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Savills Research

UK Single Family Housing 2023

Redefining Rental Living

REPORT HIGHLIGHTS

£1
BILLION

SINGLE FAMILY HOUSING (SFH) INVESTMENT

Over £1bn invested in the first 9 months of 2023, more than triple the amount invested in 2022. By April, 2023 had already become the record year for investment in the sector.

£25
BILLION

SCALE OF OPPORTUNITY

The sector has attracted in excess of £3bn of investment to date, with investors we surveyed ultimately looking to deploy more than £25bn in total.

2,000
HOMES

HOUSEBUILDERS ARE MORE ACTIVE

More housebuilders are adapting their business models to include SFH and increase sales. This year, a pipeline of nearly 2,000 homes has been sold by UK housebuilders, to institutional and other large-scale investors.

47%
OF INVESTORS

ARE TARGETING PORTFOLIOS OF 2,500 - 5,000 HOMES

An additional 33% are targeting portfolios larger than 5,000 homes, although only one investor has hit this target so far. A large minority (10%) said they have no upper limit.

100%
OF OPERATORS

REPORT IMPRESSIVE LEASE UP RATES

Respondents had sites lease-up in line with expectations (41%) or outperform underwriting assumptions (59%). No operators reported slower lease-up than expected.

69%
OF TENANTS

VALUE QUALITY OF MANAGEMENT

Access to local amenities, quality of management and asset specification are the features tenants value most.

47%
OF INVESTORS

SAID EV CHARGING POINTS ARE A MUST

Electric Vehicle (EV) Charging Points and Air Source Heat Pumps are the most in demand, with 47% and 32% of investors stating these features must be included in their homes. Triple glazing is the least in demand, with 24% stating they 'don't need to include'.

Market update

The fundamentals for investing in Single Family Housing (SFH) remain strong. Twelve months have passed since our last Single Family Housing report, yet the available supply in the rental market remains suppressed: the number of homes available to rent on Rightmove is a fifth lower than between 2017 and 2019.

Some markets have seen a particularly stark reduction in supply in recent years - Horsham, Telford & Wrekin and Crawley have 33%, 39% and 44% fewer homes available to rent, respectively, compared to the 2017-19 average. These locations all have SFH homes either in operation or in planning, suggesting that SFH is already making a meaningful contribution to housing delivery in these markets, however there is likely to be a requirement for more units to cater for strong demand.

In Q3 2023, the supply of two bedroom properties was the most constrained nationally. There were 22% and 17% fewer quarterly listings on Rightmove for two and three bedroom homes, respectively, compared to the 2017-19 average. SFH can support those segments of the market that are most in need, by boosting the number of available listings (of SFH homes either operational or under construction, 27% have two bedrooms and 56% have three bedrooms).

One reason for the reduction in supply is that the turnover of rental properties has decreased, with tenants remaining in rented homes for much longer periods. This is driven by the shortage of vacant homes for sale, as well as restricted access to home ownership, creating an incentive for tenants to remain in their existing property for longer. According to the RICS Sentiment Survey, only two months in the past 36 have seen rising landlord instructions (new supply).

The reduction in properties available to rent has been greatest for 2 bedroom homes

Source: Savills Research using Rightmove

With fewer homes to rent, increased competition is driving up rents

In addition to reduced supply, tenant demand has continued to rise. In the latest RICS survey, tenant demand remained elevated in August 2023, with the majority of surveyors citing an increase. A net balance of +47% of surveyors reported rising tenant demand. This is a similar reading to August 2020 (+49%) and May 2021 (+48%), showing just how long the UK rental market has been experiencing excess demand. Ultimately, the imbalance between supply and demand will continue to push up rents, with affordability being the only real constraint. According to the Zoopla Rental Index – powered by Hometrack, UK rental growth has been above 10% year-on-year for 19 consecutive months. Since peaking at 12.1% in July 2022, annual rental growth had slowed to 10.1% in April 2023, however it accelerated again in May, June, July and August.

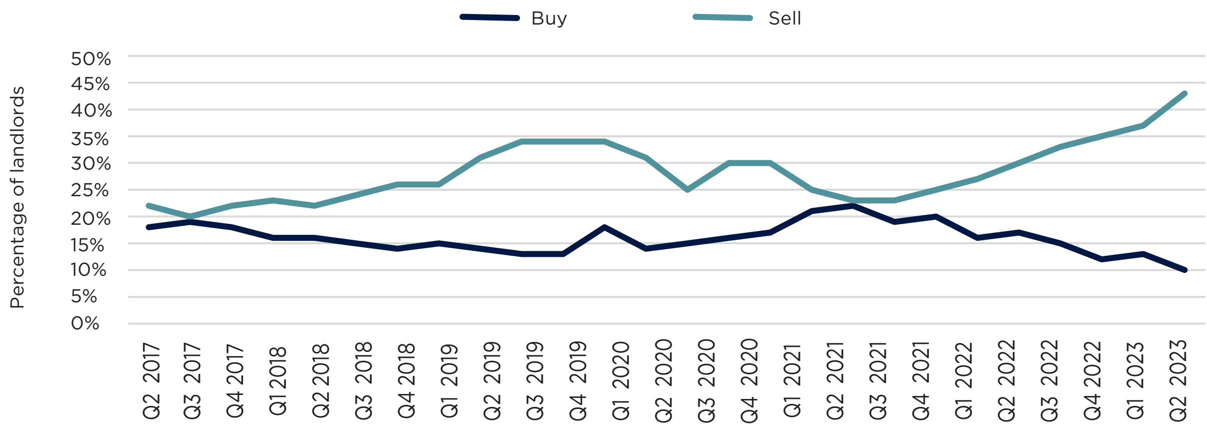
Consistent rental growth has been supported by strong earnings growth. The latest income data from the ONS shows that between April and July 2023, annual growth in regular pay was 7.8%, the same as the previous three-month period and the highest annual growth rate since comparable records began in 2001. Annual growth in total pay (including bonuses) was even higher at 8.5%, which included the NHS and civil service one-off payments made in June and July 2023.

