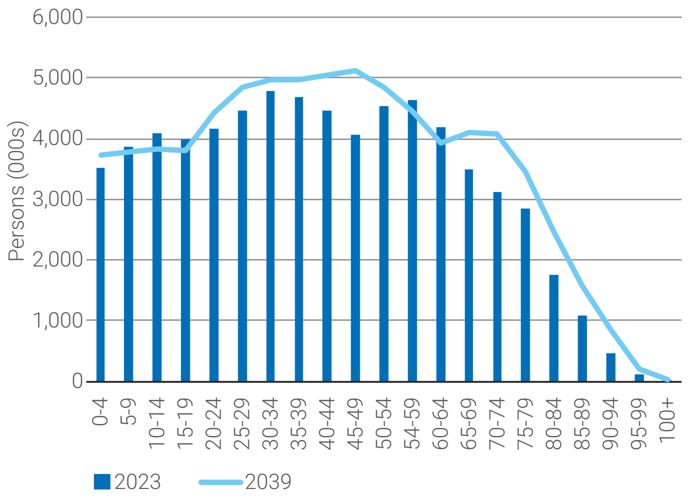


Source: ONS Household Estimates as Apr 2024

Several themes are supportive across all segments:

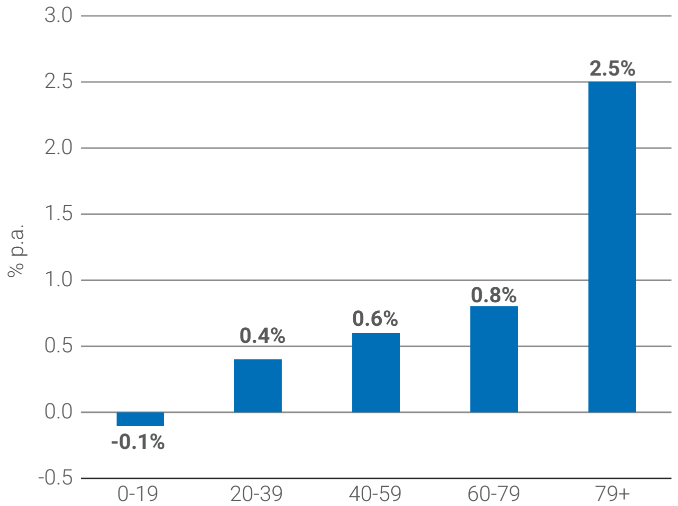
- **Population growth:** The number of households in the UK is projected to grow by 0.6% p.a. to 2039[18]. While the pace of UK population growth is projected to slow, the wider trend of smaller average household sizes is expected to continue. Household sizes have been shrinking due to higher rates of single-person households, young people marrying at older ages, more divorcees and increased life expectancy. Additionally, analysis suggests stronger growth in middle aged and 65+-year-old cohorts which we believe will shape the nature of the housing required: The 0-19 and 20-39 age cohorts are projected to grow by -0.1% and 0.4% p.a., respectively. This compares to projected growth for the 40-59 and 60-79 age cohorts of 0.6% and 0.8% p.a., respectively.

UK Population Projections



Source: ONS population estimates and 22021-based projections as at April 2024

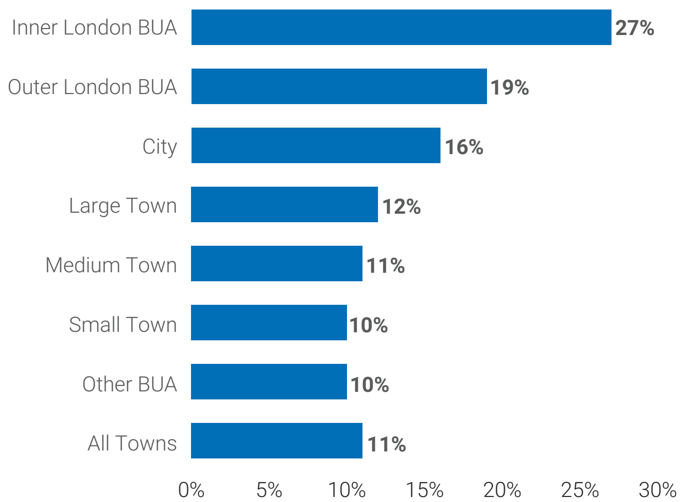
Population Projection % p.a. by age cohort (2023 - 2039)



Source: ONS 2021-based principal population projections as at Apr 2024

- **Urbanisation:** More of the UK population are moving to major cities, growing the demand for housing in these locations. City populations have increased 16% compared to 11% for towns since 2001[19].

