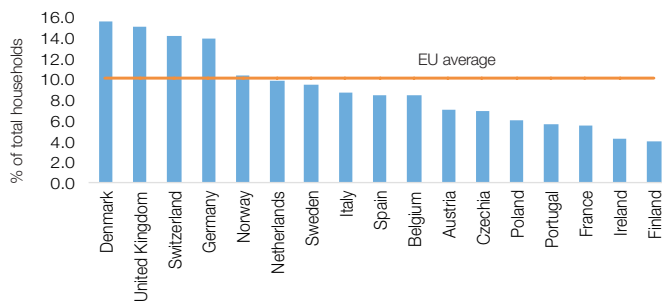


# Investing in affordable housing

The shortage of housing across Europe is becoming an increasingly politicised issue, as house prices and rents have consistently increased faster than incomes over the past 10 years. At the heart of the issue is the age-old problem of supply and demand. Urban populations are increasing as households are becoming smaller, but supply has failed to keep pace.

## Housing cost overburden rate, % of total households



Source: Eurostat, 2019

While not terrible for existing homeowners — although rising prices can make it more difficult to move — the burden of this imbalance disproportionately falls on renters and first-time buyers. Households earning less than 60 percent of median national incomes have been affected the most. Over half of this group rent instead of own, compared with an EU average of 30 percent<sup>1</sup>, while the pandemic is likely to have aggravated rental affordability, as those workers with lower incomes are more likely to have lost jobs or been placed on government salary-support schemes.<sup>2</sup>

Younger generations have also been adversely affected. The CBRE Global Millennials Survey found that 74 percent of those surveyed thought that wages are not keeping up with house prices and 50 percent were living at home due to lack of residential affordability.<sup>3</sup>

Affordability issues are widespread across Europe, but surveys show that it is most difficult in capital cities. In Paris, Stockholm, Amsterdam, Berlin, London and Dublin, more than 80 percent of citizens indicate that they do not think it is easy to find good housing at a reasonable price.<sup>4</sup>

Within these cities, there are clearly differences in the affordability of individual districts. Central locations tend to carry a higher proportion of luxury housing than more peripheral locations, to reflect higher land costs, a greater concentration of urban amenities and easy accessibility. However, even some suburban locations are becoming less affordable, particularly as remote working and a search for larger and greener space pushes more people into the commuter belt.<sup>5</sup>

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## DWS's approach to investing in affordable housing

There is a clear need to increase the quantum of affordable housing, and private investors should be part of the solution — not just from an ESG perspective, but also with a view to seeking an attractive risk-adjusted return.

Affordable housing has three key investment qualities: security of income, a high occupancy rate and stable income return throughout market cycles.

To gain exposure to this sector, the investor needs an in-depth understanding of local residential markets, including where and how to acquire high-quality accommodation that will appeal to the target market, and that is delivered at a rental level that is affordable for the local demographic.

DWS has been investing in affordable residential for over a decade, having commenced its residential investment programme in Germany. In operating affordable housing in mature markets such as Germany, the Netherlands and the Nordics, it has been possible to develop an affordability framework to invest in the newer markets such as Spain, the United Kingdom and Ireland.

Our framework starts with the Eurostat definition of housing-cost unaffordability. This definition assumes housing costs are unaffordable when they exceed 40 percent of household disposable incomes. Using data on average household disposable income by city, it is possible to screen out individual assets as being unaffordable when the rent exceeds the 40 percent threshold.

Next we consider other factors. Incomes can vary widely across a city, while “affordable” can also mean very different price points for different target markets. A group of young professionals renting together can afford a higher rent and would look for a different product than a low-income family with a single earner. Understanding the target market, including their price sensitivity and what types of accommodation and services they wish to have, is key to securing long-term occupational performance.

With this information, it is possible to increase or decrease the income input to our affordability analysis, providing a clear idea of whether the target rents for an asset are appropriate for the target market.

## Two German case studies

If we take two examples from DWS's German portfolio, we can clearly see these different methods of investing at either end of the affordability spectrum.