High levels of new supply are unlikely to come from the Buy to Let sector

The solution to the supply-demand imbalance in the rental market is unlikely to come from the Buy to Let sector. There is evidence that it is less profitable to be a Buy to Let landlord than in previous years, as the increased cost of mortgage finance is limiting the ability of would-be landlords to enter the sector or existing investors to expand their portfolio. In Q2 2023, the average net profit for a 40% taxpayer buying today with a 70% loan-to-value mortgage had fallen to just 1% of the gross rent received. That is the lowest margin since 2007 and well below the 23% seen between 2014 and 2017.

At the same time, landlords already invested in the sector will be enduring higher mortgage costs. A record high of 62% of landlords increased rents in the year to Q2 2023, in an effort to make their sums add up. It seems that many have not been able to make the numbers work, particularly where their original investment premise was long-term capital growth rather than ensuring income was able to sufficiently cover all operational and debt costs. Unsurprisingly, the proportion of landlords intending to sell property in the next year had risen sharply to 43% in Q2 2023. Unfortunately for renters, this points towards a continued shortage of stock in the rental market.

The number of landlords intending to sell their property has risen sharply

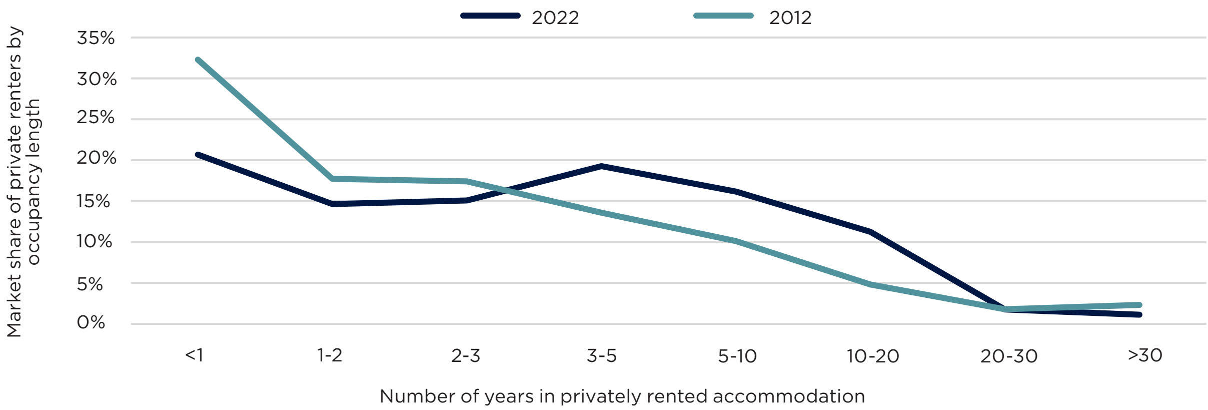


Source: National Residential Landlords Association

SFH can help to replace some of these homes being lost from the rental market. From an occupier perspective, there is unlikely to be a shortage of demand, given the aspiration of homeownership has become increasingly distant in a higher interest rate environment. There is projected to be an increased number of 'Lifetime Renters': those who currently rent privately and are unlikely to ever be able to afford to buy. Given many of these will be families, there are increased challenges of saving for a deposit while supporting children.

We have already seen a shift towards people staying in the rental market for longer, with 30% of renters in 2022 having an occupancy length of more than five years, compared to just 19% in 2012. As a result, tenant demand is growing for high-quality rental homes that meet the needs of a family. SFH has an important role to play in alleviating the UK's supply crisis, but the sector will need to scale up considerably if it is to really move the dial.

There has been significant growth in the number of long-term renters over the past decade



Source: English Housing Survey (2021-22, 2011-12)

Single Family Housing records best ever year for investment

UK Single Family Housing has attracted £3 billion of investment to date, despite being a relatively nascent sector. This year marked a step change in the pace of SFH investment, with c.£1 billion deployed in the year to September.

By April, 2023 was already the record year, boosted by several significant deals, including Project Domus, the sale by Goldman Sachs of 918 homes in the North West to PGIM.