Percentage Population growth (2001 - 2021)



Source: ONS Understanding Towns in England and Wales: Population & Demographic Analysis 2021

18. ONS 2018-based population projections
19. Population estimates by output areas

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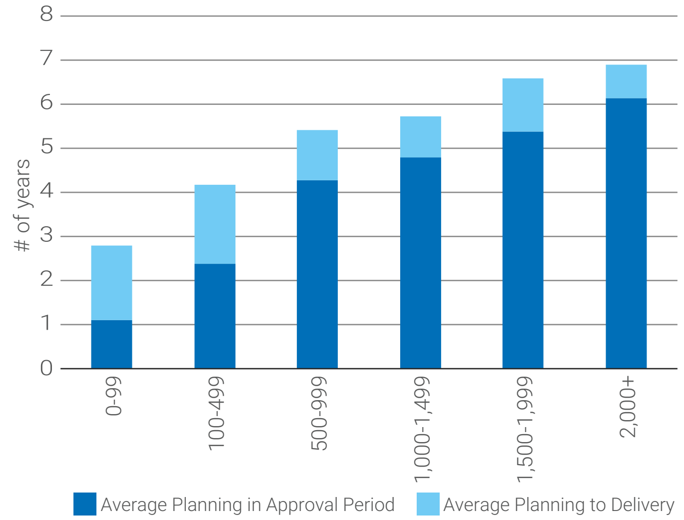
- **Supply constraints:** Small private landlords still make up the bulk of the private rented sector[20] but are reducing their exposure following changes to government taxation policy and the higher interest rate environment. Available homes for rent in the UK are estimated to be 28% lower than pre-pandemic levels[21]. Additionally, the historic relative rigidity of the UK's planning policy gives low confidence in faster construction rates. The announced reforms by the Labour Government may improve this somewhat but the magnitude of the impact remains uncertain. A more challenging development finance environment will further limit levels of construction in the short term.

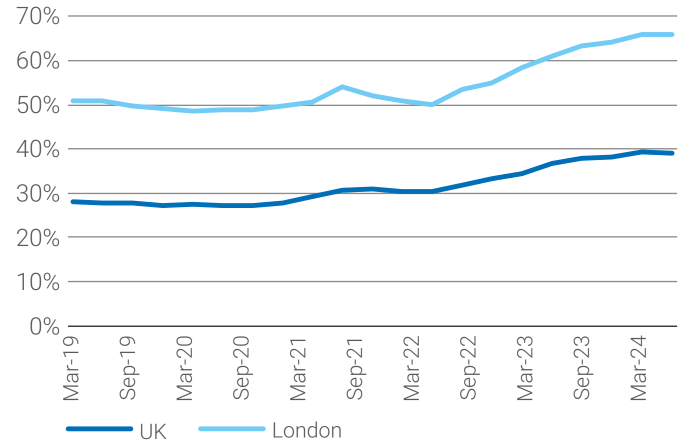
Average planning approval period and delivery of first unit by site size



Source: Lichfields – Start to Finish: How Quickly Do Large-Scale Housing Sites Delivery 2016

- **Barriers to home ownership:** Average first-time buyer home prices are now five times higher than average incomes (rising to 8.5 times in London)[22]. This, and a more expensive mortgage rate environment, will limit moves into home ownership, particularly in major cities.

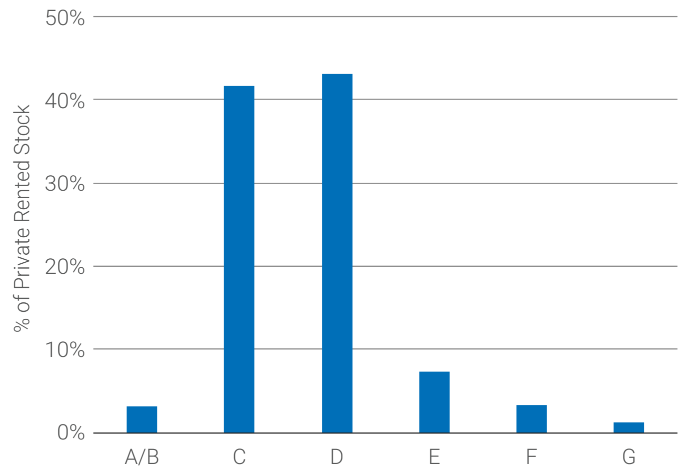
First-Time Buyer Mortgage Payment as % of take home pay



Source: Nationwide House Price Index as at May 2024

- **Environmental considerations:** The residential sector contributes 14% of the UK's carbon emissions[23]. As much of the UK's existing rental housing stock is old (46% is 80+ years old) and energy inefficient (55% has an EPC of D or lower)[24], the need to align to a net-zero future will necessitate improving energy performance across the sector and significant retrofitting.

EPC Rating Private Rented Stock as at 2022



Source: DLUHC English Housing Survey 2022/23

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20. See UK Residential Landscape on page 2 of this report
21. Zoopla/Hometrack UK Rental Market Report March 2024
22. Nationwide House Price Index as at May 2024
23. Department for Business, Energy & Industrial Strategy as at Mar 2022
24. DLUHC English Housing Survey 2022/23

