Global Counsel

There's real estate, and then there's real estate

Blog post by Adviser Leo Ringer, 08 July 2016

My colleague Ying Staton writes today in Singapore's The Straits Times that values in the UK's housing market will remain robust, after a few short-term jitters. Yet a cursory glance at the UK real estate market suggests that all is far from well, as investors rush to withdraw funds and fund managers slam the gates on them. So what explains her optimism?

The answer is that the distinction between residential and commercial real estate (CRE) is large and important, particularly in the context of Brexit. Mark Carney at the Bank of England has an eye on the residential property market, but in this week's press conference his description of real-estate driven financial stability risks as "crystallising" was a reference to the commercial side of the market, specifically. He knows that the drivers of the market panic in CRE are different to those determining future prices for housing. So far, the rush to redeem investments has been from funds invested in commercial property, not residential.

This is why Ying can be absolutely right about the robust prospects for residential prices while the CRE world sweats through the consequences of a fundamentally illiquid asset class, which is closely correlated to the outlook for UK economic growth. So why does the residential side of the market look less concerning?

First, the gap between supply and demand for housing in Britain has been growing for many years: household formation rates at 240,000 per year are on average more than double the rate of house-building, which has struggled to climb above 100,000 per year.

Second, borrowing rates in Britain hit an all-time low in the days following Brexit as investors sought safe havens in the form of government bonds. Mortgages - at a historic low for years - are set to become even cheaper. HSBC last month launched a record 0.99 per cent fixed-rate mortgage, which will put pressure on other lenders to follow.

Third, sterling. At rates as low as US$1.28 (S$1.72) to the pound, sterling-denominated investments have become more attractive, particularly to buyers using currencies pegged to the strong US dollar.

Fourth, UK housing policy has always been set in Westminster and driven above all by a chronic national obsession with home ownership. As more people have become more and more dependent on housing assets for welfare provision, so too the political pressure to preserve the value of housing has grown. Brexit will not change this.

This is not to say that the short-term jitters in the housing market might not be strong. But the same concerns swirling around the commercial side of the market do not translate straightforwardly to its residential twin. Those assessing the Brexit exposure of real estate investments in the UK need to pick through the policy drivers carefully, with this distinction in mind.