REPORT
Savills Research

UK Operational Real Estate

The Sky's The Limit?

Student Accommodation – Build to Rent – Retirement Living

savills

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Savills Summary Six

Here are our six key takeaways from this report:

1. **Residential operational real estate in the UK** is still in its early stages, representing an exciting growth opportunity for investors and developers.

2. **Institutions are already active,** but we expect appetite and activity to grow substantially as investors appreciate the underlying demographic drivers and the design & management considerations particular to the sector.

3. **The student accommodation sector** is the most mature and liquid of the operational real estate markets: currently worth over £50 billion.

4. **Build to Rent is still evolving** and has enormous growth potential: at just under £10 billion today, we predict at full maturity it will be worth almost £550 billion.

5. **The retirement living sector** also has huge capacity to grow. Within it, the care home market is more established, with institutions and REITs already actively investing. A market for retirement housing investment is now emerging. We believe the retirement living sector could grow from today's £120 billion to over £260 billion in value at full maturity.

6. **While there are differences** in design and management requirements for these asset classes, operators and investors are waking up to the potential crossover between student housing, Build to Rent and retirement living. Opportunities abound for these parties to leverage their experience and expand across the sectors.

> **"The UK's operational real estate will grow from £223 billion today to £880 billion at full maturity"**

The sky's the limit?

The sub-sectors of the UK's operational real estate are at different stages of maturity

This paper covers residential operational real estate. By this we mean places owned and operated by professional, large-scale investors where people live, whether those people are full-time students, young professionals, working families, or retirees.

Operational real estate offers attractive opportunities for investors and developers. It's supported by strong fundamental demographic and economic drivers. Already, investors have made significant inroads into many of these property sectors. However, many aspects of operational real estate are still emerging, and there are challenges still to face. In this document, we identify many of those challenges and explain how they might be addressed.

Of the UK operational real estate markets that we examine in this report, purpose-built student accommodation (PBSA) is the most mature, followed by Build to Rent (BTR) and then retirement living (RL).

As a more mature sector, opportunities for growth in PBSA will likely be by outperforming the competition on brand differentiation, rather than through innovation. Organic growth will largely be limited to growth in the full-time student population, rather than increasing penetration.

Capacity for new entrants is limited, with firms such as Unite, UPP and GCP REIT maintaining their hold on the majority of the market. We estimate the UK's PBSA sector is worth just over £50 billion.

BTR is still evolving. There is plenty of space for new entrants, and the competitive landscape is likely to look very different in ten years' time. Opportunities for growth in BTR will be driven by developing new stock and delivering innovative new products and tenure structures. While the BTR stock completed to date is worth less than £10 billion, at full maturity, w estimate the BTR sector could grow to £550 billion in today's values.

Institutions have invested in UK care homes for many years, but the scale of that activity is growing rapidly. By contrast, retirement housing has been a slower burn, with institutions only recently entering the sector. Retirement living (care home and retirement housing) is, therefore, an emerging sector where many of the rules are still being written. We expect to see competition intensify as new entrants compete to develop new product and build sufficient brand awareness to attract their target end-users. We calculate the total value of retirement living today is £120 billion: at full maturity, we predict the sector will be worth £266 billion in today's values.

The scale of investment in these asset classes is growing. Whether it's the recapitalisation of the Chapter student housing portfolio, Goldman Sachs' £2 billion investment in retirement housing developer Riverstone, or Greystar's recently launched £2 billion BTR fund, investors are increasingly confident pouring large amounts of capital into operational real estate, often across multiple asset classes.

WHAT DO WE MEAN BY MATURITY?

Emerging

- Intense competition from many small businesses
- New entrants and innovations often disrupt the market
- Revenues reinvested to fuel growth
- Innovation is the key driver of value
- Cost of capital is high
- Lack of transparency makes valuation difficult
- Customer needs evolve rapidly as knowledge and experience of the sector develops

Mature

- Market dominated by a handful of larger businesses
- New entrants and innovations gain little market share
- Profits distributed to investors
- Brand is the key driver of value
- Cost of capital is low
- Abundant comparable information makes valuation easier
- Customer needs move slower

Figure 1 Summary of UK operational real estate asset classes

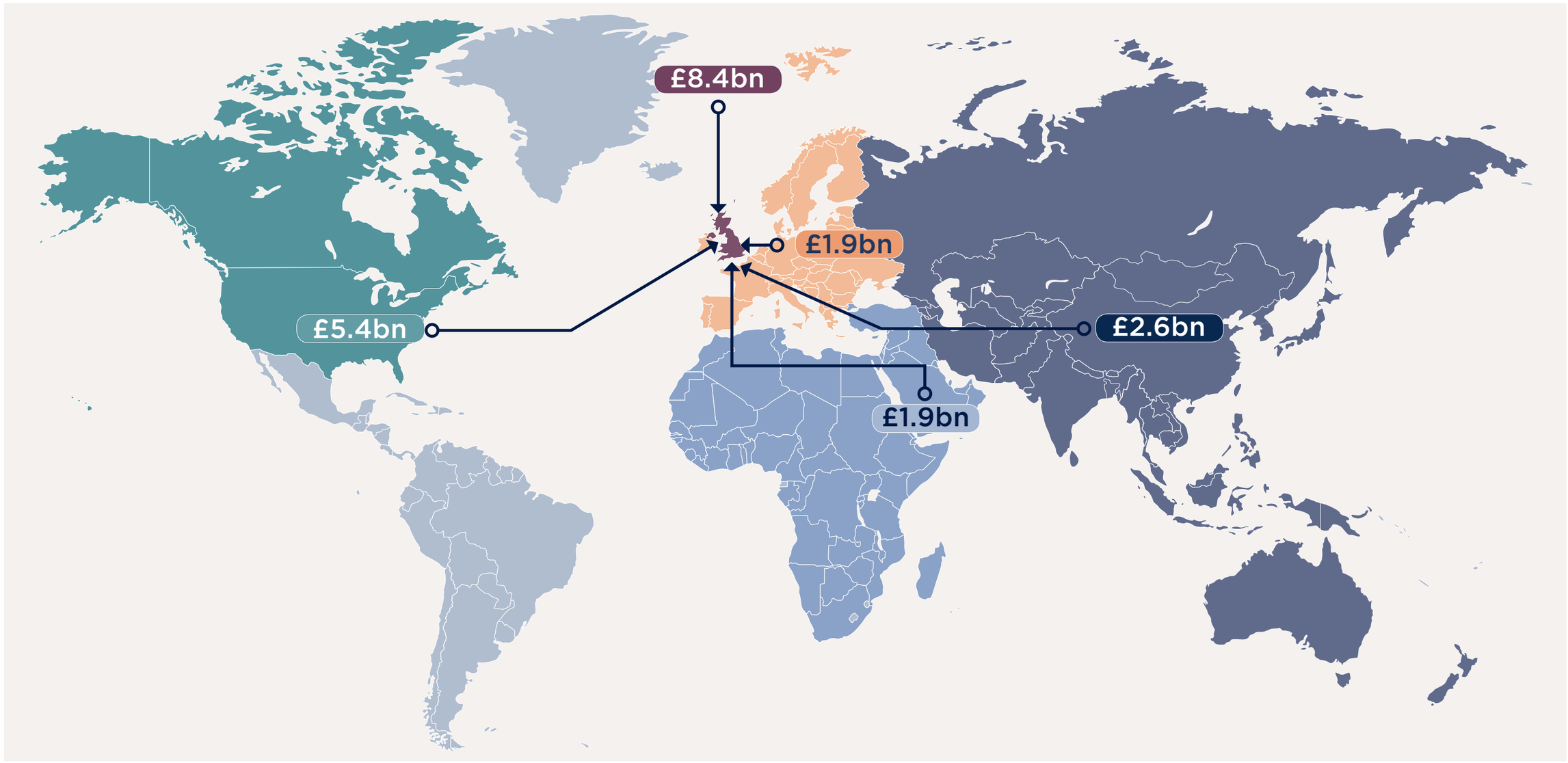
		Student Accommodation (PBSA)	Build to Rent (BTR)	Retirement Living (RL)
Size and potential	Target market	Full-time students	Households in the private rented sector	Over 75s
	Size of target market (2019)	1,844,500	5,202,700	5,693,800
	Current stock	640,000	30,400	1,193,000
	Stock at maturity	640,000	1,740,900	1,731,600
	Current sector value (bn, 2019)	£51.2	£9.6	£121.0
	Value at maturity (bn, 2019)	£51.2	£543.6	£265.6
Investment market	Investment in 2018 (bn)	£3.1	£2.6	£1.3
	Average investment 2015-17 (bn)	£4.7	£2.3	-
	Finance	Many bank and non-bank lenders, cost of finance low for borrowers with track record	Some bank and non-bank lenders, cost of finance slightly higher than PBSA	Some non-bank lenders, cost of finance higher due to untested model
Risks and evolution	Biggest risks	Brexit restricting EU student numbers In London: restrictions in Draft New London Plan	End of no-fault evictions reduces flexibility for investors In London: plans to impose social rent (with a registered provider landlord) on BTR schemes in Draft New London Plan	Local authority funding for residential care is too low, putting providers under financial pressure Potential restrictive legislation on event fees
	Possible innovation	Flexible use of space, and supporting residents to create communities and build loyalty	Greater understanding of how location and amenities influence value Support for residents to curate events, building communities	Emergence of retirement housing for rent and the 'rent-to-rent' model Co-location of retirement housing, care homes, and dementia care in retirement villages