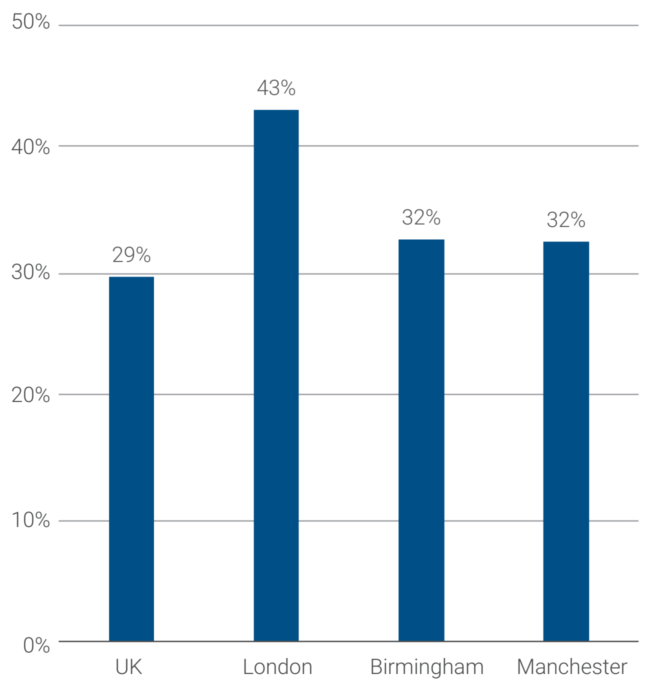
What are the key risks?

Most residential segments have two key risks in common: Affordability pressures limiting potential rental growth and political risk around rent regulations.

In some locations, particularly major cities and economic hubs, rents have grown faster than household incomes, straining finances. Levels of household income must act as a ceiling for how much rents can grow. An accepted 'rule of thumb' is that, on average, a household should not spend more than a third of its income on housing costs. Many major cities are approaching this threshold, with some larger cities above it. In London for instance, median rents account for 43% of household income[25].

It is prudent to assume that continued high levels of rental growth in the short term may act as a limit to rental growth in the longer term without notable increases in wage growth.

Median Rent as % of median household income (2 full-time workers) - 2023



Source: LGIM Research, Realyse & ONS as at Apr 2024

This links to second major risk; political and regulatory risk. The relative high cost of housing across the UK is increasing political rhetoric around further regulations in the rental sector, including the need for some form of rent control. Changes to regulation can impact the appeal of a sector. The increasing exit of amateur landlords from the buy-to-let sector following more onerous tax treatment is testament to that. The election of a more politically left-leaning Labour Government, all else equal, heightens these risks. We are, however, reassured by the Government's early rhetoric that acknowledged the benefits of the private sector and the role it has to play in increasing housing supply.

Saying this, regulation does not necessarily have to be harmful to performance. The German residential market, for instance, is highly regulated but still delivered total returns of 8.3% p.a. over the last 10 years, compared with 6.7% p.a. at an all-property level[26]. That said, there remains uncertainty. The impact will be highly dependent on the nature of the regulation implemented; and we cannot say what German performance would have been unencumbered by regulation.

25. PMA European Multifamily Service as at April 2024
26. MSCI Germany Annual Property Index as at Dec 2023

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What are the investment characteristics of the individual UK residential segments? Based on LGIM research as at September 2024

	PBSA	Co-Living	Urban BTR	Single Family Rental	Affordable Housing	Senior Living Rental
Broad Investment Case	Forecast growth in the UK's 18-year-old population and increased higher education participation rates The UK's attractiveness to international students (non-EU) and likely increased international participation rates as emerging economies develop Historically counter-cyclical sector total returns Mature segment with good liquidity Stable income, particularly through nomination agreements with universities	Imbalance in UK housing demand and supply Changing household structures with an increased proportion of single person households Typically, a value proposition for residents with average rents lower than Urban BTR schemes Segment immaturity may offer a yield premium to other residential segments	Imbalance in UK housing demand and supply Continued population growth among target age cohorts Barriers to home ownership Continued urbanisation and attraction to living close to major employment hubs Modernisation of UK rental stock	Imbalance in UK housing demand and supply Middle-aged cohorts (35 – 55-year-olds) forecast to see greatest % growth through the medium term Existing barriers to home ownership, particularly starter homes, as millennial renter generation enters a new life stage typically associated with houses than apartments Less operationally intensity compared to Urban BTR resulting in a lower gross to net	Imbalance in UK housing demand and supply 1.3 million households on local authority waiting lists 145k new affordable homes required p.a. but delivering 45k p.a. Expected new supply limited as traditional housing associations, who are key drivers of supply, face notable financial constraint from high debt and maintenance costs Limited government grant funding acts as a further barrier for required development of new affordable housing Clear social impact	Fundamentally supportive – 30% increase in >65-year-olds in the UK by 2039 Target market among the wealthiest cohort Current sector penetration weak in the UK relative to other developed markets. 6.5% of 65+-year-olds in the US live in retirement communities vs <1% in the UK Limited fit for purpose senior housing built following decades of undersupply – particularly of a rental tenure Growing government support for more institutional investment in this sector
Income/ Cashflow Profile	Implicit inflation-linked income Explicit inflation linkage with nominations agreement High occupier churn so rents mark to market frequently	Implicit inflation-linked income High occupier churn so rents mark to market frequently	Implicit inflation-linked income Occupier churn means rents mark to market frequently	Long-term inflation matching income More rooted occupier demography (families) likely to mean less churn in occupancy	Explicit inflation-linked income - Leases include annual rent increases of CPI/ RPI + xx% Rate of rental uplift set by central Government	Explicit inflation-linked income. Leases typically include annual rent increases of RPI + xx%
Key Risks	Occupational demand linked to long-term performance and quality of individual universities proximate to assets Political risk. Changes to international student immigration policy will adversely impact occupational demand but this is likely to be very location specific. Risks around rent controls Risks of affordability pressures limiting expected rental growth Operationally intensive	Flexibility of leases and occupier churn potentially disruptive to cashflow Operationally intensive Planning & development risks – inconsistent planning requirement across different local authorities Political and regulatory risk particularly surrounding rent controls Lack of track record or proven investment case	Wider market affordability issues may limit future rental growth Political and regulatory risk particularly surrounding rent controls Operationally intensive	Wider market affordability issues may limit future rental growth Political and regulatory risk particularly surrounding rent controls	Political risk associated with government setting future rental uplift Reputational risk associated with lower income and key worker household occupier base Liquidity risk as limited pool of asset buyers at exit Operationally intensive	Emerging sector and relatively niche product. Increased market penetration not assured Model's long-term sustainability remains unproven Heightened reputational risk given age cohort Operationally intensive