First off, DWS invested in a newly developed asset in the eastern suburbs of Berlin, acquired as part of a three-asset portfolio. The asset is situated in a well-established residential location with good transport connections, allowing a 40-minute commute time into the centre of the city. As the rents are at the upper end of our

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Berlin Hellersdorf

affordability spectrum at around 38 percent of the average local disposal income, new lettings are managed to ensure that rents remain below the 40 percent threshold. This approach has contributed to sustainable high occupancy levels.

A different approach to affordable investing can be demonstrated by a residential portfolio that DWS acquired four years ago, situated in the northern region of Germany. The buildings were of an older generation and required an upgrade. The prevailing rents were very affordable, with rents at less than 30 percent of local household disposal income. A key objective of the refurbishment was to deliver tangible improvements but not at the cost of materially increasing rent levels, which would have put affordability pressures on the existing residents.

In buying this asset at a higher entry yield than average (due to it being a tier 2 location requiring capital expenditure), DWS was able to add balconies and undertake a complete redesign of the communal gardens, while maintaining rents similar to pre-refurbishment levels. As a result, we were able to raise the occupancy levels without increasing rents. Through the responsible business plan, both investors' and residents' priorities were achieved.

In both German case studies, whilst the macro investment theme was the same — to invest in the supply-demand imbalance in Germany's metropolitan areas — the approach at a local level was tailored to the asset and its residents.

Aligning the building specification to the local tenants' needs and maintaining affordability is the common approach at DWS. In Spain, for instance, DWS has been investing in new developments in suburban locations on the outskirts of Madrid. These schemes are targeted towards young couples and small families, and the rent is set at around 30 percent of household disposal income.

It remains essential that such schemes offer a good range of amenities and create high-quality living environments. The schemes include

amenities such as swimming pool, events room, playground, BBQ areas, gardens, and more recent additions include co-working spaces catering to the work-from-home shift.

There is also a focus on creating high-ESG assets and reducing utilities costs to attract residents and maintain efficient operations. Measures such as moving from fossil fuels to renewable energy, investing in heat pump technology, green certification, and taking steps towards reaching near-zero carbon buildings have been key features in Spain and across other assets in Europe.

Looking for ways to improve the external environment surrounding DWS's assets is also part of our ESG process. These efforts include increasing biodiversity through the landscape design; sustainable mobility through the deployment of electric chargers or shared-vehicle arrangements; and promoting local business within our communities, to enhance proximity awareness with our tenants.

### What we have learned

A successful affordable-housing strategy needs three elements:

1. A framework to create a diversified strategy encompassing macro housing trends and evolving regulation, the assessment of affordability metrics across multiple countries, and accounting for local variations.
2. A pragmatic approach to the multiple complexities in deploying capital into affordable-housing strategies, including adjusting affordability assessment using available data sources for each locality, mitigating unnecessary cost leakage, or cost engineering to seek to create high-quality schemes at affordable rents.
3. An experienced investment manager operating at a pan-European country and city level, who knows where to originate assets, be it urban or suburban, tapping into areas set for wider public-sector investment to support the housing growth.

Investor attention is more focused than ever before on the residential sector. As a result, there is more capital available to increase the supply of residential stock to meet growing demand. In building out a framework for targeting the right markets and the right assets, DWS is well-placed to channel capital to develop and maintain residential real estate that benefits not only investors, but also society as a whole.

Notes: <sup>1</sup>Politico.eu, 2019; <sup>2</sup>Palomino et al, October 2020; <sup>3</sup>CBRE, Global Millennials Survey, 2016; <sup>4</sup>Eurostat Perception Surveys, 2015; <sup>5</sup>Gupta et al, April 2021

Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

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### CORPORATE OVERVIEW

**DWS – Real Estate.** DWS's real estate investment business has been investing in real estate assets for more than 50 years. The firm has more than 400 employees around the world and almost €68 billion in assets under management (as of 31 March 2021). We offer a diverse range of strategies and solutions across the risk/return and geographic spectrums, including core and value-added real estate, real estate debt, real estate securities, and opportunistic real estate.

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