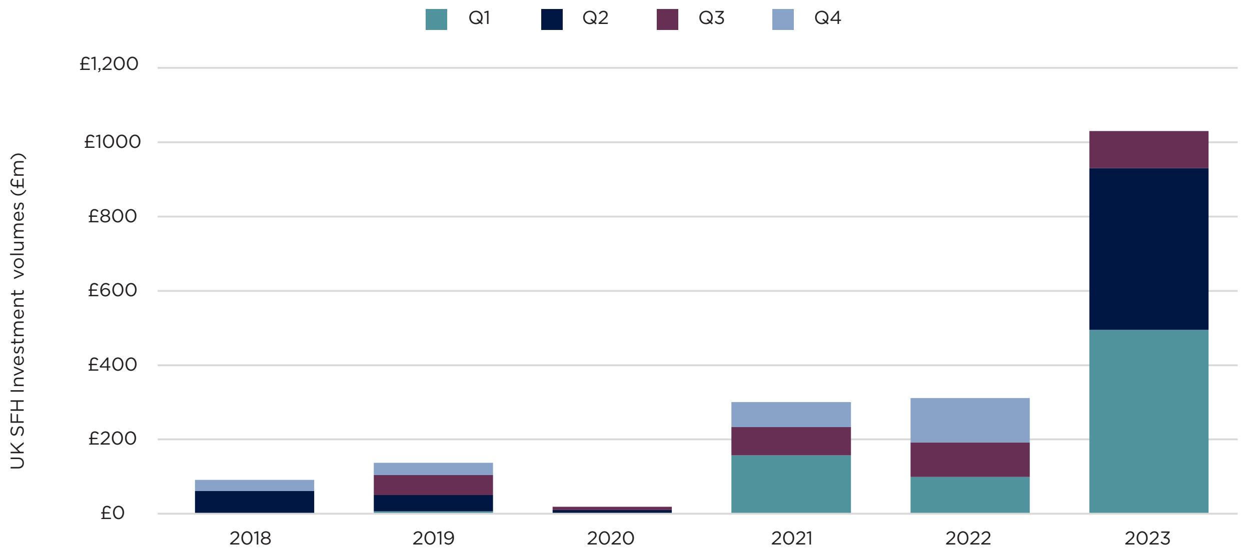
> Investment strategies for SFH are diversifying as different sources of capital, from institutional investors to private equity-backed players, seek to establish their niches and capitalise on this burgeoning sub-sector opportunity.
>
> Funding models are becoming increasingly sophisticated, ranging from funding requirements for fully bespoke and future-proofed schemes, through to bulk transactions for short-term income producing portfolios. Other factors such as geographical diversity of assets, the scale of capital deployment and ESG criteria are also varying the investment approaches in this rapidly expanding market.

Rebecca Trueman
Associate Director, Savills OCM

Over £1 billion invested in UK Single Family Housing this year

The second quarter of 2023 saw £435 million invested. The most notable transaction was a portfolio sale of 604 units by Barratt Developments Plc to Citra Living, building on Citra's fast-growing pipeline. According to its latest trading statement, Barratt Developments is actively increasing reservations in the private rented sector in order to drive revenue.

Private sales rates on housebuilder's sites have slowed since last summer. Housebuilder trading statements show that average sales rates nationally have been c.0.6 sales per outlet per week in the first six months of 2023. However, there have been weaker private sales rates reported for July and August, ranging from just 0.25 to 0.41 sales per outlet per week, due to the unexpected additional base rate rise and corresponding mortgage rate increases in June and July. These sales rates are significantly down from the peak of 0.8 per outlet per week in early 2022.



Source: Savills

A slowdown in sales rates means more housebuilders are looking to weave SFH into their business models. Not all markets have been affected evenly and some sites continue to sell well, but where this isn't the case, the inclusion of SFH can help support higher rates of overall delivery.

Vistry Group, a partnership between Bovis Homes, Linden Homes, Galliford Try and Countryside, has announced it will merge its conventional housing for-sale arm with its partnerships business. This strategy will see a significant reallocation of capital to focus on partnerships.

They are aiming to pre-sell an average of 65% of plots in bulk deals in the future, including deals with housing associations and rental investors and an immediate ambition to forward-sell 8,500 plots from its housebuilding business over the next three years.

> The balance between supply from housebuilders and demand from investors has become more aligned in the Single Family Housing sector during 2023, which has led to a flurry of transactions, including Barratt Developments' 604 unit portfolio sale to Citra Living in June.
>
> As the market continues to mature, other housebuilders are following suit, given that viability for an investment exit has materially improved, primarily due to the level of rental growth we've seen over the past two years.

Piers de Winton
Head of National Residential Investment & Single Family, Savills OCM

Savills Single Family Housing investor survey

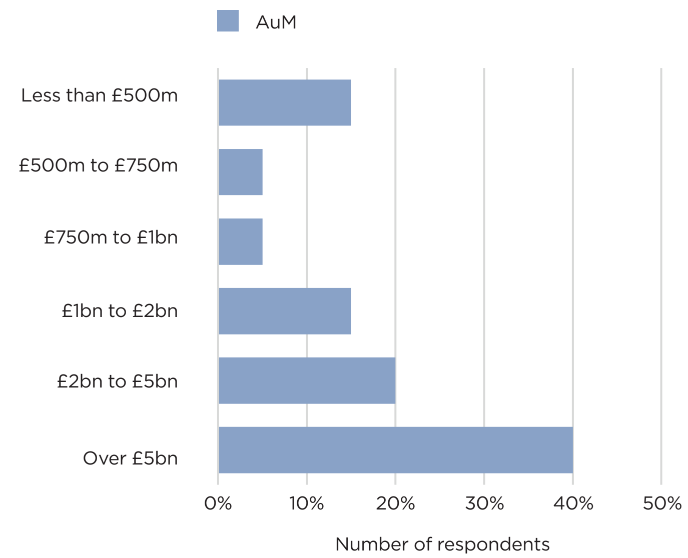
Savills Research recently conducted a UK Single Family Housing ("SFH") Investor Survey, with 20 respondents who collectively own the majority of the UK's SFH sector. Below, we highlight some of the key findings of the Survey, including investors' experiences of operating in the sector.

