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Principal Real Estate

# The Decisive Eye

A strategic bulletin on issues and opportunities in European real assets

◆ Issue #29 | Autumn 2024



## European residential: Unlocking the housing potential



**DANIEL TOMASELLI**  
Manager  
Global Real Estate Research



# Introduction

Over the last decade, the European residential market has undergone a profound transformation. Housing demand has consistently outstripped supply in most geographies, resulting in widespread affordability and availability problems. Thus, homeownership has become increasingly difficult to obtain for a growing number of households and young adults who are now forced to live with their parents or rent for longer compared with previous generations. This backdrop poses steep challenges for the industry but also creates a unique set of investment opportunities.

We believe that investors should pay keen attention to:

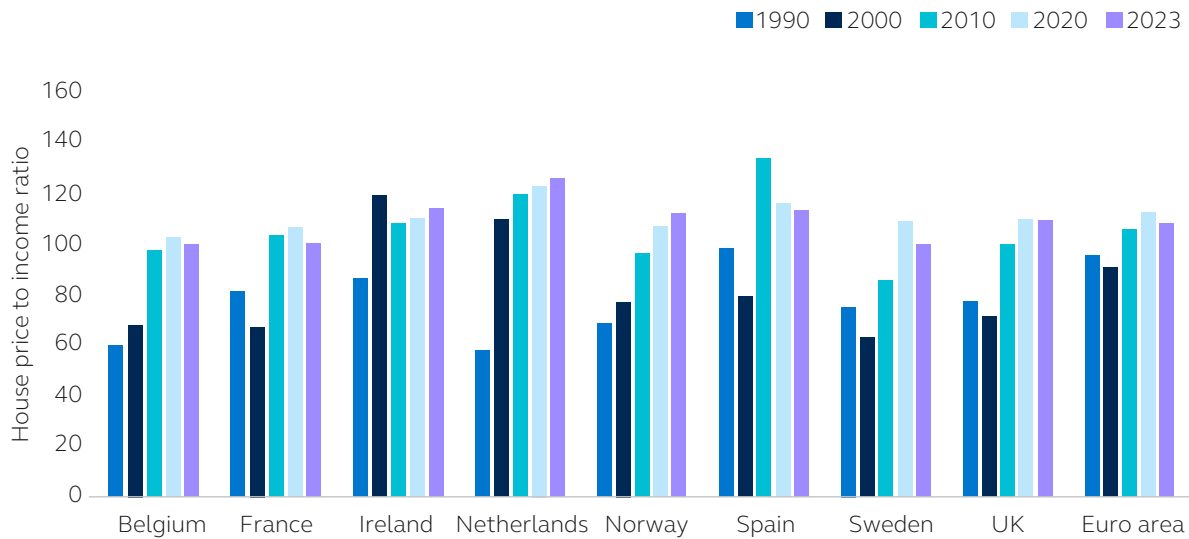
- Positive fundamentals from long-term structural drivers;
- Resilient income and cash flow, with weaker correlation to the broader economic cycle; and
- Strong values enhancing environmental, social, and governance (ESG) portfolio credentials.



## Sweet home turned sour

For decades, long-term renting through necessity was uncommon among European households, with limited exceptions. Rising disposable income, favourable social policies, looser planning regulations, and sprawling development projects enabled families to enter the for-purchase market following a short tenure as renters. In England, for example, the percentage of owner-occupied homes rose significantly during the second half of the 20th century, from just over 40% to nearly 70%. Housing became the cornerstone of household wealth, and owning a home was considered a crucial part of achieving financial security. Conversely, renting was viewed as a transient condition, something people had to temporarily endure before they could afford to buy their own home. However, when millennials reached adulthood, they faced a far different economic landscape. For those born after 1980, the path to homeownership has become far more challenging than it was for previous generations. Across Europe, from the large inland metropolitan areas to coastal cities, a significant housing affordability and availability crisis is taking place.