Source Savills Research using ONS, RCA, EAC

UK Operational Real Estate

Investment flows into the UK

Domestic investors have dominated UK operational real estate over the last three years, but the North Americans aren't far behind



Source Savills Operational Capital Markets

Figure 2 Investment volumes into the UK by source of capital and sector, 2016-18

UK	Value	Deals
Student	£4.1bn	136
Build to Rent	£3.2bn	72
Retirement living	£1.1bn	49

North America	Value	Deals
Student	£3.3bn	31
Build to Rent	£1.4bn	18
Retirement living	£673m	15

Europe	Value	Deals
Student	£877m	9
Build to Rent	£501m	10
Retirement living	£498m	5

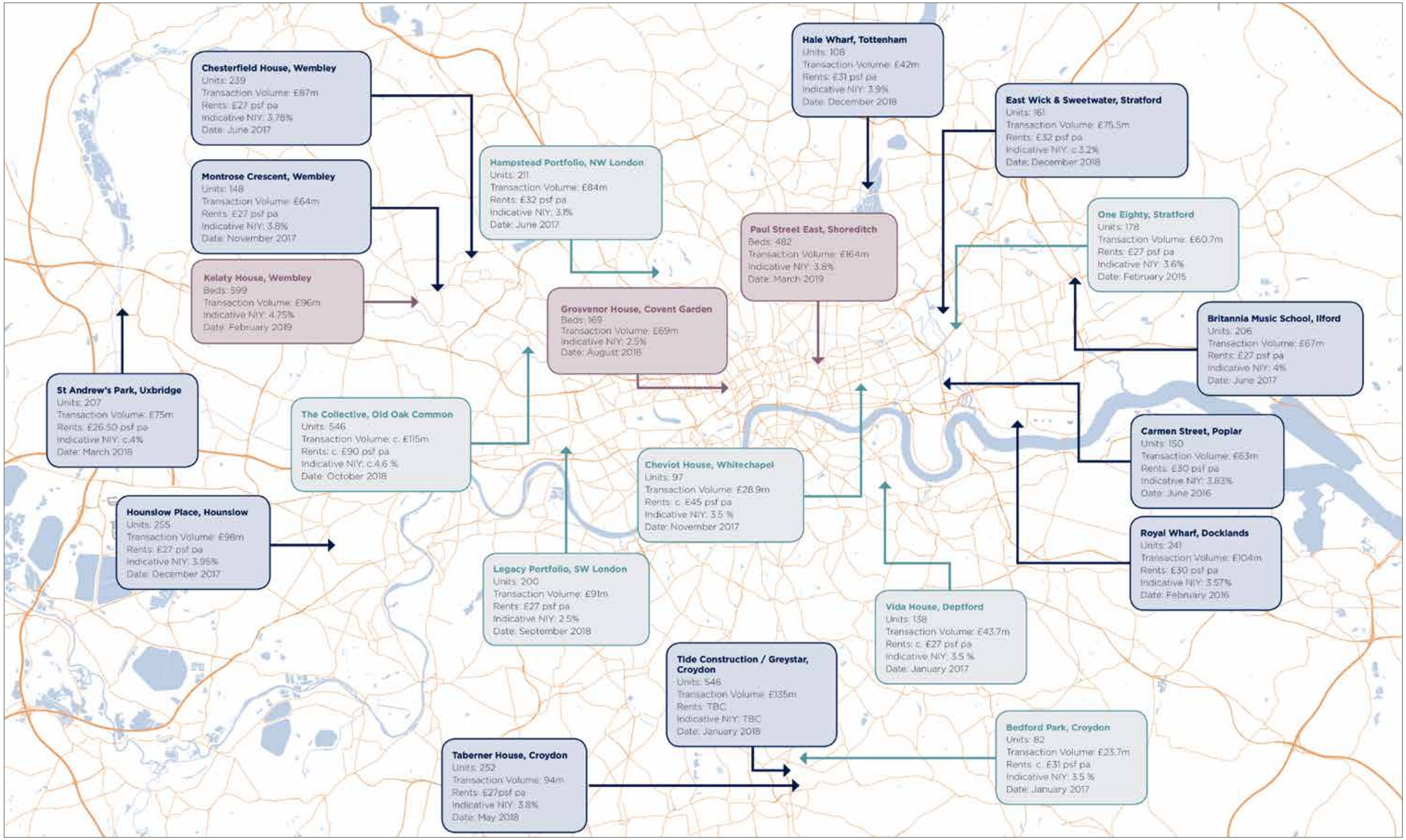
Asia-Pacific	Value	Deals
Student	£2.2bn	19
Build to Rent	£35m	1
Retirement living	£395m	1

Middle East & Africa	Value	Deals
Student	£1.0bn	31
Build to Rent	£931m	9
Retirement living	-	-

UK Operational Real Estate

What's transacting where?

