

# INVESTMENT INSIGHTS | UK COMMERCIAL & RESIDENTIAL REAL ESTATE

July 2024



## Investing in Places to Live & Work



## INTRODUCTION

AREF and its members have been working with government, regulators and other stakeholders to attract capital from a wide range of investors in real estate funds to enable increased investment in real estate in the UK. AREF's members would like to continue that collaboration to ensure more capital can be encouraged to invest in places to live and work in the UK.<sup>1</sup>

## WHERE WILL THE CAPITAL COME FROM TO INVEST IN REAL ESTATE?

### Pension schemes

The UK's pensions system is an international outlier. The seven largest pension markets globally allocate on average 23% to illiquid assets such as property, infrastructure, private equity, and venture capital. In the UK, that number is just 9%.<sup>2</sup>

DB pension schemes have been significant investors in real estate funds. They have found investing in real estate funds has provided them with long-term growth and regular income. With the move from DB to DC pension schemes, DB pension schemes are starting to disinvest from real estate funds.

Although Long-Term Asset Funds (LTAF) were designed specifically to facilitate DC schemes and retail investors to access alternative asset classes there has been low take up.<sup>3</sup> There are operational difficulties that DC pension schemes face in investing in LTAFs and other funds with notice periods accessed through platforms.<sup>4</sup> Most of the platforms they use for investing do not accommodate investments with notice periods. This needs to be addressed otherwise DC pension schemes will be inhibited in implementing investment strategies which can include funding for new housing and infrastructure.

1. The Association of Real Estate Funds (AREF) represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. These funds invest in a wide range of real estate including residential, retail, offices, industrial as well as specialist sectors such as healthcare, affordable housing, student housing, life sciences and leisure.

2. [Thinking Ahead Institute Global Assets Study 2023](#)

3. [FCA Chief Executive: International regulatory developments affecting investment management](#)

4. [Productive Finance Working Group: Investing in Less Liquid Assets – Key Considerations](#)



## Overseas capital

Last year over £19bn was invested by overseas investors in UK real estate. Real estate funds provide an attractive proposition for overseas investors.<sup>5</sup> They have seen UK law as a gold standard but some initiatives, such as reforms to leaseholds in England & Wales, may reduce the historic confidence of overseas investors in UK property law.

## Retail investors

Authorised property funds can provide retail investors with a long-term investment that provides a good diversifier for their investment portfolio and a regular income. When investing in funds, retail investors usually take advantage of the tax benefits of holding them in Stocks and Shares ISAs. However, if the FCA take forward their long-standing proposal to introduce notice periods for authorised property funds these would not qualify as Stocks and Shares ISAs (see below).

## Local Government Pension Schemes (LGPS)

Although LGPS are now in net outflows, we believe real estate remains an ideal investment for their portfolios. With the pooling of LGPS, some of the pools may invest more directly in real estate and less so through real estate funds. However, real estate funds provide an opportunity for them to invest in more specialist real estate investments.

AREF has been supporting the creation of a new fund structure, an unauthorised contractual scheme, known as the Reserved Investment Fund (RIF) (see below). This fund structure is expected to be attractive to LGPS, with its low costs and flexibility, when investing in real estate via a fund.

## POLICY DELIVERABLES

### Reserved Investment Fund (RIF)

The RIF demonstrates how a constructive engagement between the real estate fund industry, the Government and the FCA has facilitated legislative progress for a new fund product which will address a gap in the UK fund offering. The RIF will complement and enhance the UK's existing funds regime with lower costs and more flexibility than the existing authorised contractual scheme and will be open to professional and institutional investors such as LGPSs.

HM Treasury has consulted on new tax rules for the RIF. We do hope that after the General Election these will be laid down in secondary legislation to enable RIFs to be launched in 2024.

### DC pension schemes

As explained above, DC pension schemes face barriers to investing in real estate funds which in turn will provide less funding for real estate and infrastructure projects in the UK. AREF has been making the FCA, Bank of England and government departments aware of these operational difficulties. We will continue to work with policymakers to overcome these barriers and introduce additional reforms to enable more investment by DC pension schemes in productive investments.

5. Source: MSCI Real Assets

Currently DC pension schemes are regulated as retail investors because it has been assumed that individual savers in DC pensions would manage their own portfolios. However, in practice, most savers invest in the DC pensions schemes' default options. Regulating DC pension schemes as professional investors would remove unnecessary regulation without reducing protection for savers in the schemes.

## **Collective Defined Contribution (CDC) pension schemes**

AREF is supportive of the establishment of multi-employer CDC pension schemes which we expect to invest in long-term, illiquid assets, such as UK real estate, to deliver a better investment outcome for scheme members. To provide the DC pensions schemes with the scale to invest in productive investments such as housing and infrastructure, smaller DC pension schemes should also be incentivised to merge.

## **DB pension schemes**

In recent government consultations, AREF has advocated that government allow partial withdrawal of surpluses from DB schemes on an ongoing basis, spread over time, funded by investing current surpluses in higher returning illiquid assets such as real estate.

## **Solvency II UK reforms**

The Solvency II reforms in the UK are essential to unlock capital for insurers to invest in productive assets such as real estate funds.

## **Authorised property funds**

As mentioned above, the FCA are expected to take forward this year their proposals to address the mismatch in liquidity between the daily-traded authorised property funds and the assets they hold. They are expected to introduce notice periods for authorised property fund redemptions although it should be noted that notice periods are not always the best solution for all of these funds. Due to the long delay in the FCA making a decision on this and the uncertainty this has created for investors, some authorised property funds have decided to change their investment profiles and sold UK property holdings to invest in overseas REITs.

To ensure retail and professional investors can invest in real estate through authorised funds with notice periods, some operational challenges need to be resolved. The first one is similar to the one encountered by DC pension schemes; most platforms won't invest in updating their systems and processes to accommodate funds with redemption notice periods. The second barrier to investment is the insistence by HMRC to only allow investments in these funds through an ISA in an Innovative Finance ISA. These ISAs are not used, in the main, by retail investors and are associated with peer-to-peer lending. Retail investors that wish to hold their investments in an ISA tend to hold authorised property fund holdings in a model portfolio within a Stocks and Shares ISA. We advocate for this to continue for authorised funds with redemption notice periods.

### **Additional Reading**

- [Social Market Foundation \(author: Melville Rodrigues\) – How the next government can reform pensions to ensure a better deal for the economy and British savers](#)
- [Thinking Ahead Institute Global Assets Study 2023](#)



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