**EXHIBIT 1: Affordability worsened for the newer generation of first-time buyers**  
**House price to income ratio<sup>1</sup> for selected European residential markets**

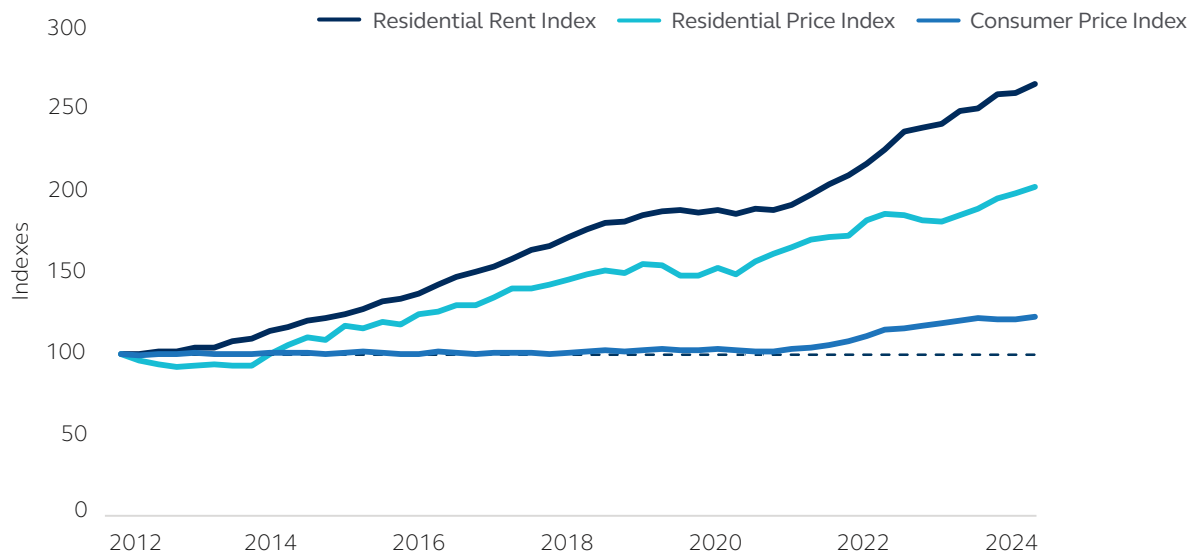


<sup>1</sup>Index, 2015 = 100  
 Source: OECD, September 2024

This shift is perhaps most pronounced in Ireland, where the share of owner-occupiers declined sharply, by more than twelve percentage points, from 82% in 2004 to 69% today, according to Ireland’s national statistical institute, CSO. At the same time, the average age at which Irish people became homeowners doubled from 22 to 44 years old. These developments reflect the significant challenges facing younger generations and less affluent families, who must now navigate a housing market that is

insufficient to accommodate households today, due to a widening supply-demand deficit. The roots of the problem date back to the mid-1990s but worsened in the period following the global financial crisis (GFC) of 2008. Since then, Ireland has accumulated a housing deficit of approximately 235,000 homes, equivalent to 11% of the national housing stock, according to a study by Ireland’s Housing Commission. In the best-case scenario, closing this gap is expected to take at least ten years.