THE RESPONDENTS

Value of investments

There were 20 respondents to our survey who collectively have over £50 billion of real estate assets under management (AuM).

40%
of respondents have real estate AuM of more than £5bn, demonstrating the scale and stature of investors surveyed

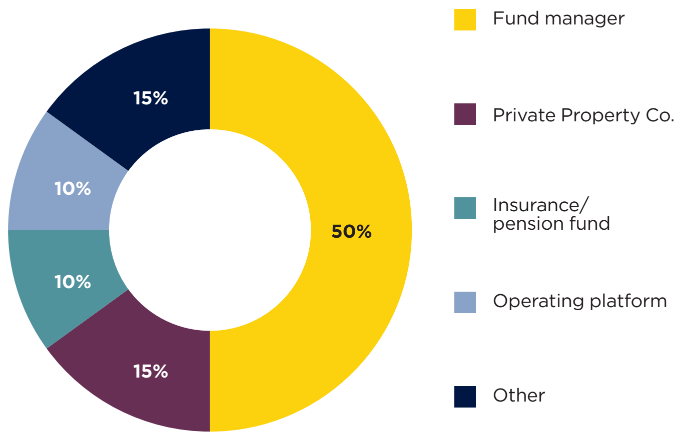


Source: Savills

Organisations

Fund managers, private property companies and insurance/pension funds made up three-quarters of respondents.

50%
the largest group of respondents were Fund Managers and a further large portion were Private Property Companies (15%)



Source: Savills

Significant appetite to grow portfolios

There is no shortage of demand from investors for UK SFH, with nearly two thirds of respondents targeting portfolios over £1bn. The sector has only attracted £3bn of investment to date, yet investors stated they are looking to commit more than £25bn in total.

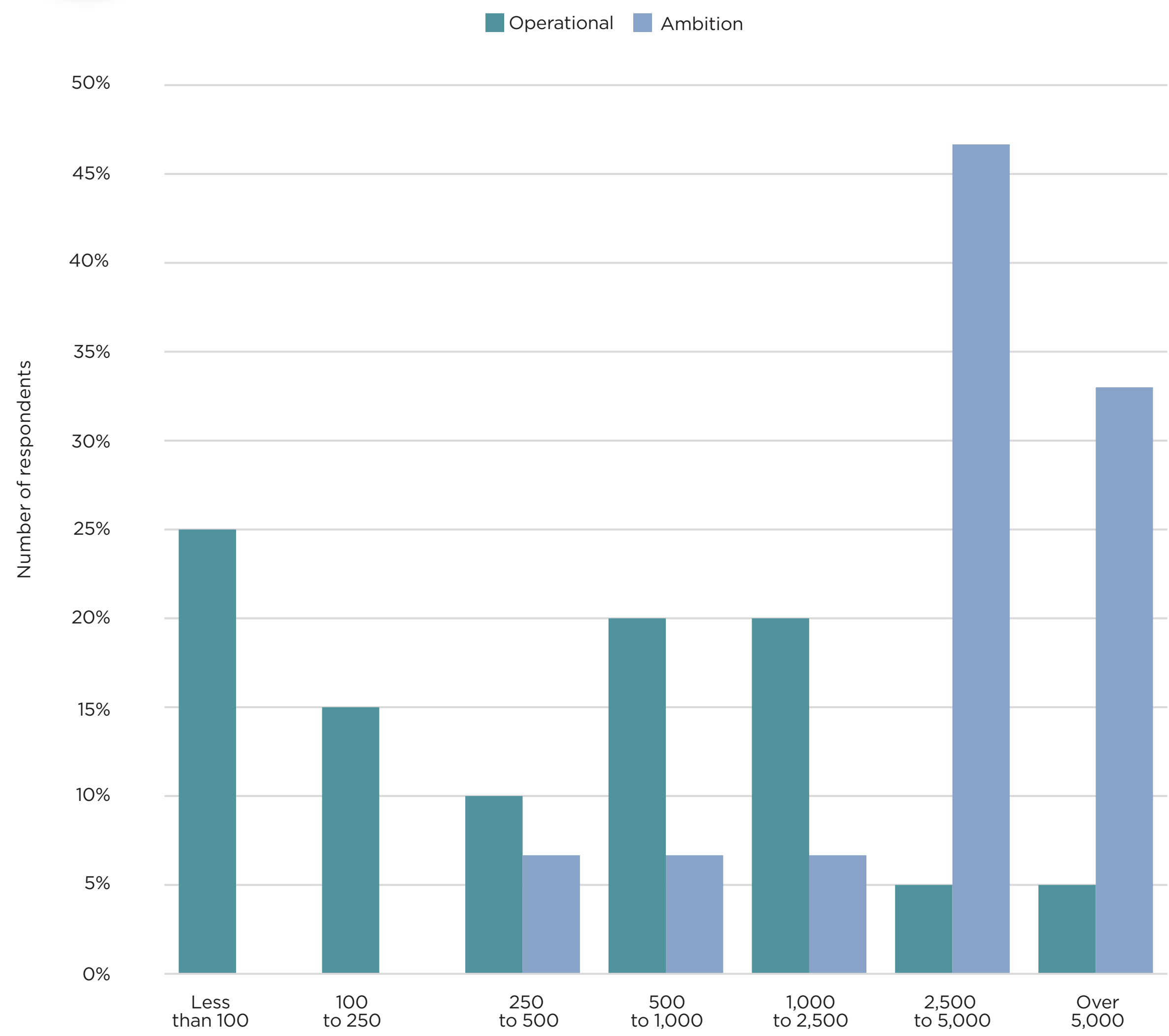
Translating this to a number of homes, the majority of investors are targeting portfolios with 2,500 homes or more. Specifically, portfolios between 2,500 and 5,000 homes are the most sought-after (47%).

