UK Residential Research - December 2020

SPOTLIGHT
Savills Research

The UK Private Rented Sector

savills

Private renting ● Investor appetite ● Impact of Covid-19

SIX KEY TAKEAWAYS

£1.84bn
BTR investment in Q3 2020, the strongest single quarter on record

160%+
yoy increase in fund capital targeting residential investments globally*

35%
of investment from investors new to UK BTR in 2019 and 2020, up from 20% in 2018

£1.1bn
invested in operational stock in the year to Q3 2020, the highest since 2015

12%
of completed BTR homes are houses, versus 63% of all privately rented households, showing potential for suburban, single family BTR

German investor Vonovia owns
over 100 times
more homes than the largest UK BTR investor, indicating there's still plenty of potential for UK investors to grow

*according to Prequin and taking into account only closed-ended investment funds.

Resilience of the sector

In spite of the challenges 2020 has presented, the UK Build to Rent (BTR) sector continues to provide resilient income returns. Occupancy levels remain high and rent collection rates are still robust, in contrast to many other real estate sectors.

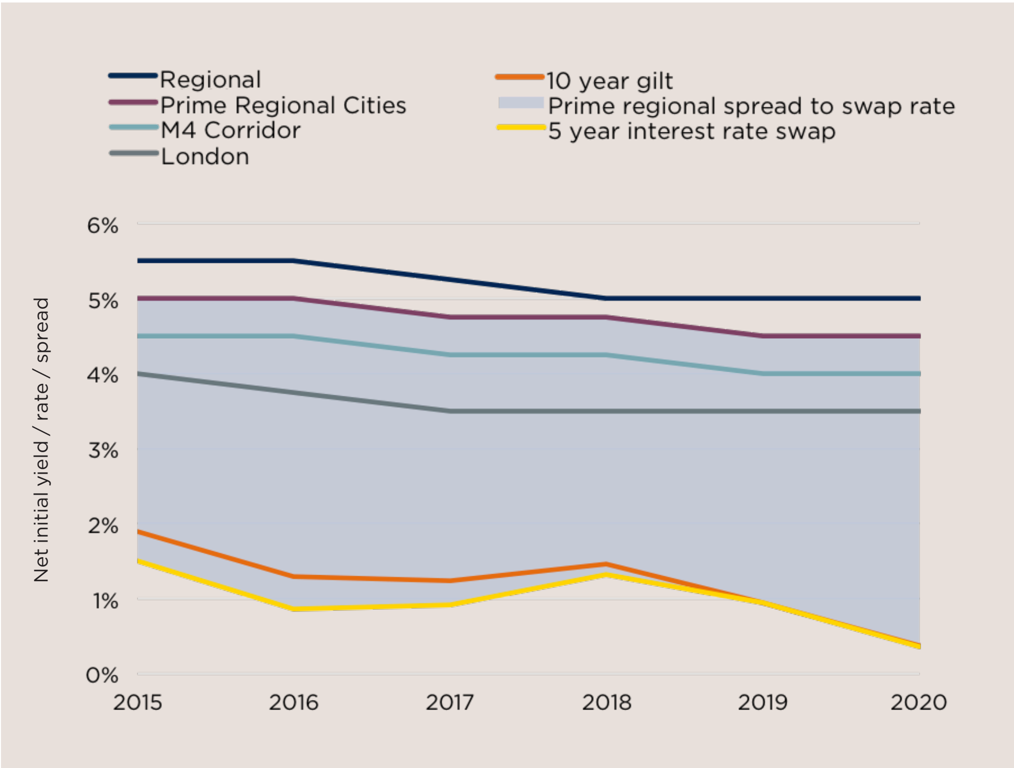
Little wonder, then, that investor appetite and pricing for BTR assets have stayed strong through 2020. The third quarter of 2020 was the strongest single quarter of activity on record, with £1.84 bn invested.

Resilient residential
BTR investors have reported robust occupancy levels over the last two quarters. Legal & General Investment Management initially reported a 9% occupancy fall in June as overseas students returned home, but occupancy has since recovered. Grainger's occupancy was 95% in the year to September 2020.