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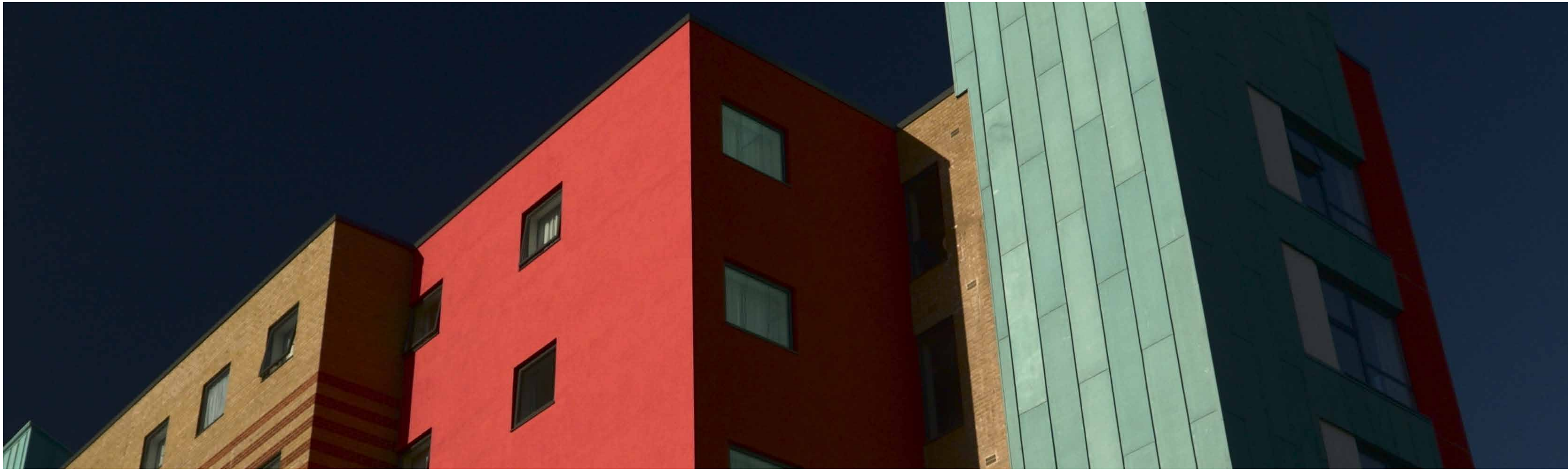

Structural megatrends and their impact on the UK residential universe

Legal & General private markets has developed a long-term structural framework to guide investment strategy around four megatrends that we see reshaping the global economy and the investment landscape. These megatrends are:

Demographics
The impact of the developed economics population structure changing, from the post-war baby boom of the past to a future of an aging population and shrinking labour force.

Deglobalisation
The impact of weakening global integration of trade, capital flows, people and cooperation.

Decarbonisation
The challenges for global economies in reducing carbon emissions across global markets to become a net-zero emissions world by 2050.

Digitalisation
The impact of new digital technologies, big data and AI across society and many industries.

Real estate sectors that embrace these megatrends are likely to see higher risk-adjusted returns over the long term, in our view. The table below indicates how residential segments may be positioned:

	Demographics	Decarbonisation	Deglobalisation	Digitalisation
PBSA	✓	✓		
Co-Living	✓	✓	✓	
BTR	✓	✓	✓	
Single Family Housing	✓	✓	✓	
Affordable Housing	✓	✓	✓	
Senior Living	✓	✓	✓	

Demographics: We believe changing populations will continue to support the demand for housing. But the nature of housing provided is likely to be of a different variety than in the past to cater to the needs of a more diverse occupational base.

Decarbonisation: With residential accounting for a notable amount of carbon emissions, the need to develop new homes, and retrofit older homes, to support the net-zero transition will be important. We believe that investors who are pro-active with net-zero buildings can future proof assets and seek to generate positive long-term outcomes.