An additional 33% are targeting portfolios larger than 5,000 homes, although only one investor has hit this target so far. A large minority said they have no upper limit (10%).

More than half (53%) of investors expect it to take 2-5 years to reach their target portfolio size, with a further 37% anticipating a 5-10 year horizon. It took the PRS REIT and Countryside more than 5 years to deliver 5,000 homes together, so efficient investor-developer partnerships will be crucial in order to meet investor timelines.

Investor's target portfolio size is between 2,500 and 5,000 homes

Q **How many Single Family units do you currently own / operate and what is your target portfolio size?**



Source: Savills Single Family Housing Investor Survey (September 2023)

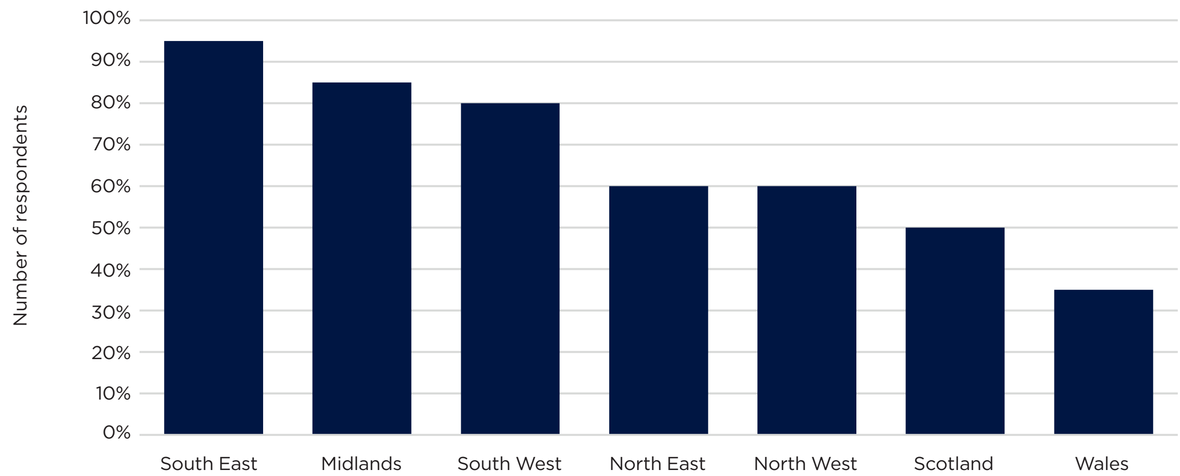
SFH investment is moving south

SFH development was initially limited to the North West of England, concentrated across just 14 local authorities, with the partnership between Sigma Capital and Countryside Properties responsible for the vast majority of SFH delivery across this region. We have since seen a geographic shift into the Midlands and the South, as stagnating house prices and strong rental growth have improved viability and investors (both new and existing) seek geographically diverse portfolios. Investors recognise that the South is where housing need is the greatest and so many are concentrating their strategies on these markets.

Nearly all (95%) of investors are targeting locations in the South East, with 85% targeting the Midlands and 80% targeting the South West. Most investors (71%) stated that costs vary geographically, largely due to the increased costs of staffing. However, our survey has shown that whilst there is regional cost variation, with costs generally being higher in the South, this is more than offset by higher rental values.

The South and Midlands are the most in-demand investment markets

Q **What are your target investment locations?**



Source: Savills Single Family Housing Investor Survey (September 2023)

Portfolios are performing strongly, with tenants choosing to renew each year

The strength of investor appetite is unsurprising given how well existing assets are running. Since our last report, SFH operators can point to another 12 months of strong performance. Respondents have seen sites lease up either in line with expectations (41%) or outperform underwriting assumptions (59%). No operators reported lease-up being slower than expected.