Rent collection has remained resilient too. Savills Residential Management team collected 97% of rents due in Q3 from the more than 3,000 homes they manage. Grainger collected 95% of its rents in September, and even reported annual rental growth of 2.5%. PRS REIT recorded a 100% rent collection rate in the three months to September. This compares exceptionally well to other real estate sectors, some of which are dealing with rent collection rates well under 50%.

That resilience has supported pricing in BTR even as yields in other sectors soften. Net initial yields for operational BTR stock continued to narrow in all major markets in the first three quarters of 2020. As the sector continues to mature, greater liquidity and economies of scale will put downward pressure on BTR's risk premium – allowing yields to remain stable even as the risk-free rate rises.

Relative returns BTR yields continue to narrow across all regions



Source Savills, Bank of England, Oxford Economics

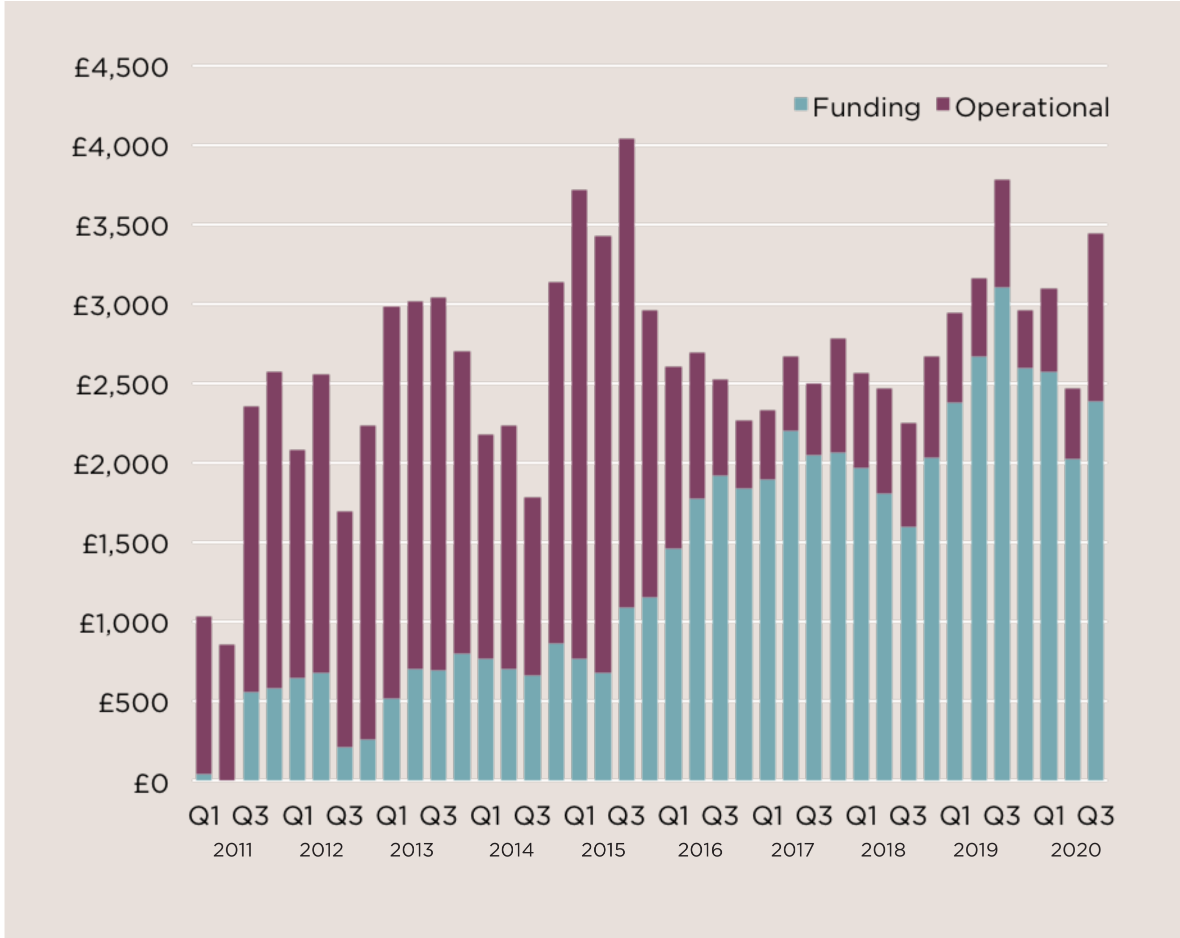
This stability in the face of pandemic disruption has reinforced BTR's huge appeal to investors seeking long-term, reliable returns. £3,097 million was invested in BTR in the year to September 2020, 4.6% more than in the whole 2019 calendar year.

