SPOTLIGHT

Savills Research

Investment in UK Operational BTR

The Next Phase of Evolution

SAVILLS OPERATIONAL CAPITAL MARKETS

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Contents

Introduction

Institutional investment into the UK Private Rented Sector continues to evolve. As more new entrants are attracted to the sector, the way schemes are designed, delivered and managed is changing.

This is the first in a series of papers that will track the continued evolution of investment into operational Build to Rent (BTR) assets.

We will highlight key emerging themes, and as the sector continues to innovate, note the implications for management and valuation practices.

Why invest in UK BTR?

100,000 — BTR homes now delivered by investors, funding the development of 542 apartment schemes.

75,000 — Homes is the average portfolio size of the G15, a group of the UK's largest housing associations.

By comparison, BTR is still nascent, offering investors a massive opportunity to grow portfolios of scale.

£35bn — Invested by institutions in UK BTR.

£300bn more is needed to meet future household growth in the private rented sector.

5X — The largest German investor, Vonovia, owns 485,000 rented homes in Germany.

That is nearly five times the size of the UK's entire BTR sector.

24% — Is the typical uplift in asking rent between a scheme designed for Build to Rent over one planned for private sale, reflective of the quality of the product and the amenity offering.

Vacant Possession Value — Is no longer relevant to BTR because schemes designed today are geared towards creating ancillary income streams.

40% — Of schemes are more than 5 years old, offering potential asset management strategies to further optimise rents.

£20bn — Of operational BTR is likely to transact over the next decade, equivalent to over 300 schemes.

UK real estate universe

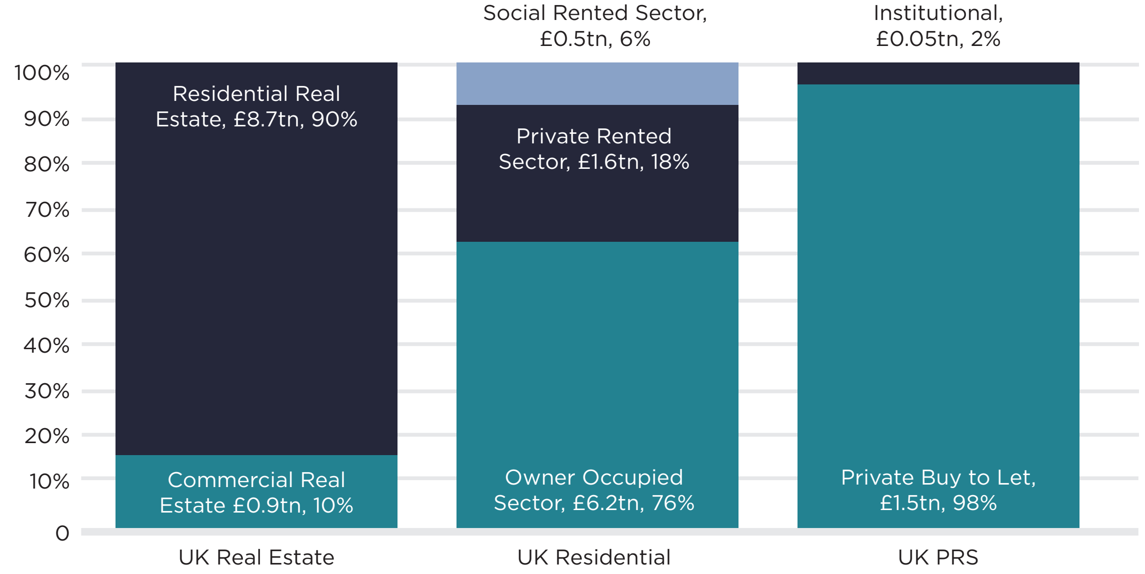
The Living sectors including UK Multifamily has attracted a huge amount of investor interest in recent years. Our 2024 **European Living Investor Sentiment Survey** showed that close to half of investors surveyed are looking to increase their allocation to the Living sectors over the next three years.

Multifamily is the most sought-after, with 84% of respondents intending to increase their exposure.

This highlights the huge growth potential of UK Multifamily, which at an estimated £35 billion is still small in the context of the wider UK real estate universe. For context, the total value of the UK's housing stock currently stands at £8.68 trillion, the UK Private Rented Sector (PRS) is c.£1.6 trillion and the Commercial real estate market is an estimated £0.9 trillion.

Just 2% of private rented sector homes are held by institutions, with the remaining 98% in the hands of private Buy to Let investors.

UK housing in the context of UK Real Estate



Source: Savills Research using British Property Federation, HM Land Registry, 2021 Census, Registers of Scotland, English Housing Survey, NISRA, ONS, DLUHC

The Private Rented Sector was the fastest-growing housing tenure over the past two decades, driven by the growth in individual 'Buy to Let' landlords. But future supply is unlikely to come from individual landlords, with many retrenching due to changing regulations and the rising debt costs seen over the past two years.

We project that there will be an additional 800,000 to 1,000,000 households in the Private Rented Sector by 2031, and institutional investors will be key to unlocking growth over this period. The scale of the opportunity is vast.

£300 billion

Of institutional investment is needed to meet future household growth in the UK PRS.

UK Multifamily in context

UK PRIVATE RENTED SECTOR (PRS)

5.8 million households

"All households renting privately"

BUY TO LET

5.7 million households

"Individuals owning properties for investment purposes."

MORTGAGED BUY TO LET

2 million households

"Individual landlords who own their property with a mortgage."

OWNED OUTRIGHT

3.7 million households

"Individual landlords who own their property outright."

INSTITUTIONAL PRS

100,000 homes

"Umbrella term for homes that are owned by institutions for the long-term."

APARTMENTS (MULTIFAMILY)

90,000 homes

"Apartments held in single or multiple blocks typically in urban areas."

HOUSES (SINGLE FAMILY)

10,000 homes

"Houses, typically in suburban areas."

BUILT TO RENT APARTMENTS

60,000 homes

"Homes designed and purpose-built to be held by institutions for the long-term and offered for rent indefinitely."

OTHER INSTITUTIONAL PRS APARTMENTS

30,000 homes

"Homes owned and operated that were not specifically planned for the rental market."

GENERATION 1

"The first generation of Build to Rent apartment schemes delivered; designed and purpose-built for private rent."

GENERATION 2

"More recently delivered purpose-built apartment schemes with a much greater focus on additional facilities, services and hospitality."

A decade in the making

The BTR sector has reached its 100,000 home milestone, with the sector having funded the development and delivery of 542 apartment schemes, all let and managed by professional operators.

It has been more than a decade since the first wave of institutional money made its mark on the Private Rented Sector. Delancey's purchase of the Athlete's Village in East London and M&G's acquisition of the Berkeley portfolio in 2013 showed real intent from investors to build rental portfolios quickly, and at scale.

BTR has made good progress since then, but it still represents just 2% of PRS households.

The investment potential is enormous. The market continues to migrate from small to large institutional landlords and we expect the proportion of homes owned and managed by institutions to consistently rise moving forward.

Reaching 10% institutional ownership (which would still be a small proportion, in an international context), would add another 480,000 homes to institutional portfolios.

