

Suburban Build to Rent



Resilient sector performance • Huge growth potential • Significant opportunity

KEY POINTS



Investors are switching their attention to single family housing schemes, to capitalise on a significant market opportunity and diversify their PRS portfolios



The sector has remained resilient through adverse market conditions, sparking increased interest from investors



Rental homes can be delivered alongside for-sale products on housebuilder sites, to accelerate delivery without increased competition



BtR land values have become more competitive, with rents increasing and yields compressing

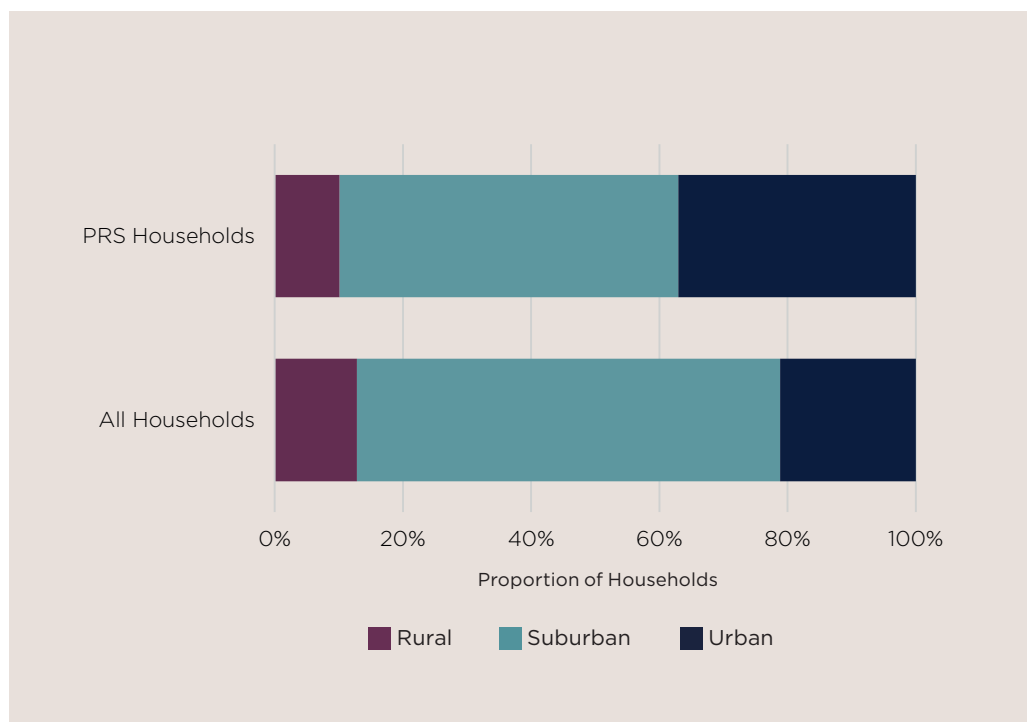


The biggest challenge in growing the sector is the lack of availability of 'oven-ready' sites and pipeline land opportunities

Introduction to Suburban Build to Rent

The UK is a nation of suburban renters

The majority of UK PRS households live in Suburban locations



Source: Census 2011, Experian

Investment has previously been focused on urban centres

There is a point of glaring contrast between the suburban and urban rental markets: the level of institutional investment. Since the sector emerged in the early 2010s, Build to Rent (BtR) investment has been almost exclusively focused on delivering multifamily housing in urban locations.

Analysis of the latest British Property Federation / Savills BtR database shows that around 90% of completed and operational BtR units across the UK are in urban locations. Furthermore, only 17% of pipeline units (construction or planning) are in suburban locations. Given the size of the suburban PRS population this indicates that there is significant scope to increase the delivery of Suburban BtR.

This means that the provision of rental accommodation in suburban markets is almost entirely through traditional Buy to Let (BtL). This

is a sector that is currently undergoing significant disruption, due to tax and regulatory changes that targeted individual BtL investors. Our analysis of the latest mortgage data indicates that over 200,000 landlords have redeemed their mortgages and left the market since the first of these changes came into force in 2016.

