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Residential

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Why investors keep coming back

KEYNOTE INTERVIEW

Living through volatility

Underpinned by demographic tailwinds, rental models across the living sector can provide stable, long-term returns as tenants progress through different life stages, argues Eagle Street's Shane Scully

The living sector has weathered a perfect storm of cascading crises: the pandemic, rising interest rates and inflation. Shane Scully, founder and chief executive of Eagle Street Partners, a real estate investment and asset manager focused on the UK and Ireland – and part of Arrow Global – explains what is behind investor interest in the sector, as well as the importance of technology and ESG moving forward.

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Q Given current market volatility, is institutional investor demand for the living sector cooling?

Investment in the living sector, like in all sectors, suffered at the back end of last year. In Q4 2022, investors naturally adopted a wait-and-see approach to see where the price floor was. However, we are starting to see Q1 investments in UK living sectors align with those from last year's Q1.

I expect the living sectors to mirror the experience of logistics, where there has been a bit of an overcorrection; yields will move out a bit and then come back in again. We have not seen the yield move out all that far yet, but the demand is very robust.

One of the factors underpinning this demand is the systemic housing shortage that exists across major European cities like Dublin and London. Positive demographic trends for high-quality accommodation living are very robust. Renting has become the norm for young people and structural elements like high interest rates and a lack of affordable stock mean the average age of purchasing a house is growing later each year.

The normalization of renting has created attractive opportunities for forward-thinking investors. We are seeing a move in the market whereby occupiers have become much more comfortable with institutional landlords, who give them a high-quality service, rather than traditional landlords, who might bring a tenancy to a short end when not expected.

With this, institutional landlords have been able to focus on product and experience. Investors are now given the opportunity to have a customer for life, following tenants through the different phases of their lives, living in student accommodation, a first-time purchase, to being married with children, or eventual downsizing and retirement.

Q We have heard of sharp declines in commercial real estate valuations, with suggestions prices could tumble as much as 40 percent. Have you seen this in the living sector?

No, we have not, but it depends on the micro market. At Eagle Street, we tend to deal with the most modern stock in prime markets, which is ESG-compliant and very energy efficient. In that prime stock, yields moved by maybe 500 basis points as interest rates went up, but the market has since cooled and there are not as many transactions.

Fast forward to today, and we are beginning to see that 'Great Pause' free up. Obviously, the effect on land – with the hyperinflation that we have seen in construction layered up with the additional cost of construction finance – has been much more dramatic. For quality products, institutional demand remains robust with investors who are not relying on leverage, and that importantly has put a floor on pricing.

Q We are still coming out of the covid-19 pandemic. How has this impacted the living sector?

The living sector was impacted in multiple ways. For example, hybrid working has opened new markets as people are more willing to commute longer distances for fewer days in the office. This is allowing institutional landlords to widen the scope of where they can find product. We are also seeing multifamily housing becoming an institutional product and it is something we are excited about.

Obviously, higher construction costs have slowed demand, which was a direct result of the pandemic – namely the disruption to global supply chains, which has since eased. Interestingly, the pandemic also accelerated the application of some modern technologies in construction and in asset management. This includes the use of sensors in building, which have provided us with data inspiring better and smarter decisions.

A good example here would be to see how space is utilized, avoiding designs where space is underutilized by the occupants, or where communal spaces are overpopulated. The ambition is to maximize the use and efficiency of buildings for long-term occupancy and a sustainable attractive yield.

Q Student housing was very much impacted by covid. How is it faring in its aftermath?

Q Is investing in residential about following demographics?

Residential real estate is all about making sure you are in the right sub-market, with the right product and the right demand analysis to see who is located there and why – and then making sure that you have the product to suit them.

One key metric is to see where the employment is and to follow the employers. For example, we are developing 1,250 apartments in Dublin city center where there are currently new offices being built for around 30,000 employees. The average wage here is €130,000 per annum and we have tailored our product accordingly. Furthermore, we know 50 percent of those new employees will come from overseas, and this is something we will also factor into our decision-making.

For general partners, this forensic analysis is essential. A sound demand analysis gives your investors assurance that it is a safe market to produce new stock and what that mix should look like. It is key to do this in every sub-market before you develop; you look at who the end user is, how they are going to evolve, and you make sure you have a best-in-class, energy-efficient building that will last for generations to come.

The pandemic has underlined the benefit and desire of students to live close to their place of education, with clear social, financial and educational benefits. There are an estimated 20 million full-time students across the UK and the EU, with at least seven students for every available accommodation room.

So, the key demand driver is still there, and we look at student accommodation as being a countercyclical defensive subsector. At the end of the day, when you have economic downturns, student demand increases, with more people attending universities and staying in education for longer.

Modern student accommodation certainly has a place in the living sector and is in strong demand from investors as it is one of the best generators of long-term predictable income. Students typically stay at university for three to four years, so the structural undersupply, combined with rent inflation, makes for an interesting investment strategy.

Q Was the pandemic's negative impact on senior housing a blip?

Yes, very much so. The long-term returns offered by existing and new models of senior housing are in demand and a very appealing proposition to investors. The rental model has become increasingly popular with investors and private equity funds.

The average stay of an occupier is about eight years. So, in countries with a high stamp duty, it can be much more cost effective to rent for that period.

I think the shift towards the rental model reflects a broader trend across Europe, as well as a focus on service provision and care services. With keen interest from investors, this subsector will continue to be an important part of real estate investment strategies.

Q How are multifamily investors keeping on top of changing demand for tech-enabled living?

We need to embrace technology and incorporate it into development at the design stage. We are a virtually integrated developer and asset manager focused on providing high-quality, modern and efficient units, and we take that view that technology will help us maximize opportunities in the private rental sector. We are adamant that it is worth investing in technology upfront even if the payback is not immediate as we are often the long-term manager of the asset.

Moreover, clever tech is essential in keeping running costs down and tenant satisfaction up. This tech-enabled building is essential to deploying ESG, which is now a prerequisite and one of the trends driving investment opportunities across Europe. We see this in the use of smart technology between occupiers, owners and tenants, which allows for instant and improved flows of communication.

If you have an app that allows you to organize events, you are able to create connections between tenants, developing a sense of community between the occupiers. We know this sense of community has a positive impact on the fabric of a building, so there are other associated economic benefits to this investment.

Sensors within a building show where it is being used and where it is not and allow you to plan efficient maintenance schedules, eg, which carpets need to be changed, when and where; which parts of the building should be lit; which should be cooled. The key to using technology is to consider the building as a living, breathing asset that you manage day-to-day with real time data.

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By seeing which parts of the building are popular and which parts are not being used, you can tailor them to keep the occupiers happy. That is part of retaining your customer, your occupier, with the high-quality service that I spoke about previously, as they go through their life cycles.

Q You mention ESG. How high on the agenda is it for residential real estate?

ESG is the agenda rather than part of the agenda. We are developing buildings that we will manage for generations, so we take every available action to create a sense of community where occupiers are happier and live longer. It goes beyond investor demand; it is about being socially responsible and making sure that you are developing and managing assets to the best of your availability, keeping ESG at the center of your decision-making process.

Q How are 'green' strategies evolving in this space?

We are developing nearly zero-emission buildings (NZEB), and it is very hard to improve on that. Now we must see how buildings can be constructed in an even more carbon-efficient manner.

Traditional construction methods will have to change, but for now, building the right stock in a way that is as energy efficient as possible, with enough social interactions between the tenants, is the best thing to do. ESG is prominent across Arrow's key real estate asset classes including residential, office, hospitality, logistics and retail, with decarbonization and changing tenant and investor demand driving that sustainability focus. ■