The key attractions of the BTR sector for investors:

Rent levels have outperformed the wider PRS, reflective of the higher quality of stock and professional management approach.

Rental growth of 3.2% p.a. over the past 20 years, compared to earnings growth of 3.1%. This close correlation is especially attractive to institutional investors and points to sustainable rental growth over the long-term.

Forecasts show rents outperforming house prices over the next two years, supporting investment values.

50% of investment in BTR in 2023 was from new entrants to the market, up from 20% in 2018. The investor profile is changing as the market matures and attracts a wider pool of Global capital.

Housing should be viewed as infrastructure investment as the cost of debt remains a barrier to core capital but could be overcome if housing was considered an infrastructure product. Rented housing (affordable and private) is especially useful to infrastructure funds who deliver many homes in other countries.

110,000 homes in the BTR planning pipeline which is the largest pipeline we've seen and indicates that the sector will now start to grow more quickly than in the past. If it grows like the student sector did previously, it will start to double in size every couple of years.

Greater BTR scale will arguably be easier over the next decade because the ground work has been done in terms of planning, development funding, development viability, partnership structures and portfolio management.

£300bn is the investment needed to meet future household growth across the private rented sector. A large part of this investment will need to be in urban BTR apartments.

Institutional PRS in 2024

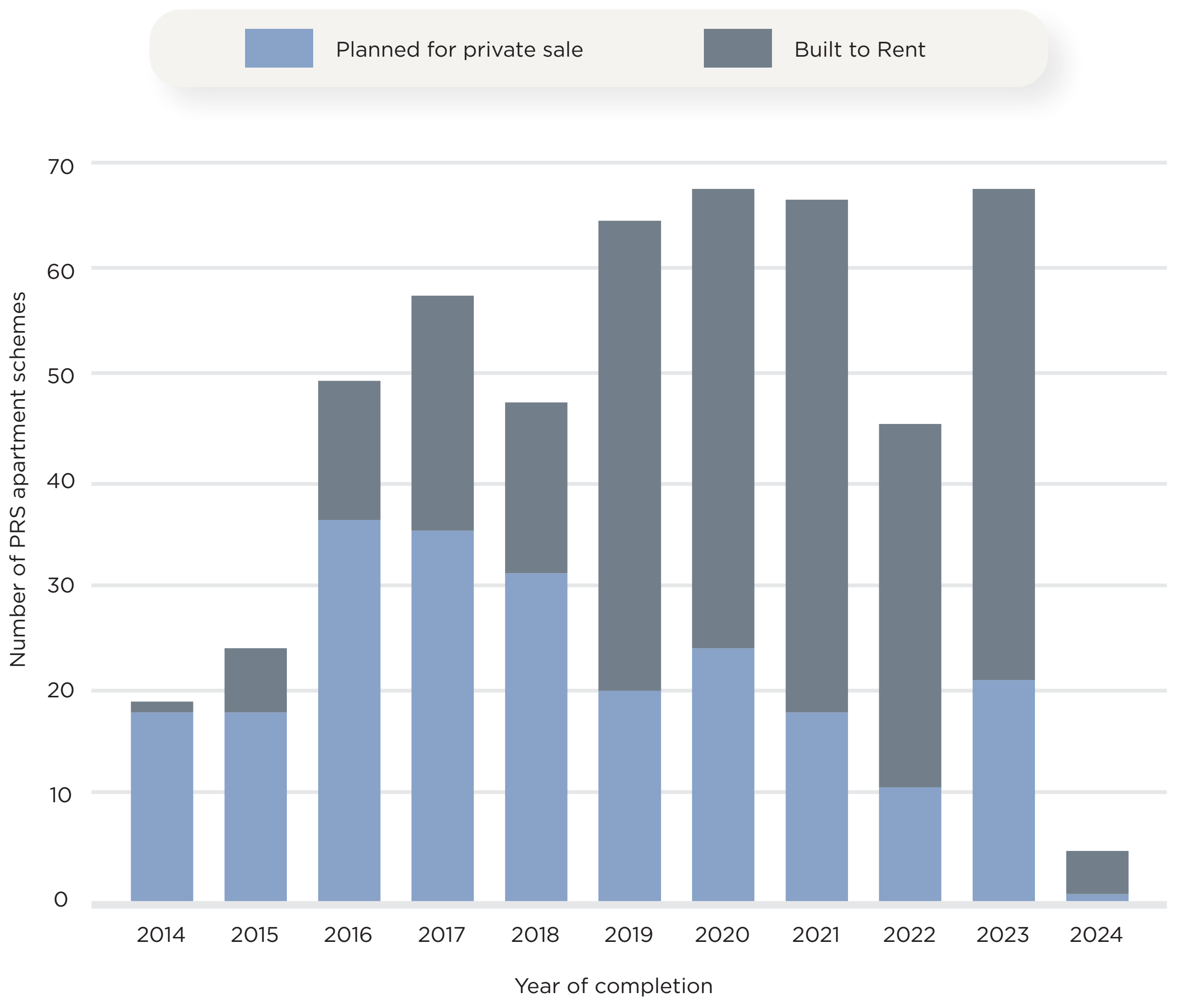
Of the 100,000 operational BTR homes, an estimated 90,000 with a combined value of £35 billion are in urban apartment blocks. London has the largest share, more or less evenly split across inner and outer London boroughs.

Core cities have closed the gap over the past five years, as investors have become confident in the regional investment and rental growth story. Much of the early capital deployed into the sector targeted schemes that were not originally planned for the Private Rented Sector.

These schemes, while not purpose-built for the rental market, pioneered the high-quality management approach and long-term rental philosophy that is now synonymous with the Build to Rent sector.

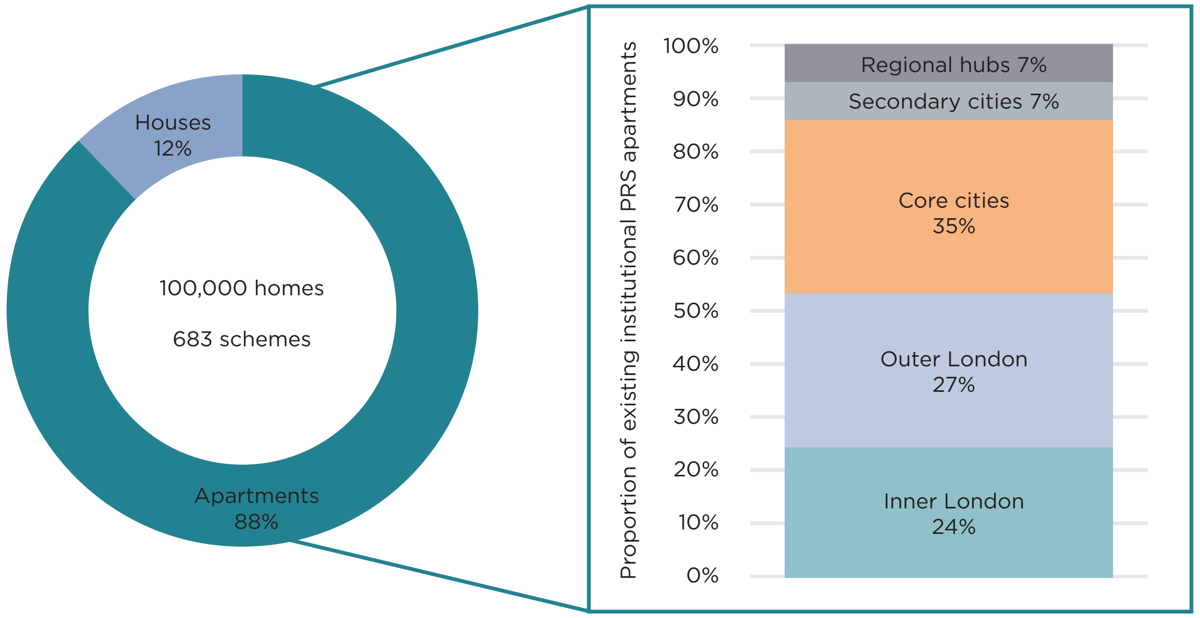
Today, a total of 261 schemes have transitioned to be owned and operated by PRS investors, but nearly two-thirds of this came before 2018. Since 2018, 64% of schemes have been purpose-built, which indicates that investors are getting involved much earlier in funding these schemes to influence the design, layout, specification and facilities of the rental apartments.

