Editorial

The emergence of a new asset class

Historically, UK institutional investors have not held housing in their portfolios; indeed, they have held rather small amounts of commercial property. Yet, both have represented good investments; they have good returns and low or negative correlations with other asset classes.

Part of the reason for the avoidance of housing is the difficulty of buying, owning and selling it directly. Transaction and informational costs are high and maintenance costs and rates are significant. Furthermore, since the typical pension fund beneficiary is already very big in housing, there are other broader aspects of diversification which may not be attractive.

This situation may, however, be changing as a number of new instruments for hedging housing are being offered by investment banks. These have emerged for the purpose of allowing mortgage lenders to hedge the housing price risk that they currently are exposed to, and which needs to be

managed. The management need follows from new regulation on mortgage bad risk, emanating from Basel II. If these new instruments lead to better products and indices and to greater liquidity, then the means for institutional investors to buy housing exposure could well become available. This should depend upon the private sector's ability to provide sufficient liquidity or a suitable duration to match the interests of institutional investment. Moreover, it should also depend upon widely building an agreed choice of house price index. From the perspective of the pension fund, home prices should have attractive long-run positive correlations with liabilities through wages. It is claimed by some commentators that the affordability ratio, ie prices to wages, represents a long-run equilibrium and, if this is true, would create a basis for long-run match between assets and liabilities.

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