Inevitably the pandemic caused a degree of disruption to the sector. Lockdown restrictions limited developers' ability to make construction progress and forward funding transactions required additional discussions on items like Extensions of Time due to pandemic induced delays. However, activity returned rapidly in the third quarter, with £1,836 million invested in just three months – the strongest quarter of BTR investment on record.

Quarter	Volume (£m)
Q3 2020	1,836
Q4 2014	1,797
Q3 2011	1,502
Q4 2018	1,159
Q1 2015	1,094

The strongest quarters for UK BTR investment
Investor appetite for BTR assets continues to grow worldwide. Data from Preqin shows investment fund capital targeting residential assets grew from US$16.4 billion in 2016 to US$26.3 billion in 2020. The significant appetite from balance sheet investors with their own equity, as well as a variety of other investor types, means that the total number is far greater still. For more detail on international residential investment, see our recent report: Global Living 2020.

Investment flows into UK BTR by deal type, annual rolling



Source Savills, RCA

Fresh blood
Another sign that BTR's appeal is continuing to grow is the widening pool of investors entering the sector. Over a third, 35%, of investment in the first three quarters of 2020 came from investors that were new to UK BTR including AXA IM (Dolphin Square, London), Pension Insurance Corporation (New Victoria, Manchester), and ECE (Dandara portfolio, various). That is almost double the number of new capital sources compared to 2018, 20%.

In our 2018 report, Investing in Private Rent, we predicted that the investors who will dominate the BTR market of the future haven't yet made their first step into the sector. We believe this prediction is still true. As the range and scale of BTR opportunities on offer grows, so too does the pool of investors looking to access the market.

£1.84 billion Q3 2020 saw the strongest quarter of investment in UK BTR on record.

> Suburban BTR is an attractive proposition for investors and can become a key growth area for the sector