Deglobalisation: A more decoupled global economy with potential trade frictions suggests higher inflation, all else equal. UK residential assets have historically seen rents grow ahead of inflation, and, in some lease structures, explicitly link inflation to annual rent reviews. However, the PBSA sector may see some adverse effects from a deglobalised world with more friction around migration. The sector's performance is partially dependent on the number of international students; 77% of international students live in private PBSA or rented accommodation[27].

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27. Migration Advisory Committee/HESA 2019/20

What are expected long-term returns for residential segments?

To construct expected long-term returns for real estate sectors, we reference three fundamental factors. Current net initial yields[28] are used to estimate the level of income generated. Expectations for long-term rental growth and depreciation are then appended. This provides a view of potential returns excluding any long-term yield shift.

Long-term rental growth

To determine long-term rental growth assumptions, we typically rely on historical rental data for established real estate sectors. However, given the lack of robust historical residential rents and the relative immaturity of the new segments, this approach is not feasible. We take the view that residential rents over the long term can only grow in line with per capita nominal incomes. We assume that CPI inflation grows at 2% p.a. over the long term, in line with the Bank of England's target. The BoE also estimates long-term productivity growth of 0.75% p.a.

Combined, these give an anchor for per capita income growth at 2.75%. We scale this up to adjust for embedded demand and supply tension in the UK market to arrive at a nominal 3%.

We then make analytical judgements on individual segments to adjust for target demography, lease structures and churn unique to the occupier base.

BTR, PBSA & Co-Living: Expected rental growth should mirror the fundamental nominal rent growth assumption of 3%. Given the short lease length and occupier churn, rents should readily revert to market rental value. There is sufficient overlap across these segments to rationalise setting the same growth rate. For example, PBSA rents cannot grow sustainably higher than BTR for the long term because the products are somewhat interchangeable with PBSA occupiers straddling both segments.

Affordable Housing: Expected nominal rental growth is also assumed to be 3% p.a. but for a different reason. This time it is in line with the UK Government's current rent settlement for affordable rent, that rents can be increased annually by CPI + 1%. For Shared Ownership, existing leases are contracted with an annual rent increase of RPI + 0.5%. Going forward, new Government regulation is for all new leases to see rent increases of CPI + 1%, in line with the affordable rent approach. However, given that the majority of leases in the sector remain at RPI + 0.5%, for our long-term assumptions we have assumed this rate. We assume the historic wedge between CPI & RPI of 70bps holds so our long-term RPI assumption is 2.7%, plus the additional 0.5% brings us to rent growth of 3.2%.

Single Family Rental: Given the occupier base is likely to remain in place for longer, with longer-term leases associated with the sector, we make the judgement that a lack of mark to market on rents will drive slightly softer rental growth than higher churn segments, together with some competition from housebuilders. This pushes us to adopt our fundamental per capita nominal income growth assumption and we assume long-term nominal rental growth of 2.75% p.a.

Senior Living: Attracts older and wealthier households. Lease structures typically include an RPI + x% rent increase. We believe this necessitates higher longer-term rental growth under this lease structure. The government intends to phase out RPI as a measure of inflation and replace it with CPIH over the long term. Long-term CPIH is estimated to be 2.9% p.a.[29] We therefore adapt our growth assumption for this sector to incorporate CPIH and the typical minimum uplift, incorporated by existing operators in the sector, of 0.5%. We project long-term nominal rental growth of 3.2%.

Depreciation

Levels of obsolescence in UK residential are low; 75% of stock was built prior to 1980 and is still in use[30]. This suggests lower obsolescence relative to other real estate sectors. There will be depreciation through functional factors (internal specification and configuration), however.

For other commercial sectors, we incorporate a higher capex adjustment to reflect our views on the required additional cost to transition buildings to a net-zero future. However, for emerging residential assets we assume no such adjustment is required[31].

28. We take current yields from transactional market yields provided by real estate brokers such as Knight Frank, CBRE and JLL.
29. ONS Inflation and Price Indices as at May 2024
30. DLUHC English Housing Survey 2022/23
31. Data from the ONS shows that homes built after 2011 had a median energy efficiency score of B. ONS Energy Efficiency of Housing in England and Wales 2023