**EXHIBIT 2: Home price and rent have defied gravity**  
**Ireland’s residential price and rent indexes<sup>2</sup>**



<sup>2</sup>Index, 2012 = 100  
 Source: Daft.ie, June 2024

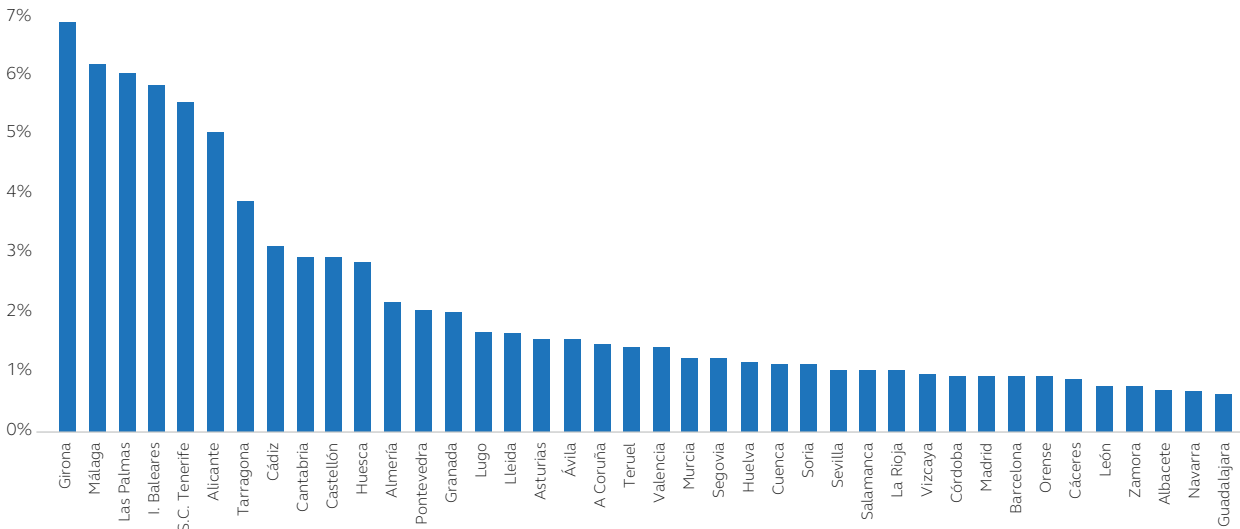
Ireland is not alone in its struggle. Across Europe, countries are experiencing a similar problem. A combination of long-term structural factors—including reduced public spending on housing, widening income inequality, restrictive planning systems, and increased migration flows—have driven housing affordability to new lows, especially in metropolitan areas.

“In my days, people bought homes in their twenties. Now, you’re lucky if you find a flat to rent when you are thirty, and one to buy by the time you are fifty” said one real estate professional on the state of the residential market in the Netherlands. Indeed, the country faces a housing shortage of approximately 400,500 homes, equivalent to 4.9% of the total dwelling stock, according to ABF Research, the agency in charge of producing annual population and housing projections on behalf of the Dutch government. Amsterdam, Rotterdam, Utrecht, and The Hague are the cities most affected by this shortfall, with deficits ranging from 23,000 to 45,000 homes.

Spain is also grappling with severe housing challenges, particularly in major cities and high-demand areas. In the years leading up to the GFC, Spain had accumulated a housing surplus, driven largely by a rapid pace of construction

and lax lending policies. However, since then, the country has recorded one of Europe’s lowest rates of new housing starts per capita. Thus, a large portion of Spain’s existing housing stock is now considered obsolete or located in areas that no longer align with current demand. Two more recent trends have exacerbated the housing shortage in Spain. First, migration has surged in recent years, leading to an increase in household formation, now at 300,000 per year, while new housing construction is around 100,000 homes annually. This demographic trend has created additional demand, particularly in urban centres like Madrid and Barcelona, where housing costs have risen significantly. Second, the boom in tourism and short-term vacation rentals has reduced the availability of long-term housing solutions for locals. According to the Institute of National Statistics (INE), the number of tourist homes in Spain has increased by 19% over the past three years, reaching 351,000 as of February 2024, equivalent to 1.9% of the total residential stock. In some provinces, the proportion of tourist accommodation reached even higher levels, including 7% of the residential stock in Girona, 6% in Malaga, and 5% in Alicante. This trend has driven up prices and rents even more, pushing residents further out.

**EXHIBIT 3: The boom in tourism exacerbates housing availability problems**  
**Tourist home rental share of total housing stock for selected provinces in Spain**