Figure 3 London has been a hotbed of transaction activity across BTR and PBSA. Here we identify some of the more significant recent deals.



Source Savills Operational Capital Markets

Key Operational / Income Producing | BTR / Forward Funded | PBSA

Student accommodation

The most mature of the UK's operational real estate sectors, investors will face stiff competition to increase their market share

Purpose-built student accommodation (PBSA) is the most mature and liquid of the operational property markets in the UK. Investors had access to the sector as far back as 1998, when Unite Students listed on the Alternative Investment Market (AIM), a sub-market of the London Stock Exchange. Its transfer to the London Stock Exchange itself in 2000 marked the beginning of PBSA's evolution into a mature, mainstream investment class.

In the following years, a host of new investors entered the market, with REITs GCP and Empiric Student Property offering retail investors access to the PBSA market. 2015 and 2016 saw the latest new entrants, CPPIB and Brookfield. Since then, new entrants have played a less significant role in aggregating stock at scale. Now the market is dominated by a tight group of large-scale investors, with only small movements in market share of late.

The year in review

Investors placed £3.1 billion in UK PBSA in 2018, 19% less than in 2017 and 45% less than in 2015. Price per student bed remains high, at £90,000, in line with the average for the previous four years.

Just four deals accounted for more than half the PBSA investment market last year, down from five deals in 2017 and 12 in 2014. Institutional investors such as Allianz, Brookfield, and Aberdeen Standard dominated the PBSA market in 2018, accounting for 61% of the value invested and 56% of the beds.

North American investors had the greatest share of investment into UK student housing for the first time since 2015: 31%. Investment from mainland Europe and the UK was roughly equal, with each accounting for just over 23% of the year's total. Investment from mainland Europe and the Middle East last year was higher than the three-year average. The disproportionate fall in domestic investment since 2016 reflects both a particularly strong year in 2017, when UK investors made up 53% of investment volume, and a shift in focus to development, with UK PBSA developers building the stock for international investors to acquire later.

The years ahead

The first quarter of 2019 has been relatively quiet, with just over £600 million of investment. That's 44% less than Q1 2018 and 38% less than Q1 2017, reflecting the uncertainty leading up to the UK's original March 29th deadline for leaving the EU.

More than half the investment in Q1 came from just two deals: iQ agreed to forward fund almost 2,000 student homes in Leeds and Coventry, and Chapter acquired Paul Street East near Old Street, London.

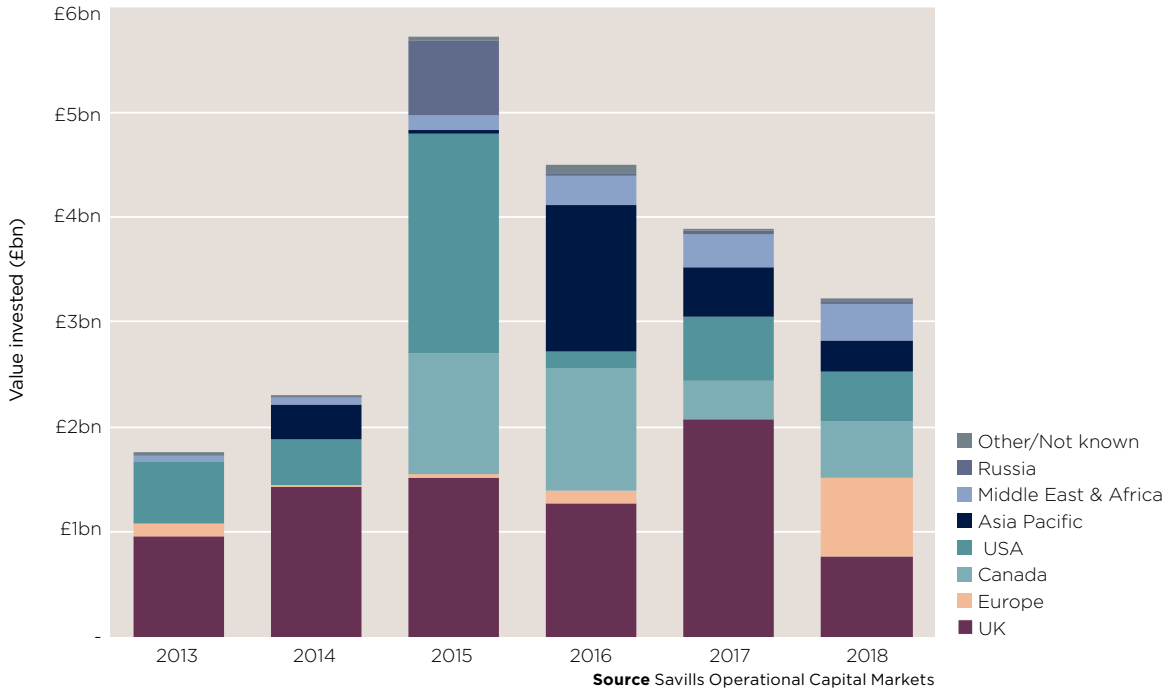
We predict that 35,000 PBSA beds will trade in 2019, with a total value of £3.5 billion. Based on the pipeline

Figure 4 Direct let net initial yields for student accommodation

	Net initial yield	Trend
London	4.00%	▼ Down
Super prime regional	4.75%	▼ Down
Prime regional	5.25%	▼ Down
Secondary regional	6.00%	▲ Up

Source Savills Operational Capital Markets

Figure 5 Student accommodation investment by source of capital



Source Savills Operational Capital Markets

of portfolios either on or approaching the market, we would expect to see a flurry of activity in the second half of this year. In particular, we expect to see activity accelerate once there is further clarity regarding Brexit, whether this arises from securing a withdrawal agreement, a further, longer extension to Article 50, or a hard Brexit on 31st October 2019.

Finance

Debt finance for development or stabilised PBSA assets is widely available through a range of lenders, including clearing banks, other banks and also non-bank debt providers. This is the case for major developments right through to small schemes, due to the relative maturity of the market: lenders feel they understand the UK PBSA proposition. The strength of some student housing developers' track records even means that their lending costs can be cheaper than for most Build to Rent developments.

Evolution

A little over a third (35%) of full-time students in the UK live in purpose-built student accommodation.

We see little scope for PBSA to increase its penetration of this target market. The sector will still be able to expand in line with growing full-time student numbers, and there will be a natural churn of development as older schemes become obsolete and are redeveloped.

Universities operating their own student housing will become more active in the market as their current schemes age: for example, Reading University has closed some of its older blocks in order to redevelop. Other universities could choose to partner with private PBSA developers to help reinvigorate their stock.

Operators trying to increase their market share will have to do so at the expense of their competitors, or in new markets. With parts of the UK PBSA market looking fully supplied, we expect to see larger investors turn their attention to less mature PBSA markets across mainland Europe, such as Italy, Spain and Portugal. Attitudes towards full-time study in these countries are changing, with more students choosing to live away from home during their time at university. This will fuel increased demand for PBSA, driving investor appetite in these markets.