Many apartment schemes switched from private for sale



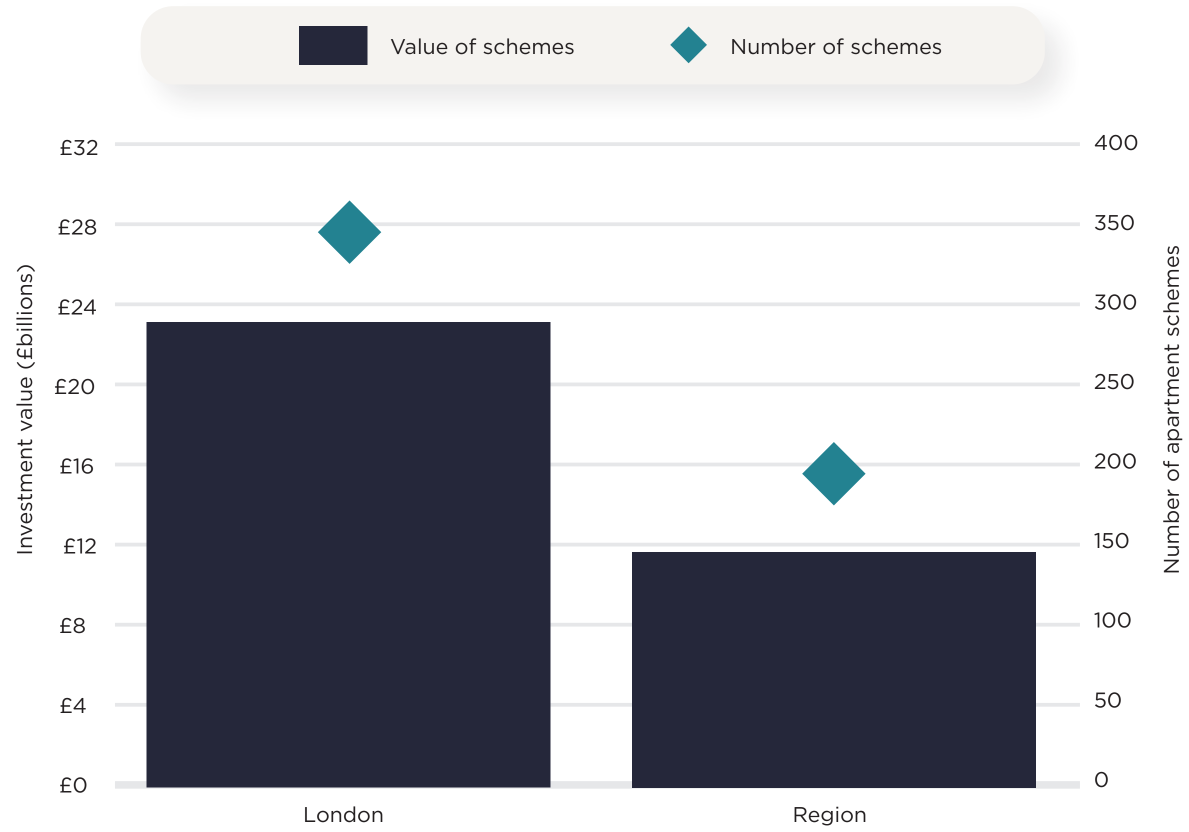
Source: Savills, British Property Federation, Molior

London and the core cities hold the vast majority of BTR apartment schemes



Source: Savills, British Property Federation, Molior

The value of the sector by type of scheme



Source: Savills

Scale of opportunity

UK BTR is spread across 100 local authorities, including every London borough. We estimate that the combined value of stabilised operational assets is £35 billion, based on the capitalised income of rents on the schemes. This amounts to £23 billion in London and a further £12 billion outside the capital.

The social housing sector in the UK is similar in size to the PRS. It provides homes for 5.3 million hohouseholds, compared to 5.8 million in the PRS. Social housing has evolved over a much longer period and the sector has seen high levels of consolidation. It provides a useful benchmark for the scale institutional PRS investors could grow to. The owners and managers of social housing are much larger, with many managing between 50,000 and 100,000 homes.