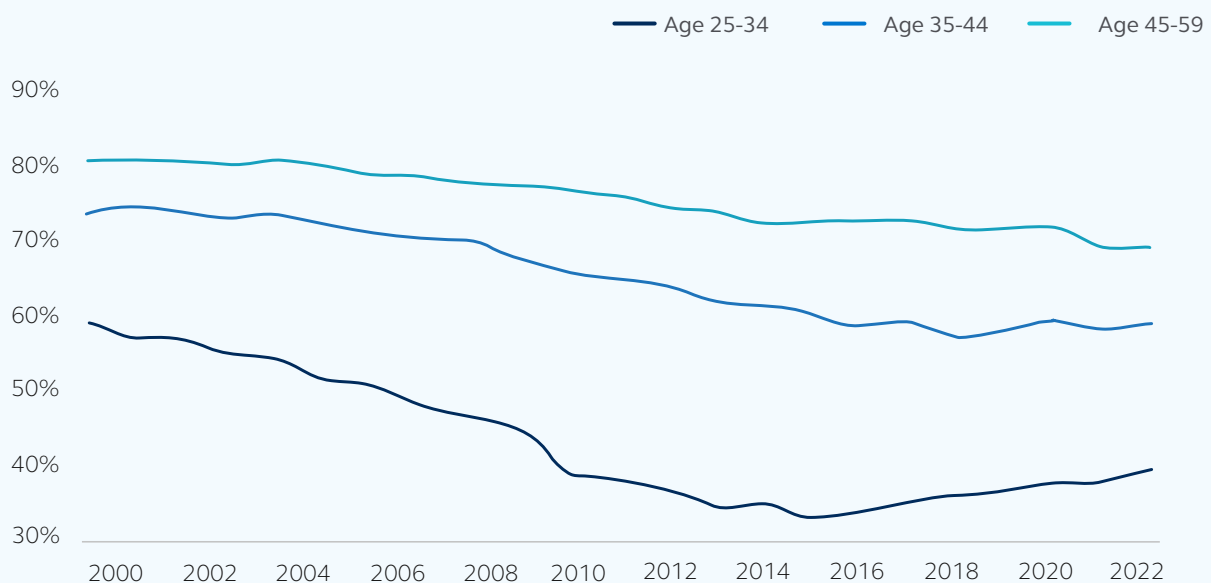
Source: Instituto Nacional de Estadística (INE), February 2024

The UK is also facing an acute housing affordability problem, at least in some parts of the country. Over the past five decades, local authorities in several regions have failed to deliver the number of homes needed to keep pace with demographic trends and social requirements. The private sector has not compensated for this shortfall either. According to the National Housing Federation, England needs approximately 340,000 new dwellings per year, of which 145,000 should be affordable homes. Despite this target, new housing construction peaked at 243,000 units in 2019 and has declined since then. The shortfall had a significant impact on house prices. Over the past 20 years, the average residential price in the UK has risen sharply, from £137,000 to £282,000, according to the House Price Index (HPI) published by the Office for National Statistics (ONS). This price surge has made homeownership unattainable for less affluent households and young adults. Indeed, among those aged 25 to 34, homeownership rates have dropped by 20 percentage points, from 59% to 39%, compared to an average decline of 6 percentage points in the total population.

Furthermore, since 2021, affordability pressure, measured as first-time buyer house price to earnings ratio (HPER), has continued to get worse across most UK regions, driven by the rise in mortgage interest rates and in the cost of living. In some areas, the affordability gap has stretched to such an extent that young adults and low-income households are being priced out of both homeownership and rental markets altogether.

In several other geographies across the continent, the affordability and availability of housing are also under strain, due to similar structural and cyclical factors. Reduced public investment in housing infrastructure, coupled with restrictive zoning and planning laws, has limited the supply of new homes. Meanwhile, the growing demand for housing—underpinned by migration, changing family structures, and urbanisation—has put upward pressure on both residential prices and rents. This trend has created a widening gap between housing supply and demand that is difficult to bridge, at least in the short and medium terms.

**EXHIBIT 4: A dramatic change in young adults' home ownership**  
**Homeownership rates by working-age adults group in the UK**







## The rising importance of institutional capital

As outlined in the previous section, the existing housing stock is not enough to cater to social requirements across several European geographies. Despite politicians of all parties making ambitious pledges to remove construction bottlenecks and ramp up supply, in our view, the housing deficit is bound to persist. Indeed, the causes that led to the current affordability and availability struggle are multiple, complex, and structurally rooted in secular socio-economic trends that are quite hard to reverse. Additionally, the resolution of the problem involves several public and private stakeholders whose interests rarely coincide. Against this backdrop, real estate institutional investors have spotted an opportunity. They can play an increasingly important role in making housing more accessible while also having a goal of achieving attractive risk-adjusted returns.