In November 2018, the UK Government gave the green light for universities to offer accelerated two-year undergraduate courses. This will allow students to remain at university studying for two 45-week years, rather than the current standard of 36 weeks for three years.

We believe that this change will have only a limited impact at established universities with a strong focus on research. One of the selling points of Russell Group universities has always been that they attract leading lecturers and professors, who are working at the cutting edge of their fields. ▸

35% **Proportion of full-time students living in PBSA in the UK**

Offering accelerated degree courses would require these professors to spend a greater proportion of their time teaching, rather than working on new research, which they are unlikely to want to do.

At newer, teaching-focused universities, demand for these intensified courses is likely to be greater. This will have a mixed effect on demand for PBSA. On the one hand, the total number of students at these universities will fall unless they can dramatically increase recruitment, as some students will be on campus for two years rather than three.

On the other hand, having a greater number of students on 51-week leases will increase net operating income for those schemes that are let.

Risks and mitigation

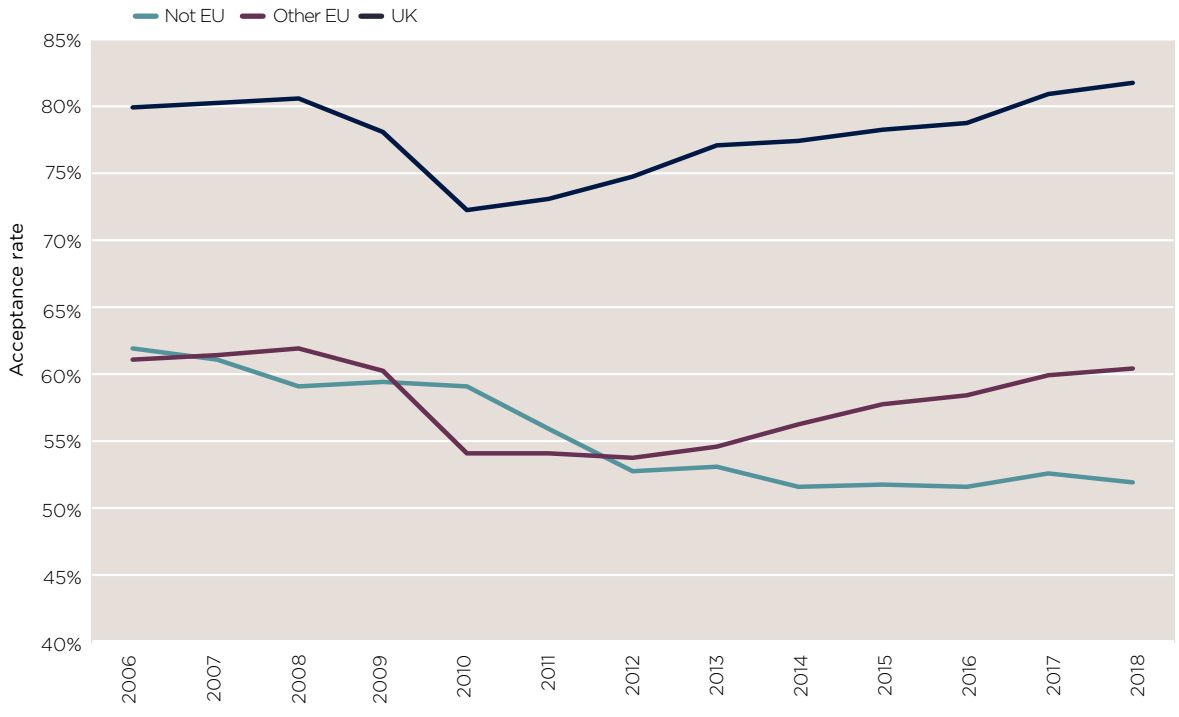
There are two categories of risk facing the student housing sector. The first and most pressing is political, with Brexit a persistent theme and immigration, education, and planning policy all high on the agenda. The second, more fundamental set of risks are demographic considerations stemming from the UK's ageing population.

The most apparent risk facing the UK PBSA market in 2019 is Brexit. Specifically, the uncertain future for international students following the UK's departure from the EU poses challenges for student housing investors.

While EU students make up just 7% of full-time undergraduate students in the UK, they're more likely to live in PBSA than domestic students according to HESA data. Currently, EU students pay the same fees as UK students. Government has yet to clarify what fees EU students will face after Brexit, but the prospect of levying substantially higher international student fees on EU students remains on the table. This would mean EU students could see their fees double or more. Those students would also lose access to finance from the Student Loan Company, meaning they would have to find a way to pay those higher fees up front. A large number of EU students might well look elsewhere for a university education should fees increase in this way.

However, changes to immigration policy could mitigate any potential falls in EU student demand.

Figure 6 Acceptance rates for undergraduate students by domicile



Source UCAS

The Project, Hoxton

As of March 2019 graduates from overseas can now remain in the UK for six months after graduating from a bachelors or masters course, up from four months. This is some way off the post-study work visa system scrapped in 2012, which allowed graduates to remain for 12 months, and countries such as the US and Australia which allow graduates to remain for up to 18 months.

However, it marks a positive shift in rhetoric. This change, and the potential exclusion of international students from immigration caps, could help UK universities recruit more students from outside the EU and further bolster PBSA demand.

Acceptance rates for non-EU students have fallen over the past decade as universities have felt increasing pressure from immigration policy. The immigration white paper suggests Government is taking a less hard-line approach with regards to overseas students, however. After the UK leaves the EU and seeks free trade agreements with countries such as China and India, student visas are likely to be a valuable part of the UK's wider trade offer.

If non-EU student acceptance rates rose in line with rates for EU students, the number of international students could increase by more than 7,000 per year. Given that international students are more likely to live in PBSA, this could have a significant effect on student accommodation demand.

Planning still presents a risk to student housing development, especially in London. The Mayor of London's Draft New London Plan suggests imposing affordable student housing requirements on PBSA schemes and requiring developers to have a nominations agreement with a university in place to secure planning permission. For now, PBSA consents are still being granted, but unless the Mayor is forced to back down, these proposals could make new PBSA development all but impossible anywhere in Greater London.

Last year we reported that the sector faces a demographic challenge (*Investing in Private Rent*, 2018), with the student age population approaching a trough. We're now one year closer to a return to growth. From 2020 onwards, population projections show rising numbers of people at university age, suggesting we'll see increasing demand for student places and for accommodation.

Old dog, new tricks

While PBSA may be the most mature of the operational property asset classes, there are still lessons it can learn from other, more emerging sectors.

With brand awareness and loyalty increasingly important for student housing operators in a highly competitive landscape, co-living and co-working offer interesting parallels and lessons to be learned. Amenities such as lounges, study/work areas and games rooms are common to all these spaces. Yet where co-living and co-working go beyond this is in the curation of these spaces. Through running events, or enabling residents to run their own events, these spaces can help create a positive sense of community that builds loyalty and encourages residents to renew their leases time after time. ■

Flexible space

The Project in Hoxton, East London, is a good example of how PBSA developers can create flexible amenity areas to support their residents and make best use of the space through the day.