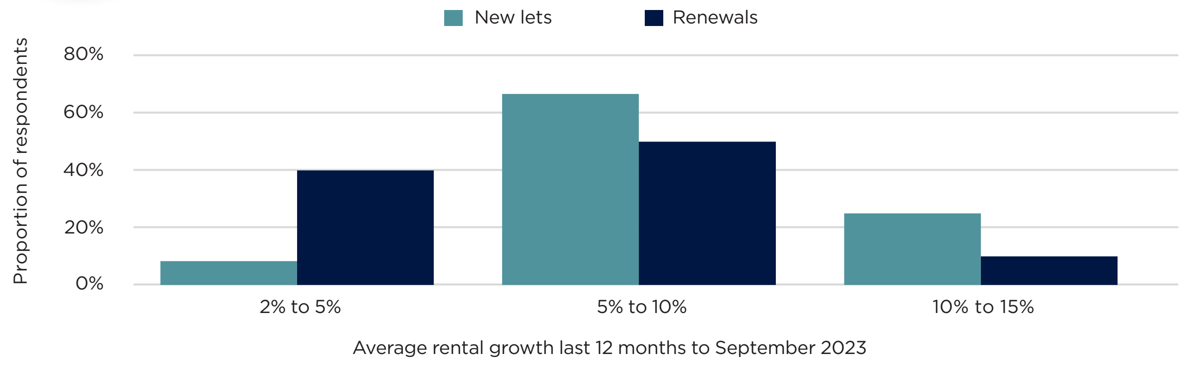
At the same time, there have been strong renewal rates across investor portfolios. 41% of respondents said their renewal rate was over 75%, with a further 29% reporting a renewal rate of 50%-75%. This high level of tenant retention is illustrative of a housing product that is meeting its occupants' requirements. From an investor standpoint, this is very positive, as "stickier" tenants mean reduced void levels, minimising the associated loss of income.

Lower levels of churn typically weigh on rental growth given rents grow more slowly within tenancies than between. But over the past 12 months, investors can point to strong rental growth across both renewals and new lets. For renewals, 40% of investors reported rental growth of between 2% and 5% and an additional 50% reported rental growth of between 5% and 10%. As we would expect, rents grew faster for new lets, as two-thirds (67%) of investors reported rental growth of between 5% and 10% and an additional 25% reported rental growth of between 10% and 15%.

Rent collection has also been high, with the PRS REIT reporting a rent collection of 98% in their latest update. The majority of investors (79%) are not concerned that non-recoverable arrears will increase after the Rental Reform Act and are confident in their resident screening and arrears processes.

Investors report strong rental growth across both new lets and renewals

What has the average rental growth been for units under management over the last 12 months, taking into account new lets and renewals?



Source: Savills Single Family Housing Investor Survey (September 2023)

What tenants value

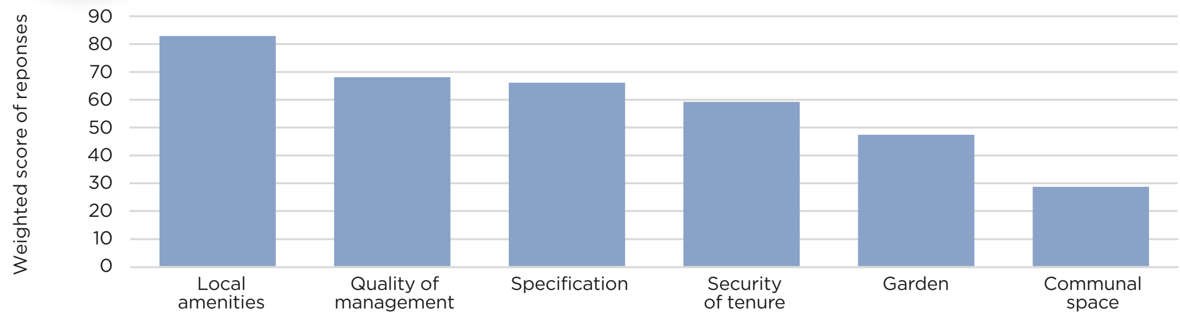
Local amenities are the number one priority for tenants. In practice, this means proximity to local schools, green spaces and health services, given the high proportion of families on SFH sites. Ease of access to major roads is important given nearly two-thirds of households drive to work in markets with operational SFH sites.

The second and third priority features are quality of management and specification.

SFH is in demand because the product being delivered is different to the majority of that offered in the local market. The housing itself is of a higher quality than existing PRS stock, and the management is more responsive. This is where SFH really differentiates itself from new build Buy to Let and tenants are willing to pay a premium for a higher standard of product. Over 80% of operators surveyed report a premium over newly built Buy to Let stock of similar quality in the local area, with just under half reporting a premium of more than 5%.

Amenities, Quality of management and Specification are what tenants value most

In your experience, what do tenants value most?



Source: Savills Single Family Housing Investor Survey (September 2023)

With Quality of management being a key attraction of SFH, some investors are bringing in operational expertise in order to provide a best-in-class service to residents. Nearly two thirds (64%) of investors use third party property managers. In addition, investors are currently outsourcing lettings and management, as operational portfolios are not yet sufficiently sized to cover the costs of creating and running an in-house platform.

This equation will change as portfolios increase in size and investors leverage economies of scale. Over half (56%) of investors plan to create an operational platform for their portfolio in the future, as Sigma Capital has done with its Simple Life brand.