In addition, pandemic related lockdowns led many households to reassess where they want to live and what they want from their homes. This drove many to look to suburban markets in search of larger homes with access to gardens.

As a result, there are major supply and demand imbalances in these markets, which fuelled stronger rental growth in suburban markets compared with city centres during 2020.

“There is significant scope to increase the delivery of Suburban BtR”

Supply and Demand

Shortage of housing delivery makes home ownership less affordable

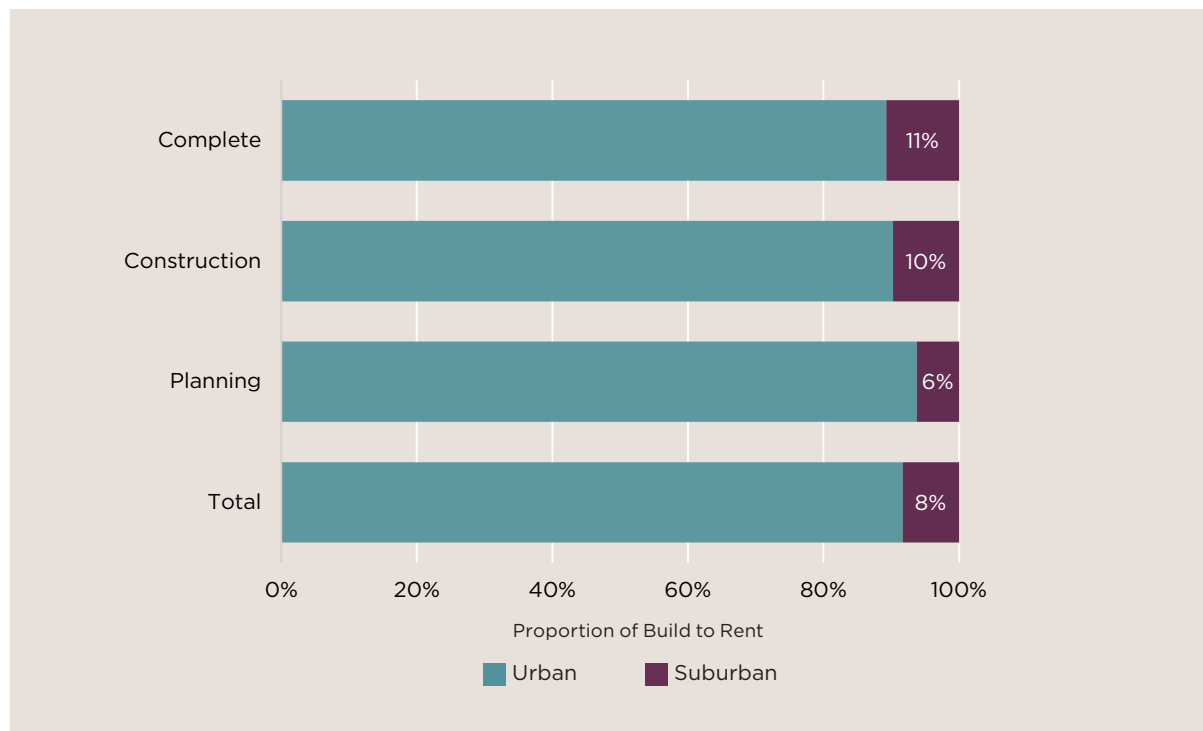
Housing delivery continues to lag behind need. Despite annual housing delivery increasing in each of the last seven years, the most recent figures from MHCLG show that we remain 56,000 homes per annum short of the government's 300,000 homes a year target.

Delivery of new housing has been a particular challenge across much of southern England. As a result we have seen affordability worsen in recent years, with the median house price to earnings ratio in the South East reaching almost 10, well above the 4.5x loan to income maximum for mortgage lending. This means the possibility of home ownership has moved further out of reach for many households.