Depending on what students want, the space can be configured for quiet study, workshops, yoga classes, film screenings, and DJ nights.

Expect to see more community creation initiatives in the next generation of UK PBSA schemes.

Build to Rent

The growth potential of UK Build to Rent is huge. The volume of funds being raised to target the sector is testament to the scale of investor demand

Private renting is not a new concept in the UK, but it's only in the last few years that large-scale, institutional investors have made their mark on the sector. 2013 was the year things changed, whether you consider the watershed moment to be M&G's acquisition of a Berkeley residential portfolio or Delancey funding the Athlete's Village in Stratford.

The sector has expanded rapidly in the years since, with over 30,000 homes complete and a further 110,000 in the pipeline that will be built, let, and managed by professional investors as homes for rent.

Looking to the student accommodation sector as our benchmark, there's at least a decade to go before institutional private rent reaches maturity. This means there is still scope for seismic shifts in the sector. There is also plenty of opportunity for new and innovative entrants to disrupt the market, as customer awareness and understanding of this tenure increases.

The year in review

Build to Rent investment totalled £2.6 billion in 2018, 11% higher than in 2017 and the highest level of investment since 2014.

Institutions, such as Legal & General and M&G, continued to grow, increasing their share of investment from £382 million in 2015 to £880 million in 2018, over a third of the total. Public companies made up a further third of the market, largely due to Grainger buying partner APG's 75% share of GRIP for £396 million.

Last year's investment volumes would have been somewhat higher had Lone Star's proposed sale of Quintain gone ahead. Even though the sale didn't go through, the scale of interest in acquiring one of London's largest BTR developments bodes well for the market in general.

Despite similarities between PBSA and BTR, relatively few investors are active across both sectors. Goldman Sachs, Legal & General, M&G, Greystar, and Aberdeen Standard are among the few to have invested in both. Goldman Sachs and Legal & General are the only two investors with commitments across all of PBSA, BTR and retirement housing.

Given the similar challenges in development and management, we would expect to see more investors expanding their capabilities to cover the full spectrum of operational residential assets. In particular, there are opportunities for firms to capitalise on brand awareness to encourage graduates leaving PBSA to move into the same investor's BTR schemes, and for those in later life leaving BTR for retirement housing.

The years ahead

Five years have now passed since 2014, when private equity firms invested over £1 billion into the BTR sector. With a typical 4-6 year investment horizon, we would expect to see those firms attempt to refinance or exit in the near future: as we saw with Lone Star's marketing of Quintain last year. Given comparatively poor sentiment in some parts of the residential sales market at present, we predict many will sell to institutions rather than breaking up blocks for sale to individuals, driving a spike in investment activity.

In addition to these investors, housebuilders are paying more attention to the demand from institutional investors to forward fund stock. This gives those developers an opportunity to reduce their risk exposure and helps generate returns more quickly, allowing them to move onto the next site faster.

Finance

Availability of development finance for BTR development is generally similar to that for student accommodation, despite the relative youth of the sector. In fact, banks and other debt providers are arguably more comfortable with the demographic drivers for BTR. The clear story of housing undersupply and stretched affordability as the premise for BTR investment is easy to understand, and perhaps provides more comfort for a lender than the more discretionary international student demand that helps underpin the UK PBSA proposition.

Nevertheless, the cost of finance for BTR development currently tends to be the same or higher than for

Carmen Street, Poplar

similar PBSA schemes, simply because BTR developers haven't yet had the chance to build such a strong track record in what is still a new sector. We expect to see the cost of finance for BTR decrease as the sector matures, potentially becoming even cheaper than finance for PBSA.

The PRS debt guarantee scheme is a helpful statement of Government's support for the BTR sector, but take-up to date has been slow simply because not much stock has completed yet. Refinancing demand for stabilised assets will grow substantially over the next five years as the pipeline of BTR stock completes and begins to let up.

Evolution

As of March 2019, there were just over 30,000 complete BTR homes in the UK, according to Savills/British Property Federation data. There were a further 37,500 homes under construction and 72,200 in planning, bringing the total pipeline to 140,100 homes.

We estimate that the 30,000 completed BTR homes have a total value of approximately £9.6 billion, based on average values for standing PRS portfolio transactions. This is just under 1% of the total value of privately rented housing in the UK, at £1.5 trillion. The vast majority of the remaining stock is owned by individual landlords: 1.9 million homes are owned with a buy to let mortgage.

Recent changes to tax and regulations have made buy to let much less attractive for individual landlords. Our analysis of UK Finance figures suggests that landlords have redeemed over 120,000 buy to let mortgages in the last two years, as they sell properties. There is an opportunity for larger scale, professional investors to aggregate portfolios of rental homes.

There are parallels here with how institutional and professional investment grew to 47% of rental stock in the US. In the aftermath of the sub-prime mortgage crisis in 2007, large-scale investors were able to acquire portfolios of scale from distressed mortgagees. While there is no crisis of such scale on the horizon in the UK, there is an opportunity emerging for investors to aggregate portfolios from individual landlords struggling to service buy to let mortgages.

In the more mature student accommodation market, 35% of full-time students live in purpose-built housing. Assuming a similar level of penetration in the private rented sector (and accounting for cross-over between the PRS and student accommodation for the younger age bands), we estimate that the UK Built to Rent sector could comprise over 1.7 million households at full maturity, with a total value of almost £550 billion.

We expect purpose-designed and built homes to make up the majority of this supply. Portfolios aggregated from buy to let property sales will comprise a significant minority.

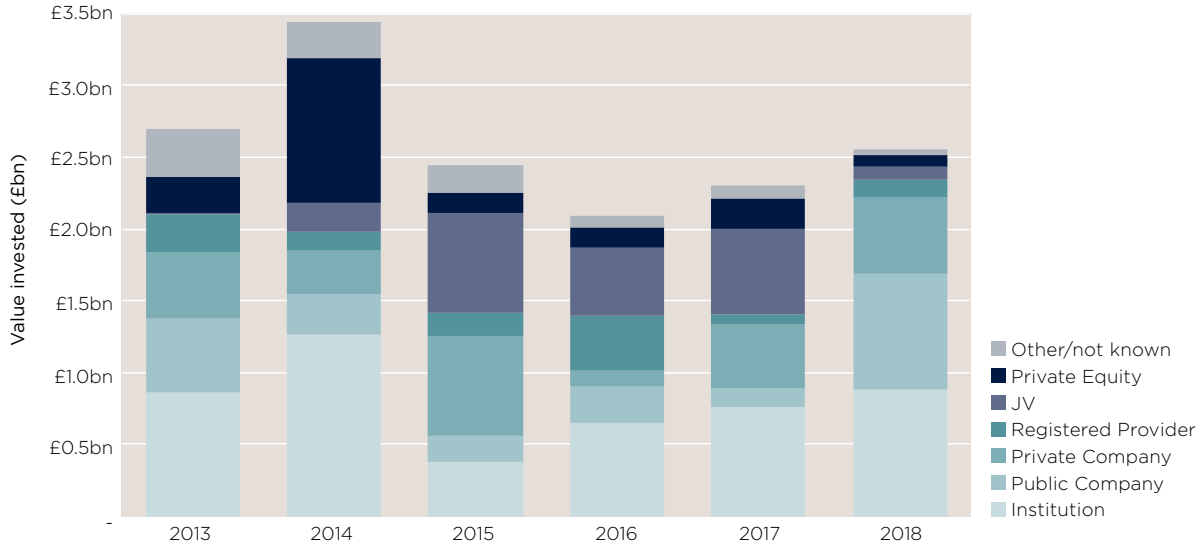
Reaching this potential will require a serious step up from current delivery levels. With buy to let looking less attractive, housebuilders will have to consider routes to market other than sales to buy to let landlords. Block sales to professional investors will undoubtedly be one of those alternatives. ▸

London and the regions

While London remains the most popular location for BTR investors, competition, planning policy, and higher costs will push more development to the regions. Many investors have already bought into Manchester's investment and rental growth story, and there are still considerable opportunities for expansion at the lower end of the market and in other regional cities across the UK such as Bristol, Leeds and Glasgow.