Indeed, the interest of institutional investors in the broader European living sector (including multifamily and single-family rental, co-living, student and senior housing) has increased markedly over time. For example, in 2013, residential was the smallest sector by assets

under management within the INREV Annual Fund Index, the benchmark for European non-listed real estate funds' performance. Over the last ten years, its share increased from 7% to 23% of total AUM, and residential became the largest asset class across single-sector funds.

Similarly, the amount of capital pouring into the European residential sector, measured as the volume of transacted deals tracked by RCA, increased from €18 billion (or 6% of total commercial real estate deals) to €102 billion (or 29% of the total) between 2007 and 2021. Since then, liquidity has retreated substantially amid a widespread correction in the global real estate market triggered by a synchronised monetary policy tightening carried out by all major central banks to tame inflationary pressures. However, the living sector remains at the forefront of investors' interest, and we believe it will be a primary beneficiary of the market recovery that is approaching. According to INREV's Investment Intentions Survey 2024, over 90% of investors indicated residential as their preferred investment sector.

## Seizing the opportunity

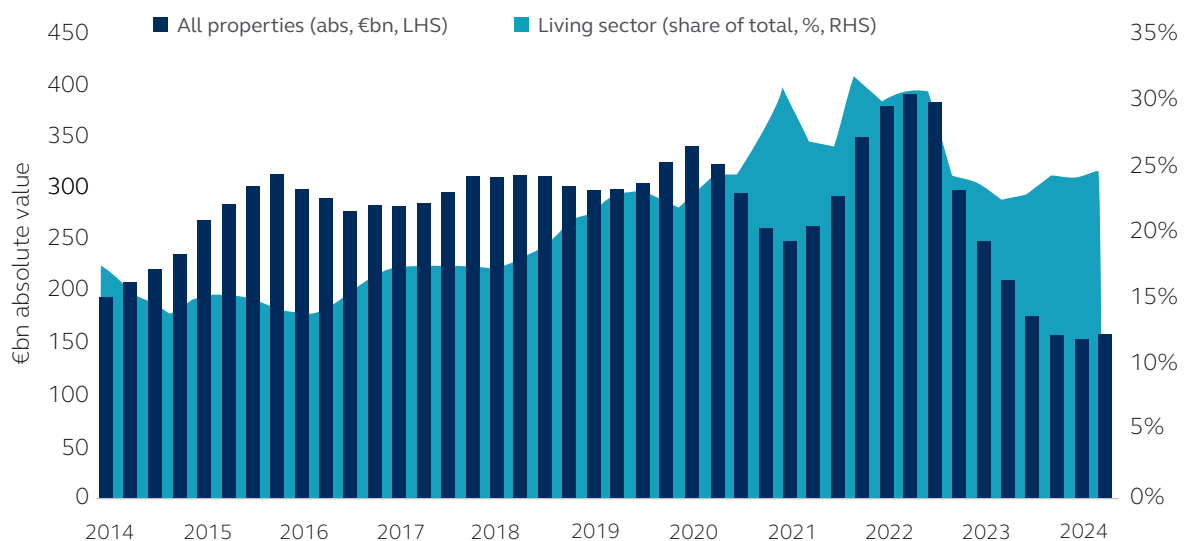
The European residential investment potential is vast in scale and wide in breadth. Institutional presence remains low relative to the domestic market or compared to other regions. In the U.S., institutional investors own more than 35% of the rental housing stock.<sup>3</sup> The most mature market in Europe is Germany, where institutional penetration reached approximately 13%.<sup>4</sup> In all other parts of the continent, the residential market is still young, fragmented, and mainly owned by public entities (local authorities, housing associations, not-for-profit organisations) or non-professional investors (private landlords with fewer than five rental properties). For example, in the UK, France, and the Netherlands, institutional capital only owns between 1% to 6% of the total rental stock. Thus, institutional investors still have a lot of room to expand their presence in the coming years. Several factors point in this direction.