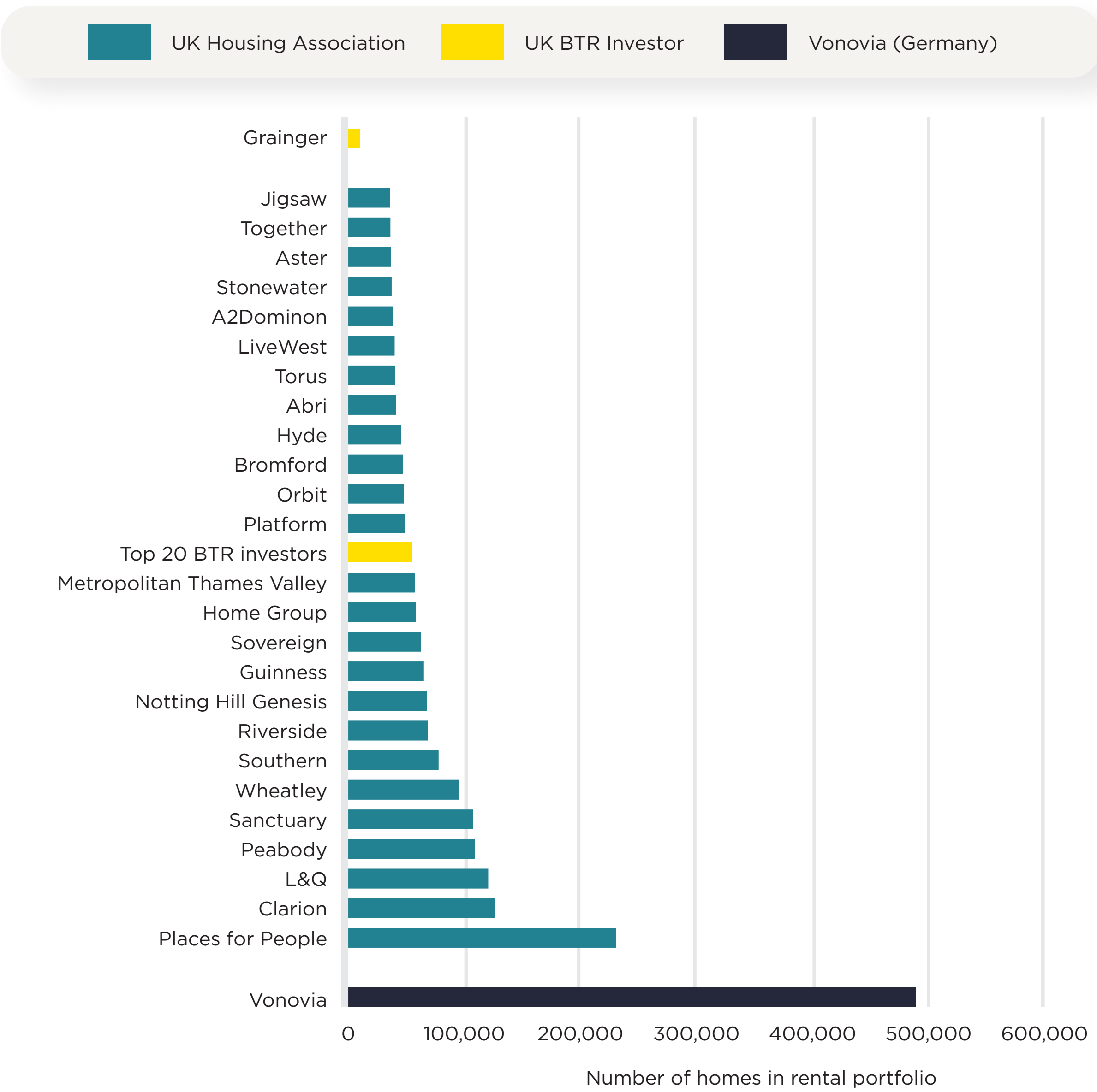
These portfolios dwarf those held by institutions in the PRS. Grainger, the PRS sector's largest institutional landlord, has 9,475 homes under management according to its latest statement. The largest housing association, Places for People, has a vast portfolio of 230,000 homes, nearly 25 times larger.

Together, the 25 largest Housing Associations own a combined 1.5 million units. This includes the G15 with an average portfolio size of 75,000 homes. To demonstrate the stark difference in scale, not a single BTR investor is large enough to feature on a list of the top 25 largest Housing Associations. Combining the 20 largest BTR portfolios in the UK, would still only rank in 14th place on this list.

The difference in scale between owners in the private and social housing sectors is huge, but could be indicative of the future shape of the PRS. Like the social housing sector and the UK PBSA market, consolidation will happen in BTR.

Our European Living Investor Sentiment Survey identified clear ambition to grow portfolios of significant scale, which we believe to be around 100,000 homes. This would bring the market more in line with UK social housing, UK PBSA and residential portfolios in Europe.

UK BTR portfolios are much smaller than those of UK Housing Associations and European BTR investors



Source: Savills Research, British Property Federation, Molior, Inside Housing

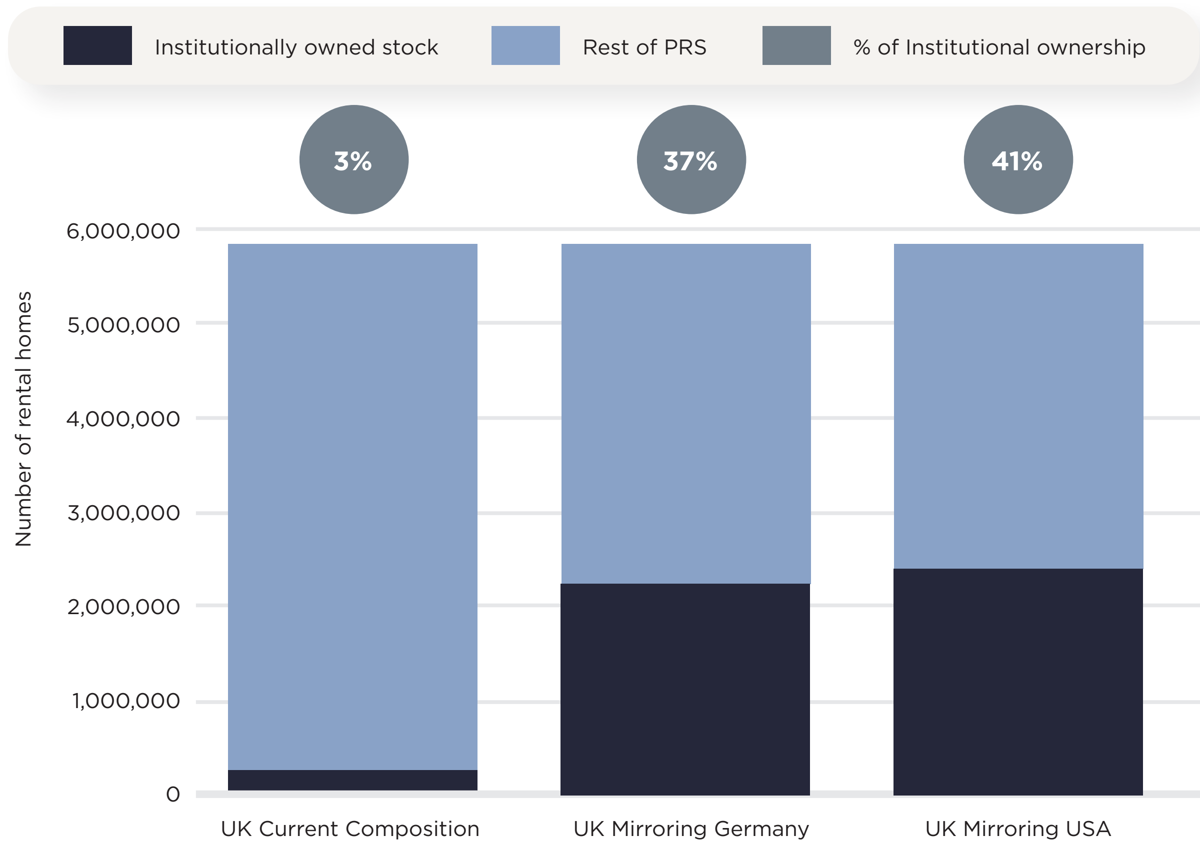
Looking to more established markets such as Germany and the USA provides further support for the thesis that institutional PRS in the UK is underweight and has significant growth potential. The largest US investors own many tens of thousands of homes nationwide.

The largest German investor, Vonovia, owns 485,000 rented homes in Germany, with further holdings in Austria and Switzerland. Its German portfolio alone is nearly five times the size of the UK's entire BTR sector.

But the proportion of the UK PRS owned by institutions is low, at just 2%, There would need to be substantial investment to increase this proportion to mirror the USA and Germany, where institutions own 41% and 37% of PRS homes, respectively.