We are also seeing large sites accounting for an ever greater proportion of new planning consents coming forward. This presents a fresh set of challenges to increasing housing delivery, in particular how to accelerate the build and absorption rates.

This creates further opportunity for Suburban BtR. Rental homes can be delivered alongside for-sale product, without competing against each other. This is a model that Sigma Capital and Countryside have been using with great success over the past few years, allowing Sigma to build a portfolio of over 8,000 homes in a relatively short period of time.

Urban BTR currently dominates the UK's pipeline



Source Savills, British Property Federation, Molior

Strong demand for Suburban BtR

Where Suburban BtR has been delivered, there is evidence of very strong tenant demand. The Thistle Portfolio, which Goldman Sachs purchased in early 2021, has had consistently high occupancy, in excess of 97%. When new schemes have

completed they have been very quick to let, in many cases letting as quickly as the units complete.

These strong fundamentals, and resilience during adverse market conditions, have sparked growing interest in the sector from investors.

💬 Suburban BtR has some distinct investment and design characteristics 💬

Suburban BtR Characteristics

Investment Characteristics

In the UK to date, Build to Rent (BtR) has primarily been associated with new build apartments in urban centres, typically including provision of amenities such as onsite concierge, gyms, cinema rooms and roof gardens. These multifamily schemes in city centres have attracted the most investor interest to date.

However, investors are now switching their attention to single family housing schemes, to capitalise on a significant market opportunity and diversify their PRS portfolios. The investment characteristics which make this asset class an attractive one include:

Lower Voids	The majority of single family housing tenants are families, who are less transient in nature, reducing the risk of tenant turnover and voids and so producing more reliable income streams.
Operational Efficiencies	There is minimal requirement for internal communal space and amenity and no requirement to service lift cores, which enables operational efficiencies to be driven, relative to multifamily schemes.
Reduced Amenity Provision and Communal Spaces	There will likely be little to no requirement to provide shared amenity provision within these schemes. Instead, it will probably be more appropriate to provide communal gardens for families to congregate and enjoy well-kept outdoor aesthetics.
Affordability	Due to the locations of suburban BtR schemes, the rents are often more affordable than those in city centres and capture a greater depth of the rental market as a result.

All of this makes suburban BtR, and single family housing in particular, an attractive opportunity for investors seeking long-term income streams, and suggests it will become a key area of growth moving forward.

Design Characteristics

The design of suburban BtR is comparable to that of a private for sale housing scheme and will generally be located in similar areas to other new build homes. However, investors are using certain attributes to determine whether a particular development will meet their requirements:

Scale	Location-dependent, but appetite typically ranges between 50 and 200 units.
Unit Mix	2 and 3 bed, efficiently sized terraced, semi-detached and detached houses are usually in highest demand, though there may be a few low-rise apartments. These units should ideally be clustered rather than pepper-potted.
Specification	Internal design will be comparable to that of private for sale units, but harder wearing materials will be required in certain areas, along with the provision of items such as fitted wardrobes.
Amenities	Access to community infrastructure, schools, areas of employment and (in some locations) public transport are of importance.
Density	Schemes are generally less than 50 dwellings per hectare.
Demographics	A broad tenant profile is likely, though a higher proportion of families (35+ years old) is expected, along with some younger tenants.

“ There is a significant opportunity for master developers and housebuilders to capitalise on the surge in appetite from investors for new-build single family housing for rent, in suburban locations ”

The Developer Opportunity

Blended, Complementary Schemes

Many developers are now seeking to include BtR as an alternative tenure on their schemes, as it allows the delivery of their larger sites to be accelerated via the provision of an additional parcel which does not compete with, but can actually promote, their private sales outlets.

This in turn can allow for site-wide infrastructure to be brought forward, assisting with building a new community and placemaking, resulting in a value increase earlier on in the development lifecycle.