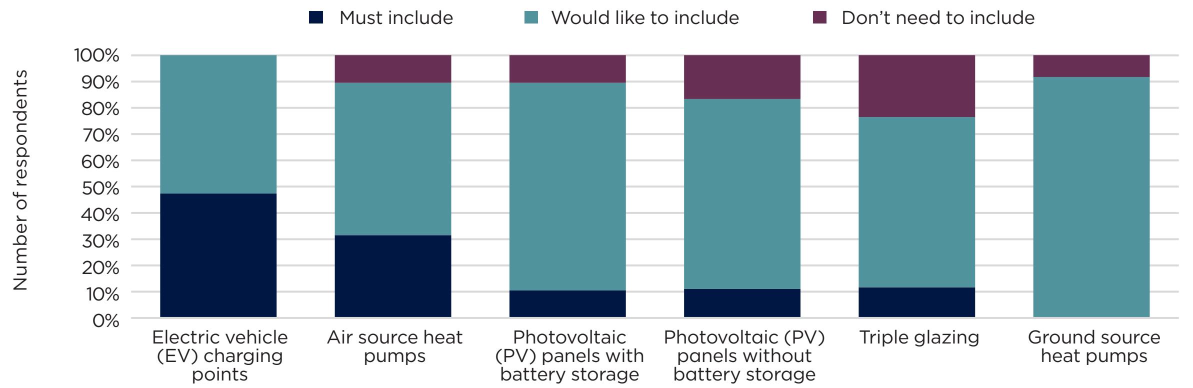
Sustainable features are in demand, from investors and tenants alike

In the drive toward net zero, we are seeing more investment in sustainable developments. To date, most SFH homes have been delivered with Energy Performance Certificate (EPC) ratings of 'B' or above. Looking ahead, all investors are targeting EPC 'B', with 21% targeting EPC 'A'. This will help to improve the quality and energy efficiency of the overall Private Rented Sector, where 58% of existing dwellings currently at EPC 'D' or below.

Sustainable features have already become a priority for many investors. Electric Vehicle (EV) Charging Points and Air Source Heat Pumps are the most in demand, with 47% and 32% of investors stating these features must be included in their homes. Triple glazing is the least in demand, with 24% stating they 'don't need to include'.

EV charging points and Air source heat pumps are top of investor priority lists

How likely are you to include the following sustainable features on your sites?



Source: Savills Single Family Housing Investor Survey (September 2023)

The investor benefits from delivering sustainable features are potentially two-fold. Firstly, they will support investment values. By paying more today, the underlying asset will maintain its value or enjoy a premium over other assets that do not meet the same environmental standards. Secondly, tenants may pay a higher rent for a more sustainable home, supporting underlying operating income, although there is little evidence of this to date.

Investors expect tenants to pay a higher rent for homes featuring photovoltaic panels with battery storage (58%), followed by Electric Vehicle charging points (47%) and Air source heat pumps (42%). That said, tenants will likely only pay a higher rent if they can achieve a net reduction in their total housing spend through lower running costs.

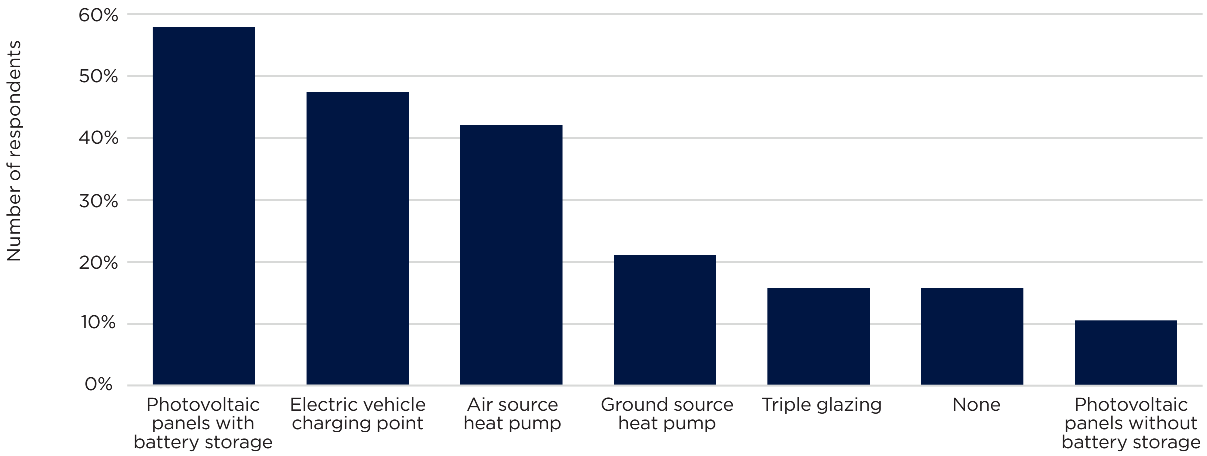
"Developers have, in the past, been reluctant to include additional sustainability features due to higher build costs not necessarily resulting in higher sales values in the private sale market. However, the institutional investment sector is now looking at the long-term viability of the residential market and are therefore keen to future-proof development against both embodied and operational carbon emissions arising from the construction and operation of residential property.

The same investors are also keen to understand how resilient properties are to the impacts of climate change, driven primarily by increased temperatures leading to higher overheating risk and changing rainfall patterns impacting both flood risk and domestic water consumption.

Dan Jestico
Director - Sustainable Design, Savills Earth

Investors believe tenants are willing to pay a premium for some sustainable features

Which of the following sustainable features do you believe tenants would pay more rent for?



Source: Savills Single Family Housing Investor Survey (September 2023)

Green Finance may help to offset some of the upfront installation costs

In practical terms, delivering additional sustainable features comes at a cost. Investors and developers need to factor in an estimated 4-8% increase in build costs for a typical house to meet the Future Homes Standard (all new homes will need to meet this by 2025).

Should investors wish to go one step further and reach net zero emissions, the cost could be closer to an additional £20,000 per home (according to the Future Homes Hub). This, and other sources, including the Passivhaus Trust, indicate that this is equivalent to a 10-14% increase in costs.