Should the UK arrive at a similar level of institutional ownership, institutions would own between 2.1 and 2.4 million PRS homes compared to just 100,000 today. As the sector continues to grow, investors will find plenty of opportunities to achieve large-scale portfolios, particularly as more operational assets start trading.

Number of PRS homes owned by institutions should the UK mirror Germany or USA



Source: Savills, British Property Federation, NMHC, German Federal Statistics Office, US Census Bureau, ONS

Investor demand for fully let buildings

Over the past decade, the primary route to market for investors has been through development funding. Of the c. £20 billion invested between 2018 and 2023, just over a fifth has been deployed to purchase fully let operational stock. We expect this balance of proportions to change as more opportunities arise to buy stabilised schemes.

This will be driven by a wider pool of Global capital that is unable to or prohibited from undertaking development. This core and core+ capital, with lower return requirements, will support the further expansion of the sector by recapitalising investors that have achieved scale through development. Those investors will then be able to pursue further development opportunities, creating yet more rented homes for the sector.

In Q1 2024, 60% of Build to Rent investment was into operational assets and 40% into funding development. This is the highest proportion of investment into operational schemes in any quarter since 2015. It included KKR's purchase of Alameda and Beton at Wembley Park, which is a good example of a new investor entering the UK market through the acquisition of operational schemes.

Over the next decade, we expect total BTR investment to grow to over £12 billion per annum, following the trajectory seen in the PBSA market as it matured. Development will continue as the primary route to market in the short term but operational deals will steadily increase their share of investment volumes.

The sector has consistently delivered better quality schemes every year. Now, as more quality assets come to market, the proportion of investment into operational schemes will rise. With greater choice we will start to see more aggregators in the market, mirroring the PBSA journey. These investors will seek to package up operational schemes into portfolios and then sell as a ready-made platform, meaning we are likely to see some schemes trade multiple times in the next decade.

We expect that between 2024 and 2028, investment into operational assets will take up a 25% share of total investment, rising to 30% between 2029 and 2033. This means that over the next decade, £20 billion will be deployed into the operational BTR space. Based on the average value of operational schemes today that would equate to over 300 schemes trading during this period, and more than half of the existing market turning over.

£20 billion

Will be invested in Operational Build to rent schemes over the next decade.

Investment into operational assets to grow its share of UK BTR investment over the next decade from 23% to 30%

Source: Savills

Evolving valuation methodology

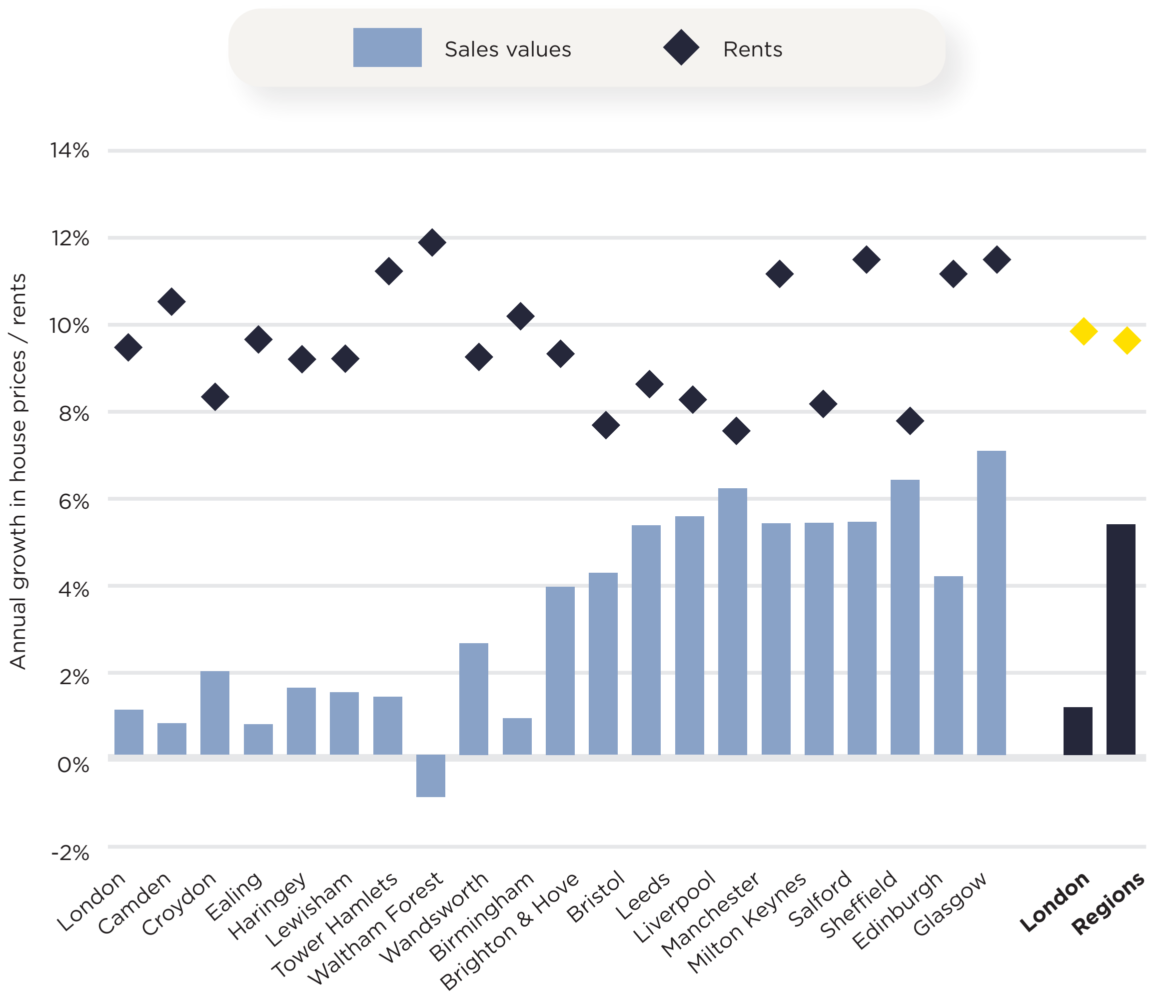
Where BTR schemes have traded, they have been sold to other investors. We are not aware of a single BTR asset that has been broken up and sold to owner-occupiers. This means that ultimately, the price/value has been determined by the investor's return requirements and the capitalised value of the income generated by the scheme.

Recent market dynamics, where rents have risen much faster than residential sales values, beg the question as to whether a Vacant Possession (VP) valuation for Build to Rent apartments is still needed.

Over the past 3 years, across core BTR markets, rents have grown much faster than apartment sales values. In many regional cities, including Manchester, Birmingham and Edinburgh, rents have grown at more than twice the rate of sales values.

This is even more striking in London where in many boroughs annual rental growth of c.10% has been coupled with sales value growth of just 1-2% per annum since the start of 2021. This has meant that investment values for Build to Rent apartments have held up during a weaker period in the wider housing market.

