SAVILLS RESEARCH

UK Build to Rent Market Update

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Performance of Build to Rent is boosting investor demand leading to yield compression

Throughout 2021 and 2022, the number of investors targeting some part of the UK Build to Rent (BtR) sector has grown exponentially which is largely down to the resilience of the sector during Covid. From a performance perspective BtR has proven its investment credentials:

- rents and income growth recovered quickly post-pandemic;
- strong rent collection & renewals;
- overall decreasing availability of rental product fuelling demand and sustaining occupancy;
- strong overall rental growth
- low voids & arrears.

This performance evidence has had two knock on effects – the first is that it has given confidence to a much broader range of investors to enter the market; and secondly, the institutions already active are accepting lower hurdle rates of return as the asset class is being priced according to a reduced risk profile. So despite the headwinds of an inflationary environment, an increasingly competitive market means we are seeing assets achieve premiums with widespread yield compression.

Increasing competiton for best assets

It is clear from the transactions in the market that the pool of investors, both domestic and international is widening. This is also true of the investment strategies being used to secure stock.

A key feature of the current market is that the number of parties, many institutions, with a relatively low cost of capital and requirement to deploy capital has generated increased competition for assets, both operational and development opportunities.

A common theme since the inception of BtR has been the lack of operational assets. This has lead the vast majority of investors down the development route. During the first half of 2022, Savills marketed nearly £2 billion worth of assets on a forward funding basis alone with some large scale portfolios achieving double digit levels of interest – and investors encouraged by the increased scale and geographically diversified assets the portfolios offered.

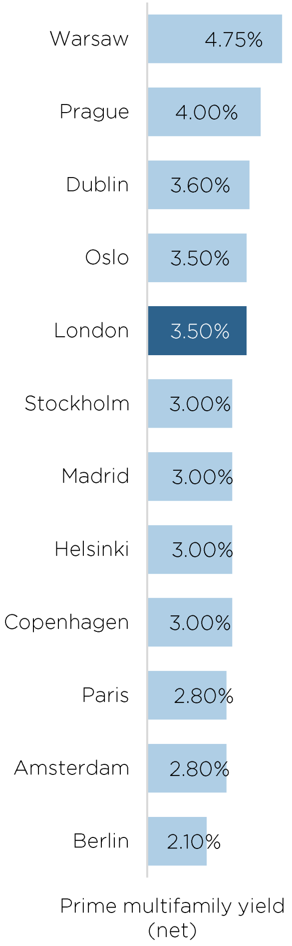
And the demand for operational, fully-tenanted assets remains considerable. We have seen income-producing assets and portfolios come to market and achieve premium prices, especially those specifically designed for long term rental. This has placed further downward pressure on yields.

Investor appetitie is so far undeterred by geopolitical and economic uncertainty

With UK inflation reaching 9.1% in May, a 40 year high, and the Ukraine conflict showing little sign of abating, the market may have expected a slowdown in activity. The reality is we are yet to see investor demand temper and investment volumes are considerably higher so far in 2022 than this time last year (Figure 3). This is for a number of reasons:

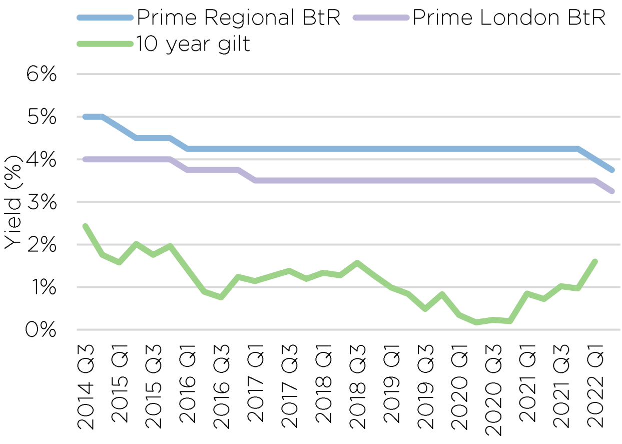
- The UK continues to offer attractive yields compared to other European markets (Figure 1).
- UK Residential has proven its resilience and is likely to be more sheltered from the consumer spending squeeze (tenants will pay their rent before spending more on non-essential items).
- Increasing exposure to Residential is creating greater diversification for large institutions.
- Investment into housing can support ESG strategies for example improving energy efficiency ('E') and providing quality homes for people to live in ('S').

Figure 1 UK offers attractive yields compared to its European peers



Source: Savills

Figure 2 Net multifamily yields for stabilised assets



Source: Savills, Oxford Economics

Convergence of yields between Regions and London

Another trend we are seeing is a convergence between multifamily yields for stabilised assets in London and key regional cities (Figure 2). Lower rates of return in London has been a trade-off for superior quality of income as well as the added security of its economy. Now, we are seeing the yield differential between the capital and the likes of Manchester and Birmingham narrow as investors realise the sustained demand for rental products outside of the capital.