Green Finance, principally Sustainability-Linked Loans (SLLs), may help to mitigate higher upfront costs. Such loans incentivise the borrower to achieve sustainability performance targets which are agreed with its lender at the outset. In exchange for meeting these targets, the investor can enjoy improved terms e.g. a slight reduction in the interest rate margin payable. Whilst there has been limited take-up to date (our SFH investor survey shows just 5% of investors have used it so far), targets are likely to be linked to energy usage/consumption or the EPC ratings of the homes. Demand is likely to grow, and 58% of investors surveyed think lower debt costs associated with green finance could help them meet higher sustainability targets.

“Real estate debt markets are increasingly bifurcated as lenders turn away from retail and offices to focus on in-favour sectors such as ‘Living’. Low investment volumes combined with a focus on these preferred sectors means that demand to lend is outstripping the new opportunities available.

Build to Rent (BtR) is a sector many lenders are keen to deploy into, leading to intense competition for the best opportunities. As well as the traditional banks and debt funds, we are seeing an increasing number of investors with hybrid capital looking to support both development and investment opportunities at higher leverage points.

Charlie Bottomley
Director, Savills Capital Advisors

CONCLUSIONS

With over £1bn invested in 2023 so far, SFH has already seen a record level of investment, with three months of the year remaining. It is one of the only real estate sectors to have seen an increase in total investment volume this year.

Investment in UK SFH is underpinned by strong structural drivers, including significant supply-demand imbalances in rental markets nationwide, stagnation of the Buy-to-Let market and shifting preferences towards long-term renting. These will continue to drive investment into the sector over the coming years.

SFH represents a good opportunity for investors given the strong performance of existing assets. Significant rental demand has underpinned fast lease-up rates, high occupancy levels and resilient income streams.

A weaker private sales market has depressed the sales rates on housebuilder’s sites. As a result, a growing number of housebuilders are looking to weave Single Family Housing into their business models. The emergence of new investor-housebuilder partnerships means we can expect delivery to accelerate.

With 80% of investors looking to amass portfolios of 2,500 homes or more and most targeting a 5-year horizon, there is no shortage of capital to deploy. The investors surveyed in this report are ultimately looking to deploy £25bn into this fast-growing sector.

Savills Earth

We help our clients develop energy and sustainability strategies and then make them a reality, through measurable actions at every level, from organisational direction to individual asset strategies.

Dan Jestico
Director,
Sustainable Design
+44 (0) 7929 659 514
dan.jestico@savills.com

Tanya Broadfield
Director, Sustainability,
Property Managment
+44 (0) 7976 265 516
tanya.broadfield@savills.com

Maria Garcia
Director,
Social Value
+44 (0) 2078 774 636
maria.garcia@savills.ie

Wesley Ankrah
Director,
Social Value
+44 (0) 7977 842 268
wesley.ankrah@savills.com

Savills Research

We are a dedicated team with an unrivalled reputation for producing insightful analysis, research and commentary across all property sectors throughout the UK, Europe, Americas, Asia Pacific, Africa, India and the Middle East.

Richard Valentine-Selsey
Head of European Living
Research & Consultancy
+44 (0) 7870 403 193
richard.valentineselsey
@savills.com

Jacqui Daly
Director, Residential Investment
Research & Strategy
+44 (0) 7968 550 399
jdaly@savills.com

Guy Whittaker
Head of UK Build to
Rent Research
+44 (0) 7970 033 630
guy.whittaker@savills.com

Savills Operational Capital Markets

We provide our clients with valuation, consultancy, transactional and financing advice in the Residential (PRS), Student Accommodation, Co-living, Senior Living, Healthcare and Hotels sectors - across the UK and Europe. Our track record is unrivalled, having advised on over £25bn of transactions in the last two years.

Piers de Winton
Head of National Residential
Investment & Single Family
+44 (0) 7807 999 176
pdewinton@savills.com

Rebecca Trueman
Associate Director,
Residential Investment
& Development
+44 (0) 7967 838 038
rebecca.trueman@savills.com

Dan Smith
Associate Director,
Residential Investment
& Development
+44 (0) 7855 171 231
daniel.smith@savills.com

Will Pearce
Associate, Residential
Investment & Development
+44 (0) 7768 735 228
william.pearce@savills.com

Peter Allen
Executive Director, Head of
Operational Capital Markets
+44 (0) 7968 550 311
pallen@savills.com

Andrew Brentnall
UK Board Director, Head of
Residential Investment
and Development
+44 (0) 7967 555 578
abrentnall@savills.com

Polly Simpson
Head of Multifamily Development,
Residential Investment
& Development
+44 (0) 7807 999 642
psimpson@savills.com

Davina Clowes
Head of London Residential
Investment
+44 (0) 7967 555 833
dclowes@savills.com

Jan Crosby
Head of Corporate Finance,
Savills Capital Advisors
+44 (0) 7715 704 901
jan.crosby@savills.com

Charlie Bottomley
Director, Debt Advisory,
Savills Capital Advisors
+44 (0) 7920 854 198
charlie.bottomley@savills.com

Peter Blake
Head of National Development
Consultancy
+44 (0) 7870 999 338
pblake@savills.com

Craig Langley
Head of OCM Valuation
+44 (0) 7972 000 162
clangley@savills.com