Annual growth in sales values and rents over the past 3 years (2021-2023)



Source: Savills Research using HM land Registry, Zoopla – Powered by Hometrack

With each successive generation of BTR, as schemes become more sophisticated and even more distinguishable from the first 'planned for private sale' schemes, we should start to see wider acceptance of income-driven valuations. Vacant Possession Value was clearly a relevant metric in the early stages of the sector's evolution, where large numbers of apartment schemes were repositioned for the PRS market.

The rental model was unproven and funders (especially commercial lenders) wanted certainty that the values would be achievable if sold on the open market. What is needed to shift the sector away from VP valuations completely is likely two things.

Firstly, we need to start seeing more examples of transactions where the investment values exceed equivalent VP values. A wave of equity buyers who aren't reliant upon debt and focus more on the value of the income stream rather than the break-up value as a backstop, would help to shift the dial. Transactions of larger, more heavily-amenitised assets will start to establish the precedent of a new valuation methodology.

Secondly, investors materially enhancing the ancillary income on their schemes beyond the rent roll will accelerate the transition. A move towards a more dynamic pricing model, where schemes offer a range of tenancy lengths, at different weekly price points, is one way investors are already enhancing the gross income position of their schemes.

Rent levels are driven by demand and keeping track of website enquiries allows operators to respond to the market in real-time, and enhance investment returns. Further innovation by investors will continue to challenge the relevance of VP valuations for these schemes.

To facilitate the shift, greater availability of performance data will be required. If investors and valuers are being asked to substantiate investment pricing on a capitalised rent basis, then they will ultimately require better evidence of the underlying net income stream.

The profile of BTR Stock

Facilities: More, More and More

Today's investors design their schemes with the needs of private renters in mind. Schemes typically feature well-designed communal spaces that promote a sense of community. A welcoming ground floor lobby with a concierge and dedicated facilities including a gym, communal lounges, rooftop gardens and co-working spaces are common.

Smart design is crucial. The key focus is on the layout of communal space to maximise useable space and ensure ease of maintenance. Given buildings can be occupied by upwards of a thousand people, easy access to building infrastructure means costs and resident disruption are minimised.

Better Schemes, Higher Rents

The quality of design varies widely from scheme to scheme. Those offering the best management and best facilities see this reflected in the rent levels.

Our analysis shows that rents tend to sit at or below the upper quartile of their local market. Many of these schemes are now between 5 and 10 years old with limited on site amenity provision.

Schemes purpose-built for rent tend to be newer, with a strong focus on the variety of facilities and quality of management. This means rents often exceed the upper quartile, reflecting the use of communal areas, facilities and WiFi which are often included within a single monthly "all-inclusive" rent.

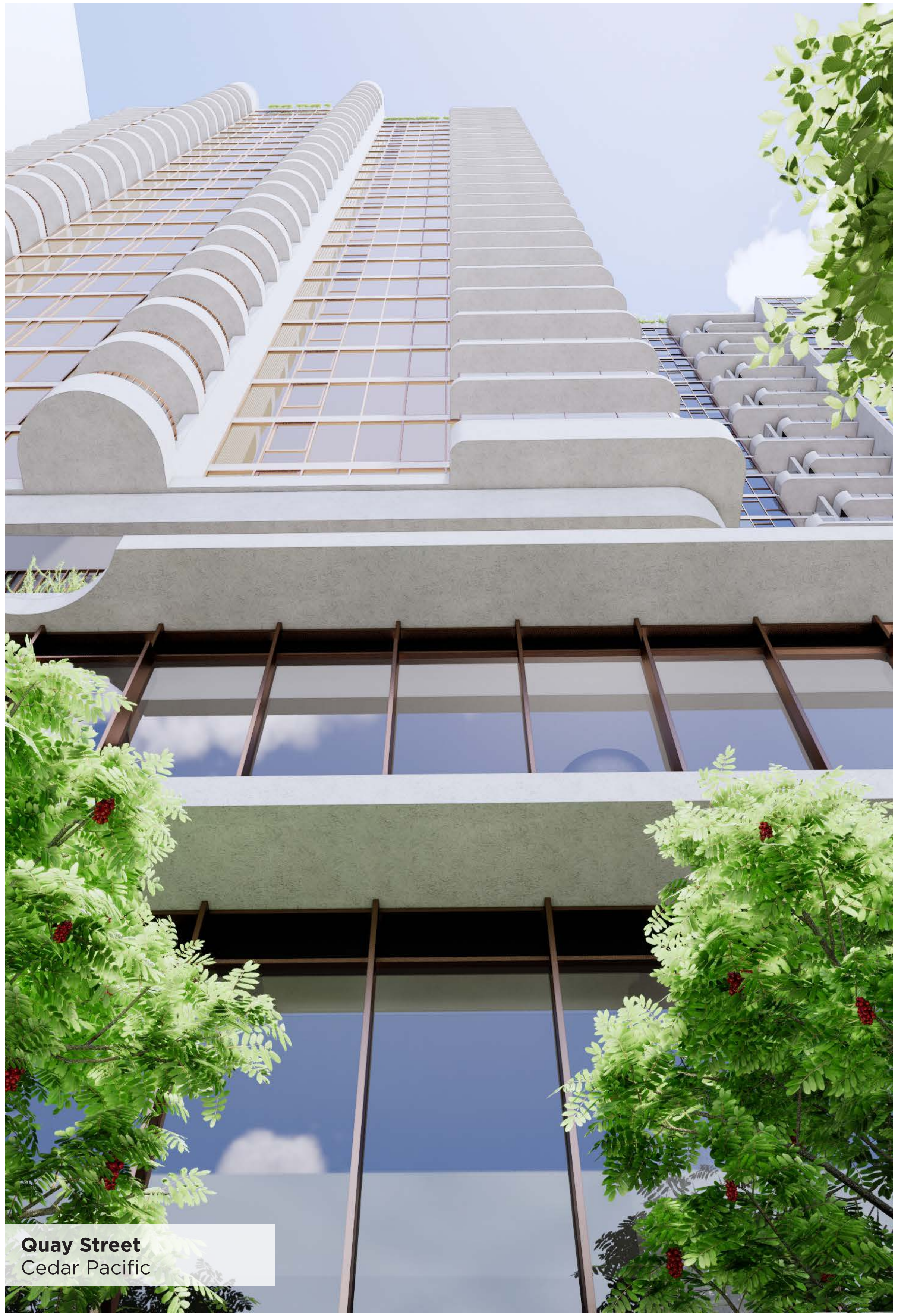
Schemes designed for rent achieve higher rents on average

Source: Savills, British Property Federation, Molior, Zoopla – powered by Hometrack

Convenience is the key for today's Renters

Quality of management is a clear selling point for the sector. The resident experience is now at the forefront of investor's minds. Consumer awareness of professionally managed homes for rent has also been on the rise, with renters increasingly able to differentiate a newly built apartment let by an agent or landlord from one 'Built to Rent' and operated by an institutional landlord.

Investor confidence in the sector has grown and some investors are now pushing professional management to new heights, particularly as key markets such as Manchester, Birmingham and Leeds have proven the depth of rental demand. Schemes delivered in these locations have seen strong lease-up rates with consistent occupancy. In other words, schemes offering high-quality, responsive management and a wide range of facilities are in high demand.