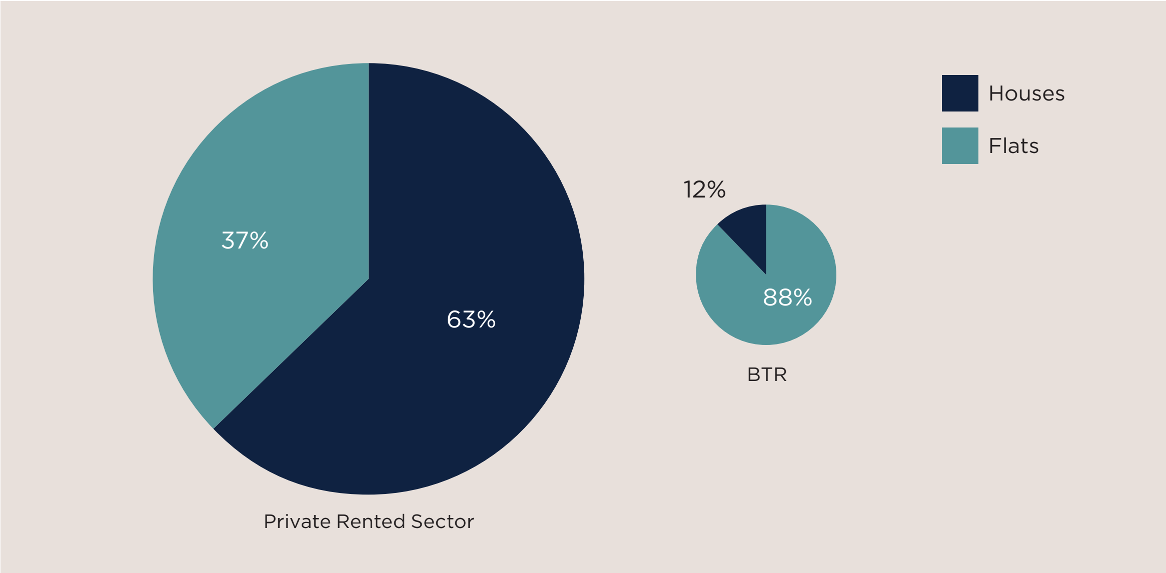
Primed for growth

Early investors in the fledgling UK BTR sector made a crucial bet: that demand for long-term, stable income would compensate them for taking on the risk of developing homes for rent. Those bets have started to pay off. Investment in stabilised, operational stock rose to almost £1,050 million in the year to September 2020, from a historic low of £360 million in 2019.

Deals such as AXA's recent acquisition of Dolphin Square in London show that investors with a low cost of capital have significant appetite for stabilised portfolios of homes for rent.

As the current wave of BTR investors accumulate portfolios of stabilised assets, we anticipate a further shift in the balance of activity from forward funding deals towards operational stock. Disposing their operational portfolios (or parts of them) will provide those early investors with the capital they need to build the next wave of homes for rent across the UK. Within the next five years, we expect to see investors acquire large, aggregated operational BTR platforms, similar to what we saw recently in PBSA with Blackstone's acquisition of iQ Student Housing and Unite's purchase of Liberty Living in the student accommodation sector.

Mismatch The mix of product type in UK BTR doesn't match the wider private rented sector, underscoring the opportunity for growth in single family BTR



Source Savills, British Property Federation, ONS English Housing Survey

The next wave

As earlier rounds of BTR development reach stabilisation and maturity, investors are broadening their search to find the next set of opportunities. In particular, they are moving away from traditional BTR city centre locations and looking to the suburbs.

Our analysis shows that the vast majority of BTR homes in the UK are flats, with houses making up just 12%. By contrast, nearly twice as many private renters (63%) live in houses compared to flats. Even accounting for BTR's geographic skew towards London, this mismatch presents an untapped opportunity for early investors looking to capitalise on the nascent suburban or 'single family' model.

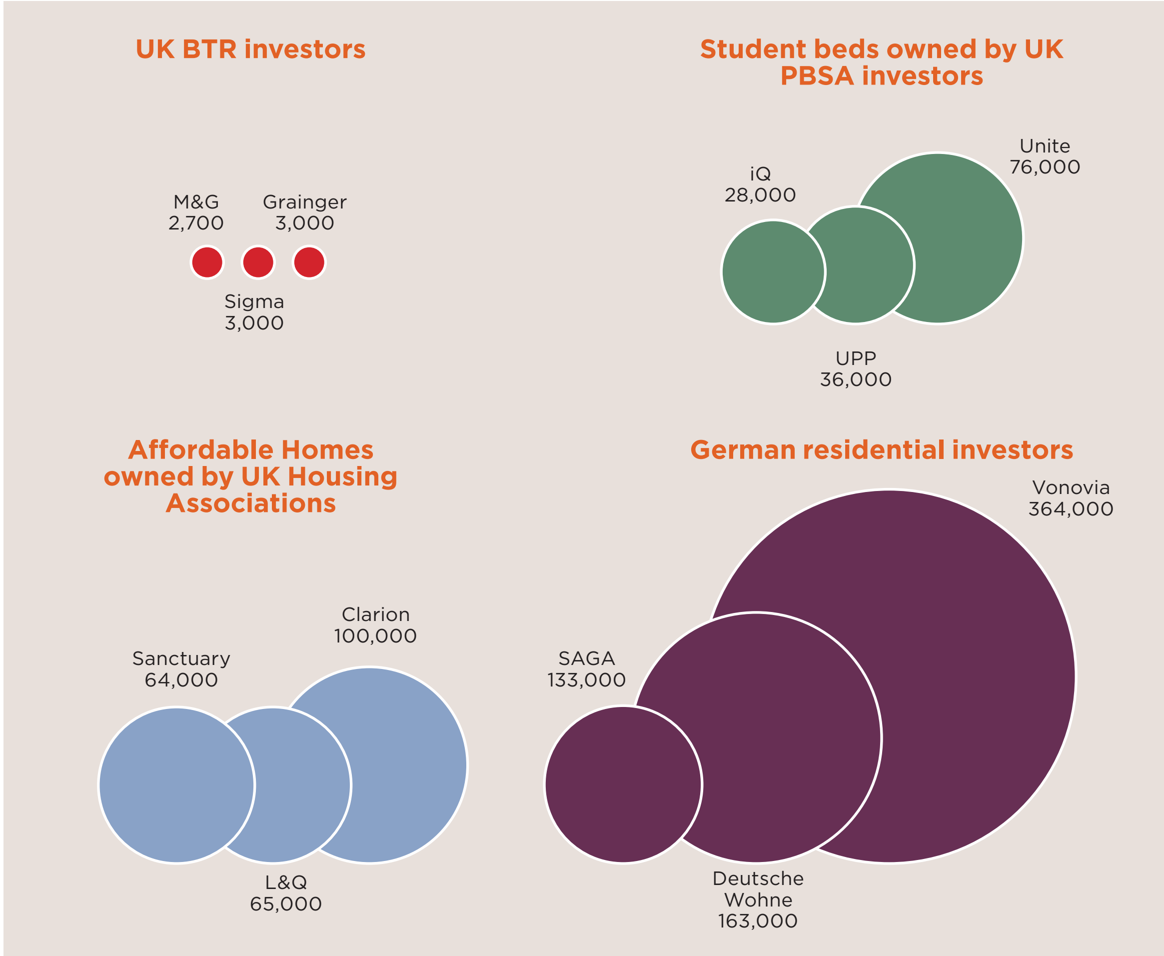
There is limited new build rental supply coming through in suburban markets, despite growing appetite amongst would-be investors who are now recognising that by shifting to single family, they can generate stable income returns without having to service several lift cores. Single-family developments also offer easier access for maintenance than flats and require less communal amenity space, helping reduce operational costs further. With lower running costs, rents can be more affordable and so capture a greater share of the local market.