First, the residential sector can offer rather stable and predictable returns amid supply-demand imbalance, a growing share of the population being priced out from the for-purchase housing market and tightening construction regulations. Occupancy rates are already above 97% in

Denmark, Sweden, and the Netherlands and above 94% elsewhere, including Germany and the UK. Second, the residential sector can offer portfolio diversification benefits due to its unique array of sub-property types and lower correlation to the performance of the broader economy compared to office, industrial and retail sectors. Third, residential properties offer institutional investors the opportunity to enhance their ESG credentials. On the environmental side, developing new stock (or modernising existing ones) can help improve energy efficiencies and reduce operational carbon emissions. On the social side, private investment is much needed to lessen the pressure on housing affordability and availability, which is affecting an increasing number of households. Lastly, markets are currently offering an attractive entry point. Following seven quarters of negative capital value growth, six of the nine main European residential national markets have turned positive in Q2 2024, according to the MSCI European Property Index. Investors now have the opportunity to purchase assets with strong underlying fundamentals at a 15% to 20% discount compared to two years ago.

### EXHIBIT 5: The living sector is gaining market share

European transaction volume and the living sector's share of total, rolling 12-month



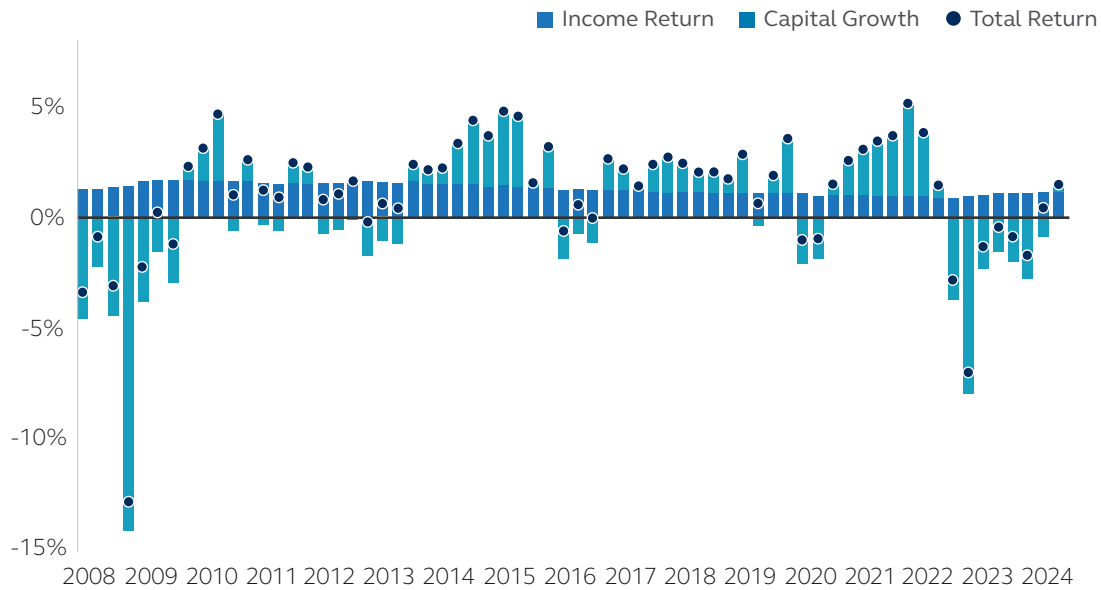
Source: RCA, Q2 2024

<sup>3</sup>Federal Reserve Bank of St. Louis (FRED)

<sup>4</sup>Property Market Analysis (PMA)