Improving development viability to unlock new markets

Over the next 5 years rental growth is set to outpace house price inflation, especially across London and the South East. Oxford Economics forecast that UK earnings will grow by 15% over the next 5 years which will support rental growth and improve viability.

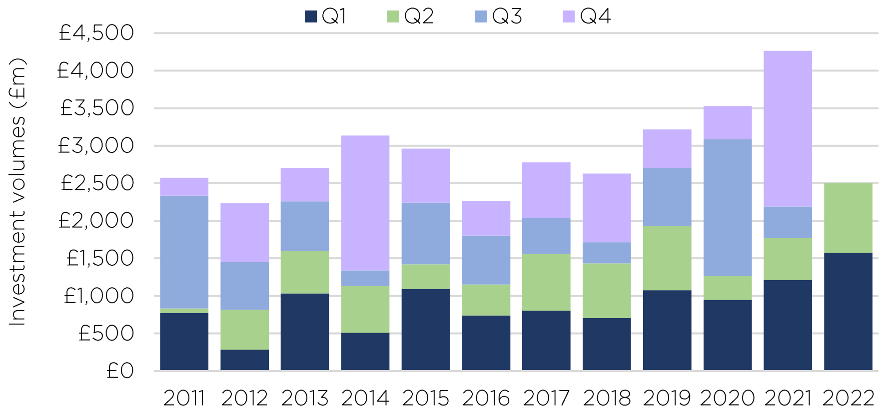
Improving viability is helping to unlock new markets as BtR investors can be more competitive when purchasing sites. The gap in returns between developing a site for open market sale and open market rent is narrowing. This is leading investors to expand their areas of operation.

UK Build to Rent Investment

Around £2.5 billion was invested into UK Build to Rent during the first six months of 2022. Q2 saw some notable transactions including Heimstaden Bostad's forward funding of Platform_'s Bonnington Road development in Edinburgh - once complete the development will total 464 homes adding to the 752 new BtR homes it acquired at Soho Wharf in Birmingham last year. But the most significant forward funding transaction of Q2 came in the form of Telford Homes' London based portfolio across three development sites within the capital.

On the operational side, we saw DWS acquire 182 homes for rent at the Royal Albert Wharf development. The seller was Folio (Notting Hill Genesis). This was a significant transaction for the sector, marking one of the first operational BTR assets of scale to trade in the London market since the start of the pandemic.

Figure 3 £2.5 billion invested into UK Build to Rent during the first six months of 2022 including the highest Q2 on record



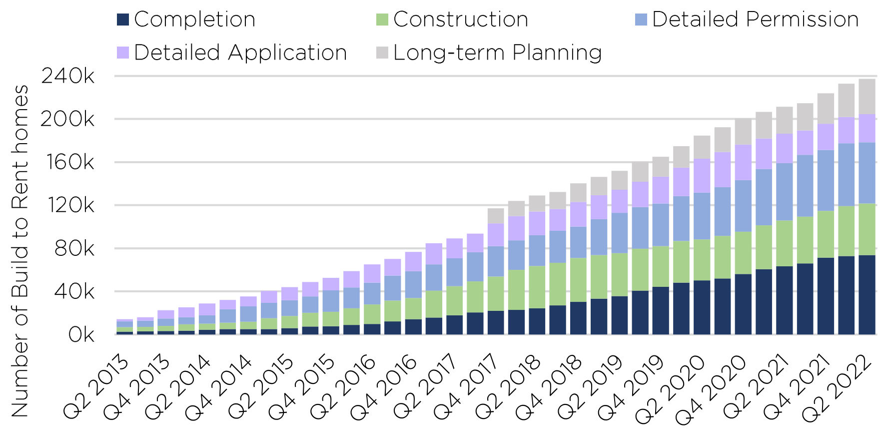
Source Savills

UK Build to Rent Development

The UK's BtR stock now stands at 73,700 completed homes with a further 47,800 homes under construction. The future pipeline currently stands at 115,900 homes, including those in the pre-application stage. This brings the total size of the sector to 237,400 homes completed or in development.

Growth has been strongest for Single Family BtR. The total planning pipeline for this segment of the market has grown to reach 21,000 homes, an increase of 44% over the past 12 months. The expansion of Build to Rent, particularly Single Family BtR, has been supported by investment into new markets. Build to Rent has been earmarked for an additional 29 local authorities in the past 12 months meaning 45% of local authorities now have BtR in their pipeline, up from 37% in Q2 2021 and 20% in Q1 2017.

Figure 4 Investment into new markets continues to support BtR expansion



Source Savills, British Property Federation, Molior

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