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BTR Milestones

2013

BERKELEY PORTFOLIO

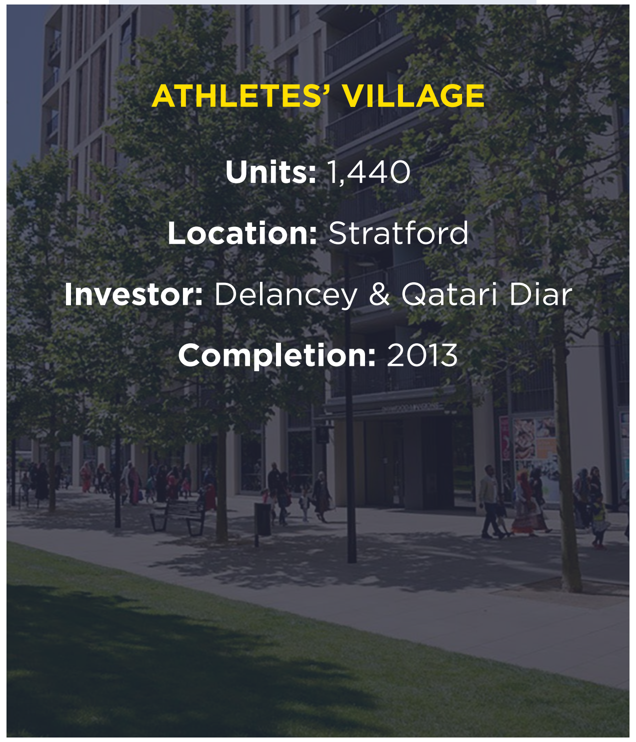
Units: 534

Location: Various

Investor: M&G Real Estate

Completion: 2013

Delancey's purchase of the Athlete's Village in East London and M&G's acquisition of the Berkeley portfolio showed real intent from investors to build rental portfolios quickly, and at scale.



ATHLETES' VILLAGE

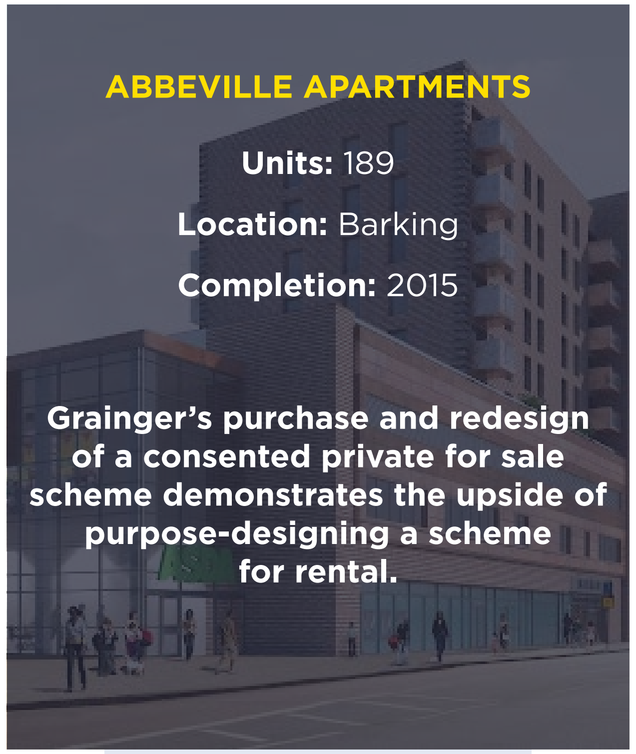
Units: 1,440

Location: Stratford

Investor: Delancey & Qatari Diar

Completion: 2013

2015



ABBEVILLE APARTMENTS

Units: 189

Location: Barking

Completion: 2015

Grainger's purchase and redesign of a consented private for sale scheme demonstrates the upside of purpose-designing a scheme for rental.

THE KEEL

Units: 497

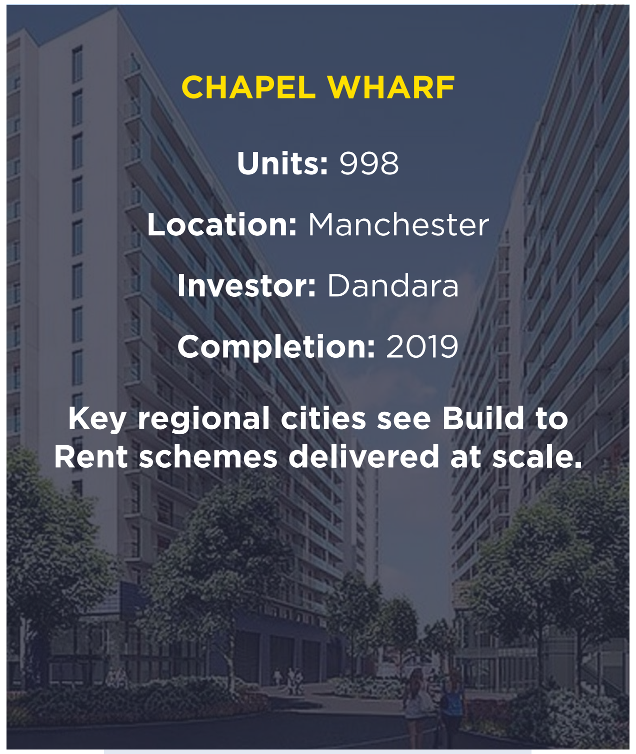
Location: Liverpool

Investor: Moorfield

Completion: 2015

The Keel marks the first major apartment scheme to be delivered outside of London.

2019



CHAPEL WHARF

Units: 998

Location: Manchester

Investor: Dandara

Completion: 2019

Key regional cities see Build to Rent schemes delivered at scale.

EXCHANGE SQUARE

Units: 603

Investor: LaSalle

Completion: 2019

2020 - 2023

ANGEL GARDENS

Units: 466

Investor: Apache Capital

Completion: 2020

Moda Living set a new benchmark for rental living in Manchester. The scheme marks the start of a new generation of Build to Rent apartments.

COPPERMAKER SQUARE

Units: 1,225

Investor: Westfield Europe/ Quadreal/PSP Investments

Completion: 2023

Greystar, Legal & General, Apache Capital and others continue to redefine what Build to Rent schemes offer.

