Residential investments offer 'best inflation hedge' within real estate

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Investments in residential property offer the best inflation hedge within real estate because of their sustainable value growth, a Dutch professor of property financing has claimed.

Speaking at the congress of IPE Real Assets Dutch sister publication Pensioen Pro last week, Piet Eichholtz, argued that investors should “immediately ditch” offices and retail objects, as they were a bad cover against currency depreciation.

Drawing on developments since 1650, Eichholtz said that only since approximately 1950, residential property had started to provide protection against inflation as a result of rising prices in real terms.

The hedging effect improved with the duration of the investment, he added.

According to Eichholtz - affiliated with Maastricht University – property had turned out to be a “slightly” better inflation hedge than equity and “much better” than bonds.

He underlined that society badly needed sustainable housing.

“We need a million homes in the Netherlands, in particular for single person households and mainly in the large cities and the Randstad,” he said.

Offices, in contrast, were a bad inflation hedge, argued Eichholtz, referring to the current 12% vacancy rate while the economy was on the top of its cycle.

“They only generate returns on investment due to short term-based investor demand,” he said.

With a vacancy rate of 8%, retail objects weren’t performing much better, “as the growth of consumer spending was driven by the internet”, the professor contended.

He added that a range of international surveys indicated that the prospects applied to property worldwide.

Also during the congress, Jeroen van Hessen, co-founder of Dutch mortgage investor DMFCO, put the illiquid character of housing loans into perspective.

He argued that the duration of a mortgage against a 20-years fixed interest rate was no more than nine years on average and that annually 5% to 7% of the loan would become available for investment again through paid interest and repayments.

Van Hessen also highlighted that the largest losses on Dutch mortgages during the financial crisis had been limited to 12 bps, and that the spread of mortgages had been "relatively stable" in the past four years.

Citing figures provided by supervisor De Nederlandsche Bank (DNB), he said that demand for Dutch mortgages could increase by €100bn to €175bn in the next six years.

In his opinion, further growth of housing loans must be picked up by new investors.

"With their holdings of approximately €550bn of mortgages, Dutch banks have by and large reached their limit under the capital requirements of Basel III."