In March 2019, London developer Telford Homes plc entered an agreement with Invesco and M&G, giving those investors first refusal on funding any new Telford developments. While these deals will result in lower profit margins for Telford in the short term, this funding model allows them to recycle capital and deliver sites more quickly, while also reducing their risk exposure.

Figure 7 Build to Rent investment by type of investor



Source Savills Operational Capital Markets

Risks and mitigation

While Brexit dominates the foreign policy agenda, housing sits at the top of parliament's domestic policy priorities. That's been reflected in the policy announcements made since the tail end of 2018.

Since 2013, Government has supported households buying new build homes through Help to Buy. That changes from April 2021, when Government plans to restrict the scheme, and in March 2023, when the scheme is set to end entirely. Without this source of Government support, demand for rental homes will rise as fewer households are able to access home ownership.

Last year also saw the publication of the Letwin Review, which reported on housing delivery rates on large residential sites in England. One of the key recommendations of that report was to encourage a greater diversity of tenures on large residential developments, including BTR.

More recently, Government announced that it would end no-fault evictions. While Build to Rent landlords are unlikely to want to evict residents without good reason, losing this option makes BTR look riskier as a long-term investment. It could seriously delay redevelopment if a landlord needed to go through a lengthy Section 8 court hearing for every home on a scheme, for example. Much depends on the detail of the proposed changes, which will not become clear until later this year.

We have more clarity on Labour plans for rent control. Reassuringly, these resemble rent stabilisation measures, as seen in New York City, for example, rather than rent caps. Shadow Housing Minister John Healey has clarified that Labour plans would be to cap rental growth within tenancies to CPI plus a small premium.

Capital complications

Uncertainty regarding the possibility of rent controls and the Draft New London Plan may be why regional schemes now make up a majority of BTR homes under construction.

There is a caveat to John Healey's comments on Labour's rent control plans to consider. The Shadow Housing Minister has said that their policy would support introducing more assertive rent control measures in areas where rental affordability is most stretched, such as London. For now, the detail behind this policy aspiration remains unclear. Should Labour reveal plans to introduce rent caps, however, this could make London look far less appealing for BTR investors.

The Draft New London Plan, currently still in examination, could also make it much more difficult to deliver BTR schemes.

Key BTR deals

In January 2019 Legal & General forward funded Buchanan Wharf, a 324 apartment scheme on the south bank of the River Clyde in Glasgow. This was the first forward funded BTR deal in Glasgow and Scotland's first transaction involving a purpose-designed rental scheme.

Transport for London's (TfL) recent agreement with Grainger is a prominent example of a trend that Savills expects to see much more of in the coming years: public/private partnerships. The TfL and Grainger partnership combines the two entities' expertise, capital, and land to unlock delivery of 3,000 BTR homes across London.

With mounting pressure on government departments to release more land and reduce reliance on central government funding, we expect to see more deals like this over the remainder of this parliament.

In addition to urban apartment schemes, we expect to see an increase in activity from investors developing house-led schemes in suburban locations. This type of housing appeals to a different part of the market from flats, which comprise most Build to Rent development to date. PRS REIT has been notable in investing in houses to rent so far, but firms such as Grainger, Legal & General and M&G all have BTR houses in their pipelines.

£544 bn Size of the UK BTR sector at full maturity

The Collective, Old Oak

In particular, some of the Mayor of London's Further Suggested Changes to the plan include allowing boroughs to set affordable housing requirements on BTR schemes that include social rent homes, where the homes are managed by a registered provider. Since most BTR investors are not registered providers, this would make it impossible for single BTR blocks to remain in single management. Where this is a requirement, the likelihood of securing investment is poor at best, potentially making some BTR development in London much less attractive.

Learning from student

There are a few things the BTR sector can learn from the more established PBSA market to help make the most of schemes.

Firstly, it's important to consider location at a micro level. Cities are not homogenous: they have areas of high and low value, stronger and weaker amenity offering, and better and worse access to public transport. In the case of PBSA, developers must also consider proximity to universities, as there is often a steep downward gradient in the rent you can charge as you move further away from campus. BTR schemes must consider these factors, taking heed of proximity to the prime localities in their wider area and setting rent expectations accordingly.

When providing amenities on schemes, BTR developers need to think about what provides actual value to residents as opposed to headline-grabbing novelty. PBSA operators often help their residents with setting up events, providing space and logistical guidance. We've seen a similar approach at The Collective's co-living space at Old Oak Common, where staff support residents running yoga classes, business coaching and cooking courses.

Resident amenities

The management of The Collective bought the firm's scheme at Old Oak Common in October 2018 for £115m. It is the only stabilised co-living scheme in the UK, and comprises 546 residential units with associated amenity space and commercial units.

These events can help foster a sense of community, encouraging residents to stay in the scheme longer and decreasing voids. Even without events, there are ways to promote communities in schemes: in PBSA, shared study and recreation spaces bring people together organically.

Finally, it's vital to consider how a scheme interacts with its surroundings. Plans for PBSA schemes often meet objections that they will "studentify" the surrounding area, which means they have to work even harder to get local communities on side. Ensuring that a scheme engages and interacts with its surroundings, regardless of tenure, will be key in securing public support.

Retirement living

Care homes and retirement housing each face challenges, but the demand for these products will only grow as the country's population ages

Retirement housing

Retirement housing has been a feature of the UK housing market for decades. The bulk of existing stock is sheltered housing for social rent, built using grant funding in the 1970s and 1980s. Much of the balance is made up of owner occupied homes, built by specialised housebuilders such as McCarthy & Stone.

A more investible market is beginning to emerge, however. Demographic and affluence trends show there's huge potential: an ageing population with vast stores of housing wealth is an attractive customer base. New Zealand, the US and France serve as examples of the potential for retirement housing to grow into a large scale and appealing asset class.

The sector so far

There are 730,000 retirement housing units across the UK, according to the Elderly Accommodation Counsel (EAC). More than half these homes, 52%, were built or last renovated over 30 years ago.

There are two models for developing retirement housing for sale. The first, and simplest, is largely indistinguishable from the traditional housebuilder sale model, with a price premium to reflect the added cost of providing communal facilities such as a residents' lounge, café or gym. Alternatively, a developer might charge an "event fee" – a charge when the resident sells their property, usually for a proportion of the sale value – to fund these shared amenity spaces.