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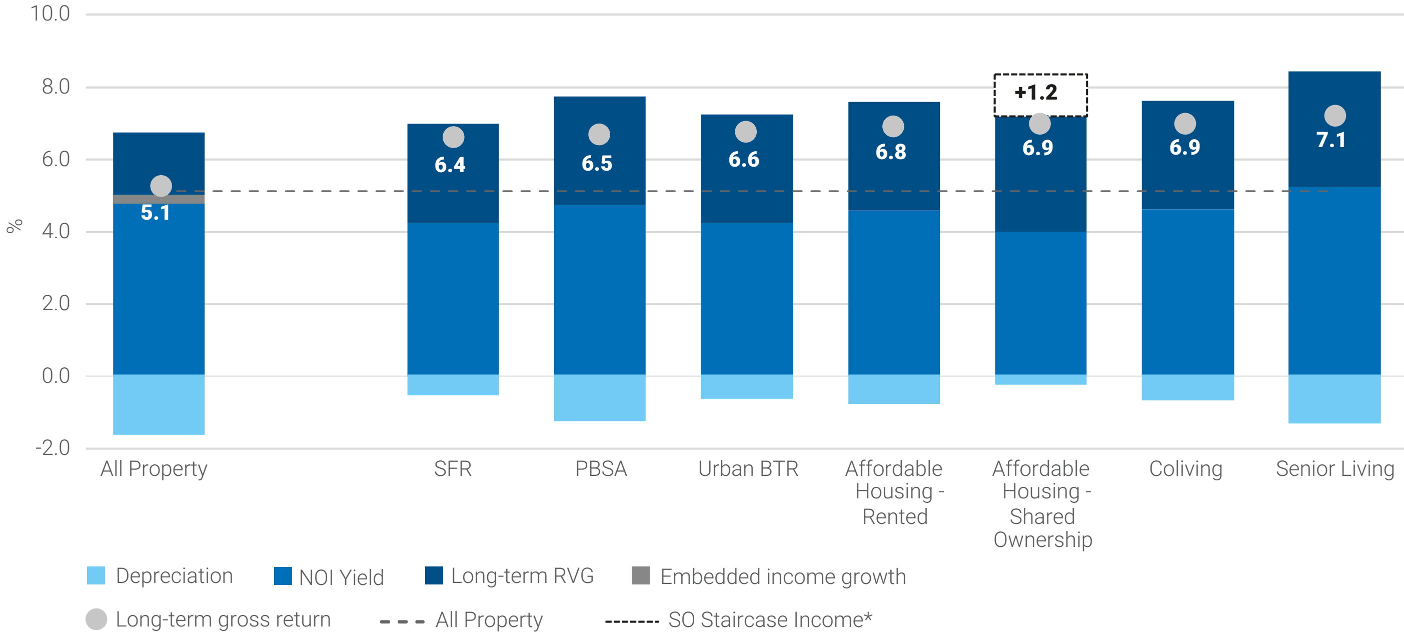
LGIM Long-Term Real Estate Returns (ex yield shift)



Source: LGIM Research as at Sep 2024
* The shared ownership sector also benefits from the additional income received as tenants purchase additional shares of the unowned portion of their home. This is known as staircasing. On average, tenants purchase an additional 2.4% of their home p.a.

Based on the above approach, we expect to see all residential segments outperform the all-property average over the long term with returns ranging from 6.4% for SFR sector to 7.1% p.a. for Senior Living, excluding any yield shift. The unweighted average of 6.8% compares to the all-property average of 5.1%.

Relative performance is predominantly driven by higher starting yields for the more immature sectors.

We would expect the SFH and Affordable Housing segments to see lower income volatility given longer lease lengths in the former and the regulated nature of the latter; dependent of course on government policy remaining unchanged.

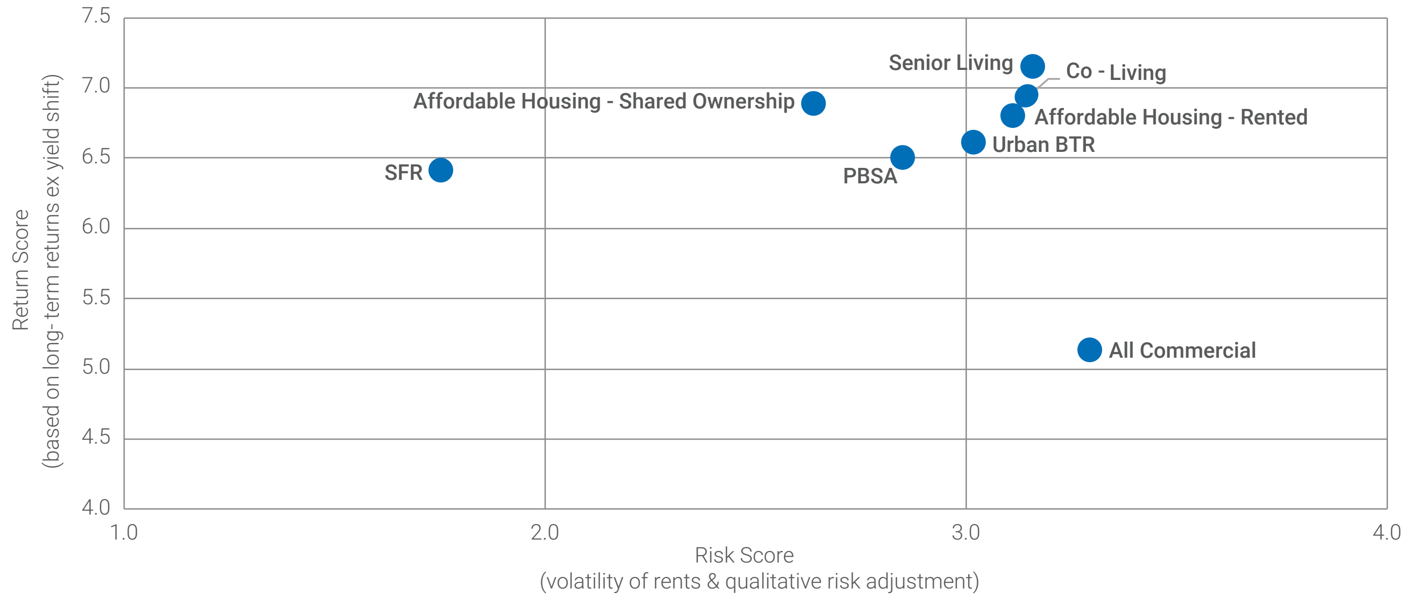
Typically, investors identify risk as the volatility of long-term returns (calculated as a standard deviation) but in lieu of robust data, particularly for emerging segments. We therefore use the volatility of estimated rental growth. For emerging segments, synthetic estimates of a historic rental growth based on sector lease structures were created[32]. We then make an additional qualitative adjustment to incorporate our views on additional risks that may impact long-term value[33].