The new kids on the block

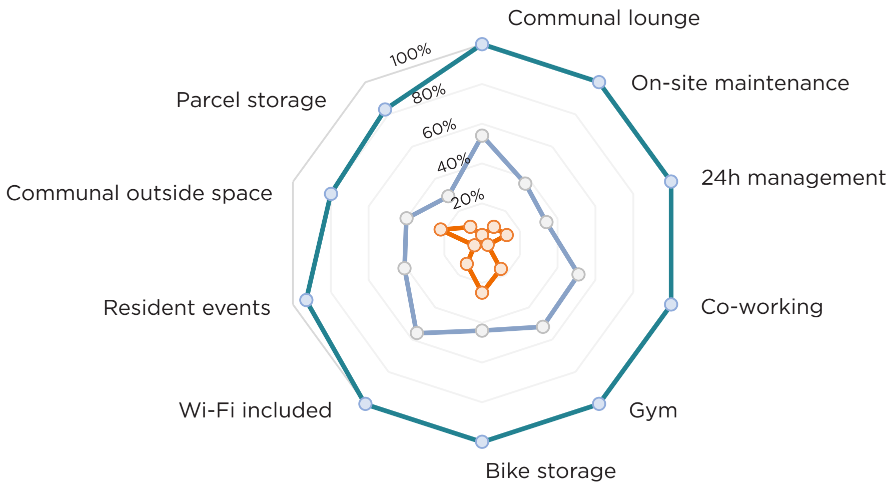
We are now starting to see the rise of newer, higher quality schemes, where the quality of management and range of facilities far exceeds that on offer in earlier schemes. These 'Generation 2' schemes are coming forward in existing Build to Rent markets and are typically much larger, with with investors growing in confidence and recognising the economies of scale that larger schemes afford.

Apache Capital's Angel Gardens, in central Manchester, was a trailblazer of the new generation.

The 466-apartment scheme delivered in 2020 set a new benchmark for what Build to Rent apartment schemes can be, offering best-in-class management alongside unique facilities such as a rooftop football pitch, resident event schedule and a bookable personal trainer.

A total of 46 Generation 2 ("Gen 2") schemes have been delivered since, setting new standards of renting in their local markets.

Proportion of schemes that include facilities



Source: Savills, British Property Federation, Molior

Those bringing forward these schemes are also experienced, with 70% having already invested in the sector in the UK. Buoyed by improving operational data, and the strong performance of their existing assets, they are confident in delivering new schemes at scale. The average Gen2 scheme has 340 apartments, compared to 187 across their Gen1 peers.

Larger schemes bring economies of scale that support the inclusion of higher quality facilities. This is constantly evolving but has recently included rooftop running tracks, pet spas and keyless door entry. Access to facilities is nearly always included within the base rent and so naturally these schemes tend to sit at the top end of their local markets.

Schemes are getting larger as investors grow in confidence

Source: Savills, British Property Federation, Molior

Ancillary income

With each successive generation, the level of hospitality provided by schemes has increased. Investors have recognised the similarities with the Hotels sector and have borrowed ideas to improve the resident experience and establish additional sources of income.

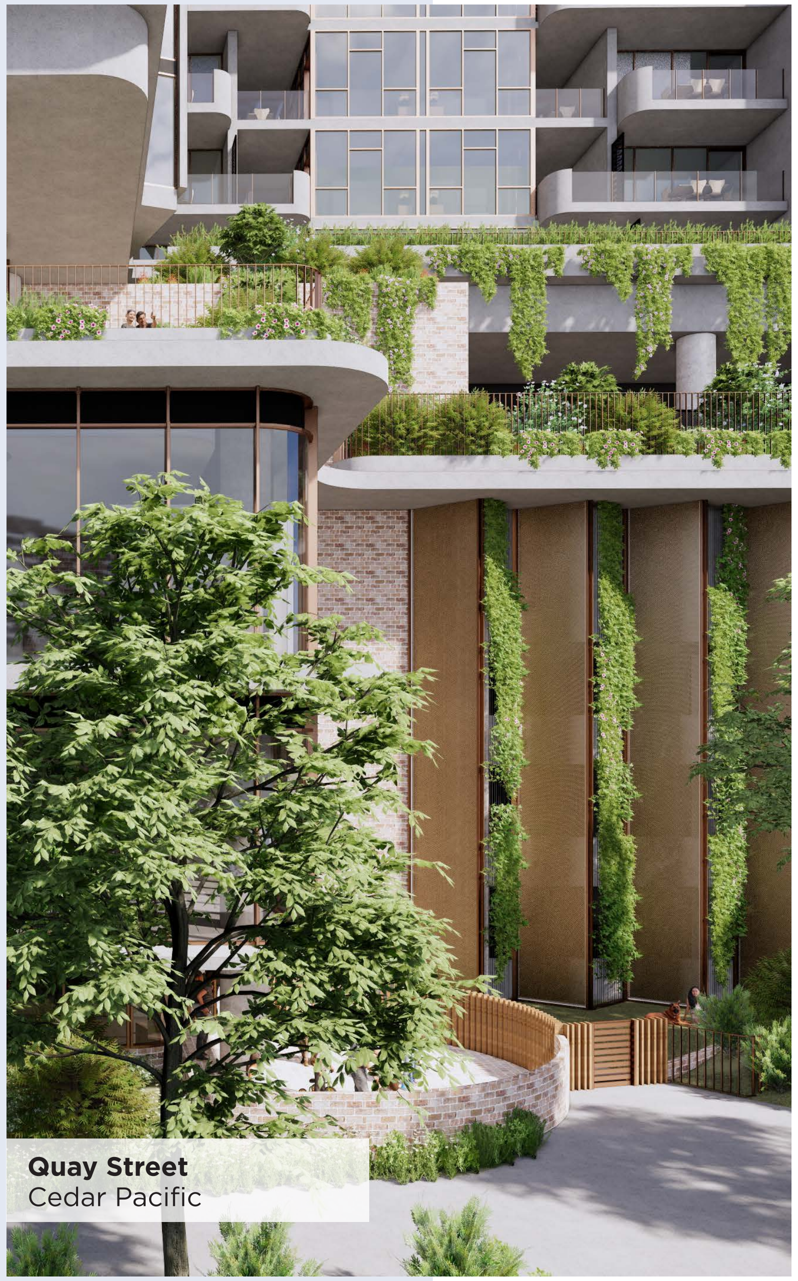
On top of their base rent, residents can pay for extra on-site services.

Time-poor residents might take advantage of in-house cleaning and laundry services; fitness enthusiasts can book in-house personal trainers; those working from home may upgrade to ultra-fast Wi-Fi speeds while self-employed residents can rent rooms for client meetings.

Nearly all resident facilities are available for private hire, with on-site management teams happy to adapt a room's layout to match resident's needs.

Evolution of institutional PRS and BTR assets

	Planned for private sale	Generation 1	Generation 2
What is it?	New schemes that were originally destined for the private for sale market. They were instead either retained for private rent by the developer or purchased by an investor to rent out.	New schemes purpose-built and designed for private rent.	The same as Generation 1 but a much greater focus on service and hospitality.
Number of schemes	261	235	46
London: regional % split	85:15	40:60	60:40
Estimated value of generation (£billions)	£11.7	£14.7	£8.8
Average size of schemes	105	187	340
Average age of schemes (years)	7.0	4.7	3.1
Level of amenity	Little focus. Any resident facilities are likely to be light touch e.g. a basic gym/ concierge.	Focus on providing high quality, resident facilities for tenants, above and beyond what is offered on a typical Private For Sale development. This includes gyms, co-working spaces, concierges etc.	The specification and resident facilities are of higher quality than a Gen1 scheme.
Types of ownership	Domestic investors, Registered Providers, UK developers	UK and Global investors	Primarily Global
Price point relative to local PRS	Below Upper Quartile	Upper Quartile	Upper Decile
Management approach	Low	Medium	High



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