It's only in the last few years that we have started to see institutional investment into the sector. Legal & General assembled Inspired Villages from its acquisitions of Renaissance Villages and English Care Villages in 2017, and has recently made headlines by launching its urban retirement brand Guild Living. ReSI REIT has been building its portfolio of retirement housing, purchasing schemes from Aviva and Places for People. And Goldman Sachs-backed Riverstone aims to build a London retirement housing pipeline worth more than £2 billion over the next two years.

More recently, some developers have departed from these traditional models. Auriens and Birchgrove will shortly begin letting retirement homes for private rent, each targeting very different price points. While retirement PRS is unusual today, there are excellent reasons for older people to choose this tenure.

In the case of Goldman Sachs-funded, luxury London scheme Auriens, customers will avoid a stamp duty bill equivalent to over a year's rent by choosing not to buy. In the case of more mid-market Birchgrove, renting enables residents to unlock the equity held in their former homes. The nation's largest retirement housing developer, McCarthy & Stone, has also started offering homes to rent in its schemes.

There is significant untapped potential in retirement homes for rent. While many older households own their homes, a rent-to-rent model could help them move into retirement housing while retaining ownership of their family home and avoiding stamp duty.

We estimate that more than 570,000 households over 75 could afford to rent a retirement home using the rental income from their main home.

Size matters

Prior to 2000, 80% of retirement housing supply was on smaller schemes with fewer than 50 homes. More recently, the bulk of supply has come from larger developments, with schemes of over 50 homes making up 56% of supply in the ten years to 2018.

As the sector continues to move towards a care-based model, developments will get larger to incorporate efficiencies of scale. Larger schemes can also accommodate a range of tenures more flexibly, as demonstrated by the Extra Care Charitable Trust on their large, multi-tenure developments.

The largest retirement village in the UK today is Lark Hill Village in the West Midlands, with 340 homes. In the future, this size of scheme could become the norm.

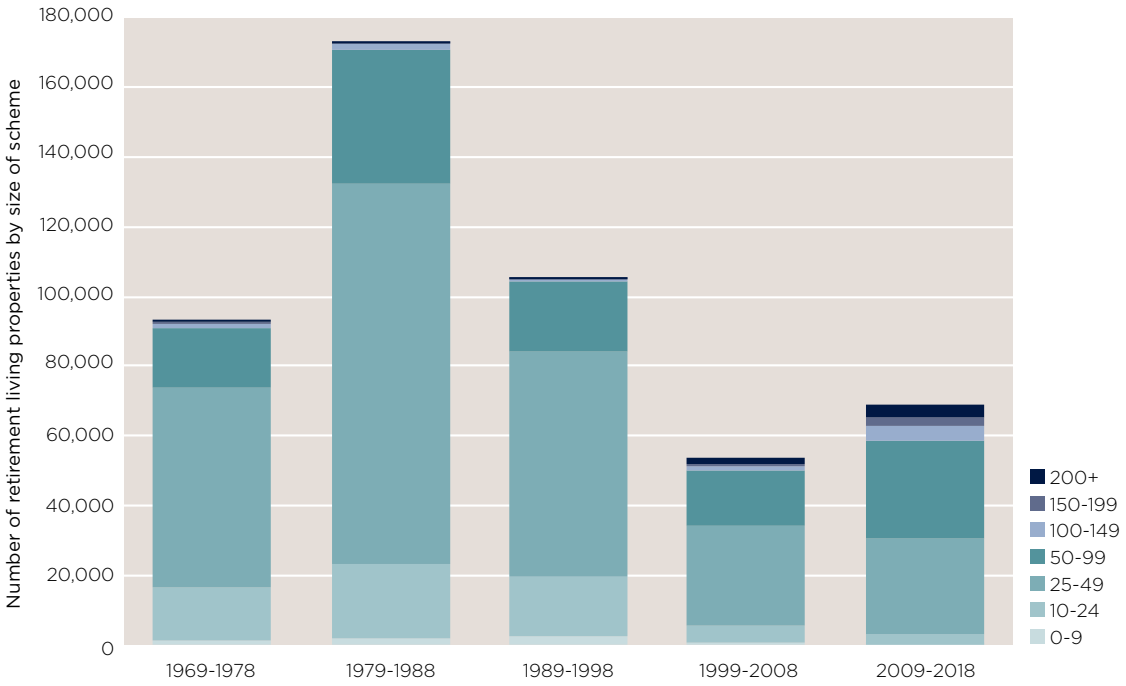
Risk and mitigation

Retirement housing currently sits across two planning use classes. The C3 use class is the same as for regular residential developments, and requires a developer to provide affordable housing. The C2 use class requires some kind of care to be provided on site, but without an affordable housing contribution.

Guidance on the amount and type of care needed to qualify as C2 is inconsistent across the country, leading to uncertainty over whether a potential retirement living scheme will be viable. In London, guidance is clearer, in that C2 developments are expected to provide both care and affordable housing, putting them at a disadvantage to C3 schemes.

£244 bn Size of UK retirement housing sector at full maturity

Figure 8 Retirement living schemes by number of units



Source Savills Research using EAC

Clarity on what level of care is required on C2 developments, perhaps through an update to National Planning Practice Guidance, would reduce this uncertainty and could unlock more retirement housing development, particularly if it levelled the playing field for schemes in London.

Some retirement living providers have 'event fees', charging former residents a proportion of the property's value on resale. Poor communication of what these fees pay for and when they are levied has harmed the sector's reputation.

Government has promised to implement the Law Commission's recommendations for event fee reform, including restrictions on when they can be charged and standardised information to be included in marketing and sales documents. New Zealand, which has a better-established retirement living sector, enacted similar legislation back in 2003.

This suggests that greater transparency around event fees could help rebuild trust between residents and developers, enabling faster retirement housing delivery.

Evolution

We estimate that the 730,000 retirement housing units across the UK are worth just under £100 billion. Accounting just for today's over-75 population, we believe that the retirement living sector could grow to 1.7 million homes at full maturity. This is an increase of 138% over current stock. Accounting for population growth, this figure would be even higher.

We noted in our earlier publication (*Spotlight on Retirement Living*, 2018) that the supply of sheltered homes for social rent is in line with need. This additional stock will, therefore, comprise a mix of market sale and intermediate homes, either privately rented, shared ownership, or new products such as rent-to-rent. The mix of different housing tenures and types required affects the values of these homes.

Accounting for the tenure of this additional stock, we estimate that at full maturity the UK's retirement housing sector could be worth £244 billion.

To put this figure into context, we have calculated the value of housing owned and occupied by the over 65s to be over £1.6 trillion. Much of the increase in the value of the retirement housing sector could be funded through older people choosing to downsize. The challenge here will be providing a product that can tempt these older residents out of a home they've likely lived in for decades.

The potential benefits of a larger retirement living sector are substantial. Offering homes that allow older people to age in place, retirement villages can help free up much needed family housing, reduce the nation's social care costs, and address feelings of isolation and loneliness in the older population. Based on research from Demos and The Aston Research Centre for Healthy Ageing, government saves between £1,000 and £1,540 per year for each person moving into retirement housing with care.