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

32. For Co-Living we have assumed rental growth mirrors that of the market let units in the wider private rented sector; for single family housing, we created a synthetic rental growth estimate based on a weighted average of market rental growth (20%) and CPI inflation linked rental growth (80%) as per market evidence from PRS REIT which has a large exposure to single family housing; for senior living, we created a synthetic rental growth estimate based on a weighted average of market rental growth (50%) and RPI inflation linked rental growth (50%) as per market evidence from the US Senior Living sector
33. These include rent regulation risk, immigration policy risk, planning policy risk, reputational risk, penetration risk (to account for low uptake of senior living by the UK population)

The chart below illustrates where each residential segment sits across this risk-return spectrum. On this basis, we expect the SFH, Senior Living and Shared Ownership sectors to provide the highest compensation for additional risk.

Residential Living Segments Risk-Return Matrix



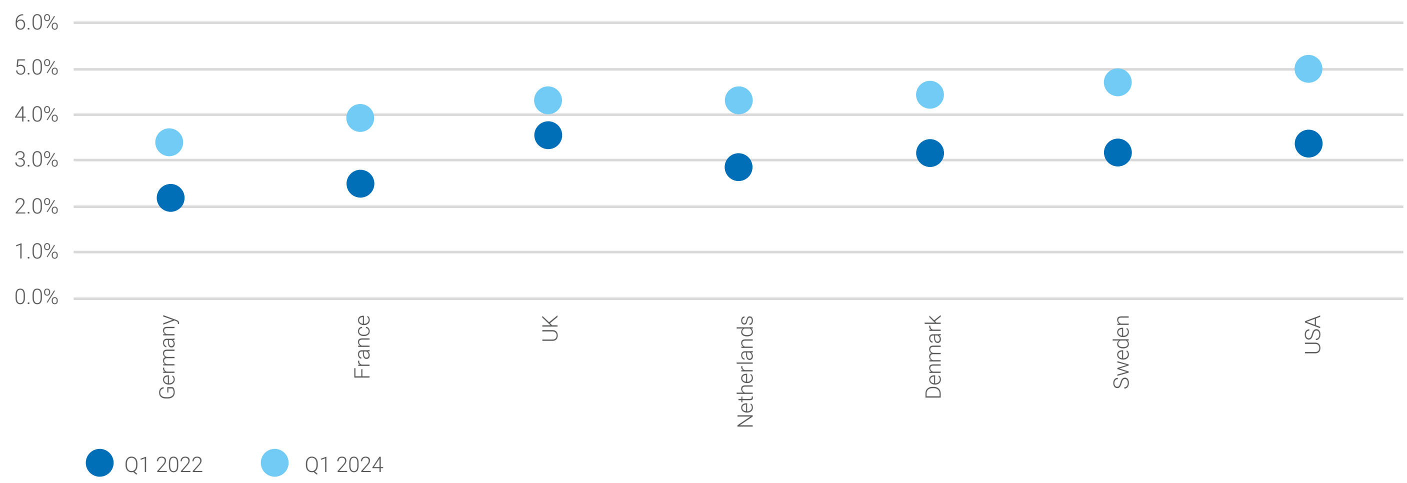
Source: LGIM Research as at Sep 2024. **Past performance is not a guide to the future. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.**

How does the UK compare?

The relative immaturity of institutional exposure to UK residential stands out. It has enabled the UK to offer attractive yields relative to European and US markets.

Since Q2 2022, global residential yields have softened as the interest rate environment changed. While UK yields softened too, they proved more resilient than markets in Europe and the US. Residential yields moved out by 120 basis points and 160 basis points in Europe and US, respectively. The UK, in contrast, saw yields move out by 70 basis points[34].