Suburban BTR developments are geared towards families and tend to operate with lower turnover because these households move less frequently. Nearly two thirds of suburban renters are aged over 40, which government data shows is the fastest growing segment of the rental market. More than half of these households (56%) have children, which will impact on their ability to raise a deposit to purchase their first home. In addition, households in this age bracket, especially those at the upper end, could find it challenging to secure longer mortgages as they will be at or beyond retirement age by the end of a 25 year mortgage. Combined, these factors mean that many of these households are likely to be life-long renters and will be seeking longer tenancies.

All of this makes Suburban BTR an attractive proposition for investors seeking secure, long-term income streams and suggest it will become a key growth area for the sector.

> At full maturity, the UK's BTR stock could consist of some 1.5 million homes - 10x its current scale

Scale of the opportunity The UK purpose built student accommodation (PBSA) and European PRS markets show us the enormous scope for growth in UK BTR



Source Savills, British Property Federation, Regulator of Social Housing, Company reports. Totals are approximate. German investors' stock in Germany only.

What do we mean by scale?

In The Sky's The Limit? in 2019, we estimated the UK's BTR sector could make up a third of the private rented sector at full maturity, or 1.5 million homes. What does this mean for the scale of the investors operating in that market?
Some of the largest investors in rented homes in the UK are housing associations. The largest of these, such as Clarion Housing Group, own many tens of thousands of social and affordable rented homes, a scale that dwarfs even the largest BTR investors. However, there are almost 5 million privately rented households across the UK, compared to 2.3 million in social housing. That suggests there is the potential for the largest BTR investors to accumulate portfolios well in excess of 100,000 homes.

Looking to more established markets such as Germany and the USA provides further support for this view. The largest US investors own many tens of thousands of homes nationwide. The largest German investor, Vonovia, owns 363,500 rented homes in Germany alone, with further holdings in Austria and Switzerland. Its German portfolio alone is twice the size of the UK's entire BTR pipeline.

Build to Rent is now emerging into the mainstream in the UK. As it continues to grow, investors will find plenty of opportunities to achieve similar large-scale portfolios as those in more mature markets.

5 million privately rented households in the UK.

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We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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