85% Increase in care home investment in 2018 vs 2017

Care homes

Almost 420,000 people live in elderly care homes in the UK, accounting for just under 15% of the population aged over 85, according to LaingBuisson figures. The ONS projects a 36% increase in the 85+ population by 2025, and we expect to see a corresponding increase in care home demand.

However, despite the demographic drivers supporting care home demand, some operators are facing financial pressure due to a heavy reliance on local authority-funded residents.

Investment

Elderly care home investment was £1.3 billion in 2018 across 26 deals. That's almost double the investment we saw in 2017, £0.7 billion, despite a similar number of deals (24). Net initial yields averaged 6.6% in 2018, slightly down from 6.9% the previous year. While average yields only compressed by 22 basis points, last year also saw three transactions with yields below 4.0%, with Aberdeen Standard paying a record low 3.75% for Moore Place in Esher.

Just two deals made up more than half the value invested last year: Aedifica's acquisition of the Forest portfolio from Lone Star, and Chinese private equity firm Cindat's purchase of HCP's Ice portfolio. This interest from overseas marks a change from 2017, when 74% of investment volume in elderly care homes was domestic.

The long lease lengths and indexed rents on care home leases make them attractive for investors. Leasing to an operator means investors can expect a stable, steady rental income stream, similar to more established property sectors such as offices.

Risk and mitigation

Four Seasons has dominated recent elderly care headlines with their fall into administration. This comes alongside a 33% increase in insolvencies for elderly and disabled care homes between 2017-18 and 2018-19, according to our analysis of Insolvency Service figures.

Care homes are funded through a mix of sources. Residents with more than £23,250 in savings (more in Wales and Scotland) must pay for care themselves, while local authorities fund care for those below this savings threshold.

Local authority funding for care homes is severely restricted, with the state paying substantially lower rates than an individual funding their own care. This puts financial pressure on care homes with a high proportion of local authority-funded residents. Without reform, we are likely to see more care homes close as they struggle to remain profitable on local authority fees.

In spite of these funding challenges, the UK's ageing population will drive growing need for elderly care. For the many care home operators attracting a high proportion of private paying residents, it's possible to deliver strong and sustainable returns.

Evolution

We estimate that, in pure numbers terms, the amount of care home places available today is broadly in line with need.

That's not to say there is no potential for growth, however. As with retirement housing, many of the UK's 470,000 care beds are in dated buildings with facilities that are no longer fit for purpose. The number of care beds is decreasing year on year, as unviable, smaller or older homes close faster than the restricted rate of new development. As stock levels fall and the number of older people increases, we expect a swell of demand for new care home development over the next few years.

While there are many reasons a person might move into a care home, one of the most common causes is the onset of dementia. The Alzheimer's Society reports that 70% of elderly care home residents in 2019 had dementia or severe memory problems, and one in six people aged over 80 across the UK suffered from the illness. PHE estimated that 645,000 people aged over 65 in England had dementia, of whom just two thirds (68%) had a diagnosis.

These conditions require careful management. While retirement housing may be suitable for helping older people live independently without care for longer, even the best-designed retirement village cannot hope to care for dementia patients without specific care facilities and staff on site.

As the population with conditions such as dementia grows, the need for care homes and dementia care facilities will rise in turn. We would expect demand for retirement housing to be strongest on village schemes offering the option of residential and dementia care on site, so that residents are able to age in place. ■

Conclusions

Operational real estate in the UK offers exciting growth opportunities for investors and developers

Operational real estate is a broad term, covering a huge range of sectors at different stages of maturity.

On one end of the spectrum, the student accommodation and care home markets are highly liquid. Comparable information and debt finance are both readily available. Some way further along that spectrum we have Build to Rent, which continues to evolve as landmark schemes demonstrate a strong track record. And at the far end, we have institutions taking their first steps in the retirement housing sector.

Common to all these sectors is the recognition that investing in where people live is attractive. The fundamental demographic and economic changes supporting these sectors are difficult for investors to ignore. Institutional interest will continue to grow as these asset classes mature and can increasingly demonstrate their track record.

The student accommodation market is among the most mature of these operational sectors. Worth over £50 billion, we predict the rising student-age population and expansion into new markets will be the main drivers of growth. The sector faces challenges in the form of Brexit and the planning system, but can boast a long history of strong, stable returns in the face of political and economic turmoil.

Build to Rent has come a long way in the last decade, growing from a niche topic at investment conferences to one of UK real estate's most exciting asset classes. Worth a little under £10 billion today, we predict it has capacity to grow to more than £500 billion in value at full maturity, accounting for around 1.7 million households. The volume of funds being raised and invested in this sector, even in the face of political uncertainty, demonstrates the sheer strength of conviction investors have in BTR.

Retirement living is perhaps the most diverse of all these operational real estate sectors, with the nascent retirement housing market on the one hand and the more mature, liquid care home market on the other. The challenges they face are very different: for care homes, restricted local authority funding; for retirement housing, lack of a proven track record. However, both benefit from strong demographic support, with the UK's 75+ population projected to grow more than a third by 2030. Increasing demand for retirement living will force us to find solutions to these challenges, as the sector grows in value from £162 billion now to £235 billion at full maturity.

In total, the UK's residential operational real estate is currently worth £223 billion. Growing these sectors to full maturity will require investors to hold their nerve in the face of political headwinds and economic uncertainty. Overcoming those challenges, however, will increase the value of these sectors fourfold to £880 billion.

That is an opportunity worth getting excited about.

Figure 9 The bluffer's guide to operational residential real estate

Term	Explanation
Operational residential real estate	Property owned and managed by professional investors where people live. Includes student accommodation, Build to Rent, and retirement living.
PBSA	Purpose-built student accommodation - student halls.
PRS	Private rented sector. Can be homes owned by individual landlords or professionally managed, purpose-built homes for rent.
Buy to let	Small scale investment into privately rented housing, often financed with a mortgage.
BTR	Build to Rent. Homes that are professionally operated for rent by large-scale investors.
Multifamily	Professionally managed blocks of flats to rent: so called because many families live in the one building.
Single family	Professionally managed houses to rent: so called because usually only a single family lives in each building.
Senior living	Homes for older people (typically 75+). Includes retirement housing and care homes.
Retirement housing	Homes purpose-built for older people, often incorporating common amenity spaces such as lounges, cafes and spas.
Care homes	Facilities with higher levels of social and medical care provision for people with more serious care needs.
C3	A residential planning use class. C3, dwelling houses, covers standard housing, BTR and retirement housing without care.
C2	A residential planning use class. C2, residential institutions, covers care homes and retirement housing providing elements of personal, social and/or medical care.
Institutional investor	Large, long-term investors such as pension funds and insurance firms. Typically these investors seek long-term, stable returns.
REIT	Real Estate Investment Trust. Provides investors tax-efficient exposure to property assets.
Risk-free rate	The rate of return an investor would receive from an investment with zero risk. In practice, no such investment exists, but gilt rates or swap rates act as a good proxy.

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