Prime Multifamily Yields



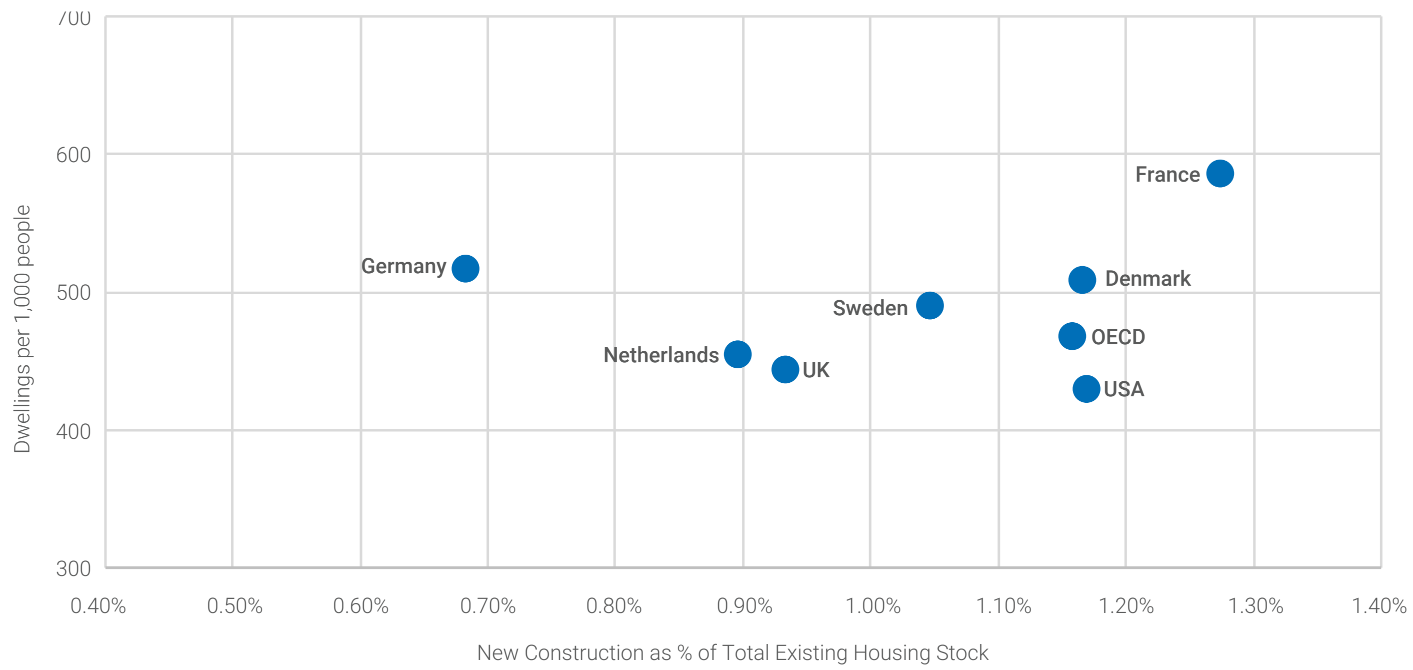
Source: CBRE as at March 2024

34. CBRE as at April 2024

While the differentials between UK and other international yields have closed, the UK remains attractive in our view due to the structural support from a tightly regulated supply environment coupled with less regulated leasing structure.

The UK also typically sees some of the lowest proportion of available housing compared to prevailing population growth. We believe that this should continue to support rental tension.

Housing Supply: International Markets



Source: OECD Statistics as at Apr 2024

PMA forecast average rental growth of 3.6% p.a. in the UK over the next 5 years with only the US (3.8% p.a.) and Germany (3.2%) expected to outperform out of the eight markets measured[35].

Additionally, many markets in Europe and the US have more onerous regulations around tenant rights and the ability to grow rents at market rates. This is not the case in the UK, making it a favourable destination for investment. However, we do note that tighter residential regulation is increasingly on the political agenda as affordability pressures have risen since the pandemic.

The table below provides a high-level overview of the regulatory position across key markets[36].

	Rent regulation	Landlord friendly lease structures	Future legislative risk
UK	Green	Green	Amber
Germany	Red	Red	Amber
Netherlands	Red	Red	Amber
Sweden	Red	Red	Amber
France	Amber	Red	Amber
Denmark	Amber	Amber	Green
US	Amber	Amber	Amber

Source: LGIM Research (Red, amber, green indicate severity of regulation in each country)

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

35. PMA Global Multifamily Forecasts as at April 2024
36. Rent regulation refers to existing legislation in place which to do not allow for rents to be freely set. Landlord friendly lease structures refer to flexibility of lease lengths and the ability for landlords to terminate leases. Future legislative risk reflects a qualitative judgement on the risk of future regulatory changes given current political rhetoric.

Conclusion

Residential assets have historically been a niche part of the UK real estate investment universe but are now becoming mainstream. There are fundamental occupier demand drivers, while structural changes discouraging investment into core traditional commercial asset classes provides an additional tailwind.

Growing investor comfort with the relatively more mature sectors of PBSA and BTR, and more nuanced views on the type of housing supply required to meet the UK's housing challenges, is driving the emergence of new segments.

The scope of the broad residential universe has therefore widened to include new product types beyond BTR and PBSA targeted at different age groups and income levels. Institutional residential investment now encompasses four additional segments, in our view: Co-Living, SFH, Affordable Housing and Senior Living.

These segments display the potential to deliver attractive cashflows at levels similar to those that attracted investors to more mature segments like PBSA and BTR in the first place. Nuances around explicit and implicit inflation linkage, income volatility and the social impact generated offer options to investors looking to broaden their exposure to the sector across risk styles.

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Key risks

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

It should be noted that diversification is no guarantee against a loss in a declining market. Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

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