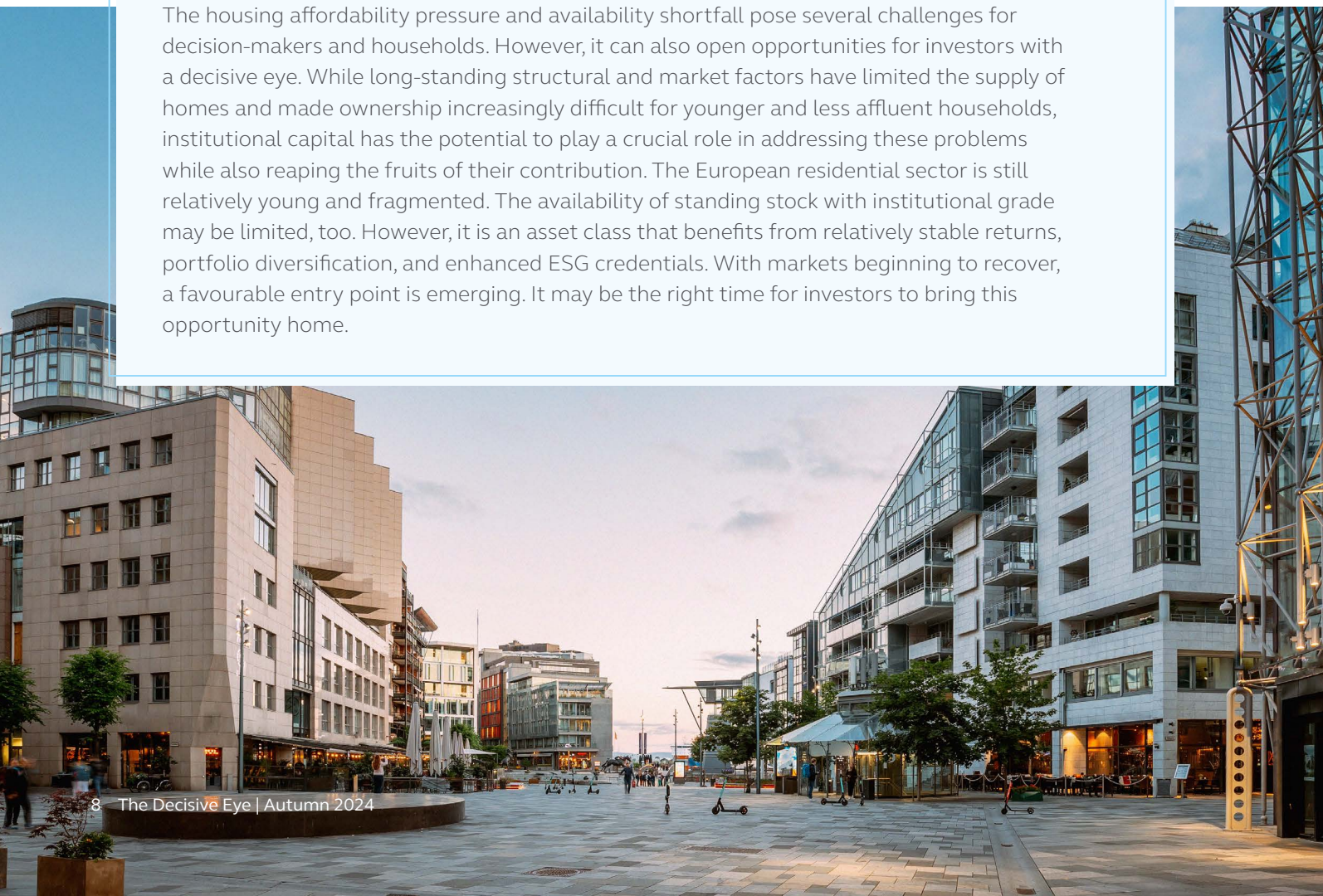
**EXHIBIT 6: Returns turned positive after six negative quarters**  
**European residential sector, quarterly total returns**



Source: MSCI, Q2 2024

**CONCLUSION:**

The housing affordability pressure and availability shortfall pose several challenges for decision-makers and households. However, it can also open opportunities for investors with a decisive eye. While long-standing structural and market factors have limited the supply of homes and made ownership increasingly difficult for younger and less affluent households, institutional capital has the potential to play a crucial role in addressing these problems while also reaping the fruits of their contribution. The European residential sector is still relatively young and fragmented. The availability of standing stock with institutional grade may be limited, too. However, it is an asset class that benefits from relatively stable returns, portfolio diversification, and enhanced ESG credentials. With markets beginning to recover, a favourable entry point is emerging. It may be the right time for investors to bring this opportunity home.





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