Financial Gains

With rents increasing and yields compressing over the last 12 months, BtR land values have become more competitive and are an increasingly attractive option for developers to pursue. This has resulted in many taking advantage of the different funding and deal structures available to de-risk their sites at different stages of the development process. For example, in forward funded deals there is minimal upfront cash expenditure for the developer, resulting in a significant improvement to their reported ROCE and IRR. This allows for an alternative pool of revenue to be captured, giving PLCs the ability to record profit earlier.

It is expected that with schemes such as the recent stamp duty holiday and Help to Buy coming to an end, housebuilders will seek to pursue this additional tenure model further, to de-risk their larger sites away from private sales whilst maintaining, and potentially accelerating, their current delivery rates.

All of these points combined mean there is a considerable opportunity for master developers and housebuilders to accelerate delivery and improve cashflow through the inclusion of suburban BtR within their current schemes and future pipeline.

Withdrawal of Help to Buy

Help to Buy (HtB) has become a core element of the new build sales market since it was introduced in 2013. The latest statistics show that 57% of new build sales in the past 3 years have been supported by a HtB loan nationally, with some areas reaching as high as 62%.

In April 2021 HtB entered a new regime, with the scheme restricted to first time buyers and new regional price caps introduced. This will reduce the usage of the scheme, as 17% of users over the past three years weren't first time buyers. Furthermore, there will now be some markets and developments where pricing is above the regional cap. This could create opportunities for suburban BtR to help support the delivery of larger sites.

The new regime is due to run for two years and will end on April 2023. The ending of the scheme presents a new challenge for developers and housebuilders to navigate. At present the Government has indicated that there will be no continuation or replacement for the scheme. Therefore, now is the time to be thinking about ways in which the demand that has previously come from HtB can be replaced. This is something that the delivery of BtR homes can do, providing a source of demand that doesn't compete with the delivery of for sale homes and can be done alongside – as shown by the success of the Countryside and Sigma Capital partnership.

“ The biggest challenge investors currently face in building their suburban BtR portfolios is deploying the volume of capital they have raised targeting the sector ”

Market Activity

The single family housing investment model is a relatively new one in the UK, with very few parties other than Sigma Capital/PRS REIT and Hearthstone investing at any scale prior to 2021

As the sector matures and new capital enters, we expect transactions of smaller portfolios to become less frequent, with housebuilders and master developers partnering with investors to forward fund a larger parcel of BtR units across their sites instead.

Since the second half of 2020, a number of new entrant investors signalled their intentions in the single family housing market, including Goldman Sachs, Leaf Living (backed by Blackstone) and Legal & General Capital's Suburban Build to Rent arm, to name just a few. More recently, TPG Real Estate Partners and Gatehouse Bank launched a £500m joint venture to acquire a significant single family rental portfolio across the North and Midlands. It was also announced in June 2021 that a subsidiary of PineBridge Benson Elliott had agreed to acquire Sigma for £188.4m, providing it with the platform required to capitalise on the considerable single family housing opportunity in the UK.

Goldman Sachs kicked off the year strongly with its acquisition of 918 operational units in the North West of England from Gatehouse Bank for c.£150m in January 2021 - the largest single family housing transaction in the UK to date.

Over the last 12 months housebuilder Countryside Properties signed two deals with investors to deliver additional BtR units over a three year timeframe. The first was a refreshed agreement with Sigma Capital to deliver an additional 5,000 homes, expanding on their original agreement from 2018 which has already seen over 4,000 units delivered. The second is a new partnership with Goldman Sachs to deliver 1,000 homes. Citra Living recently followed suit by forming a strategic partnership with Barratt Developments to deliver single family rental homes across their sites.

Many of the UK's master developers and housebuilders are now seeking to replicate this, mindful that the current strength of individual unit sales is unlikely to be sustainable over the medium term, they are aiming to partner with an investor to deliver an additional sales outlet and accelerate the delivery of their sites.

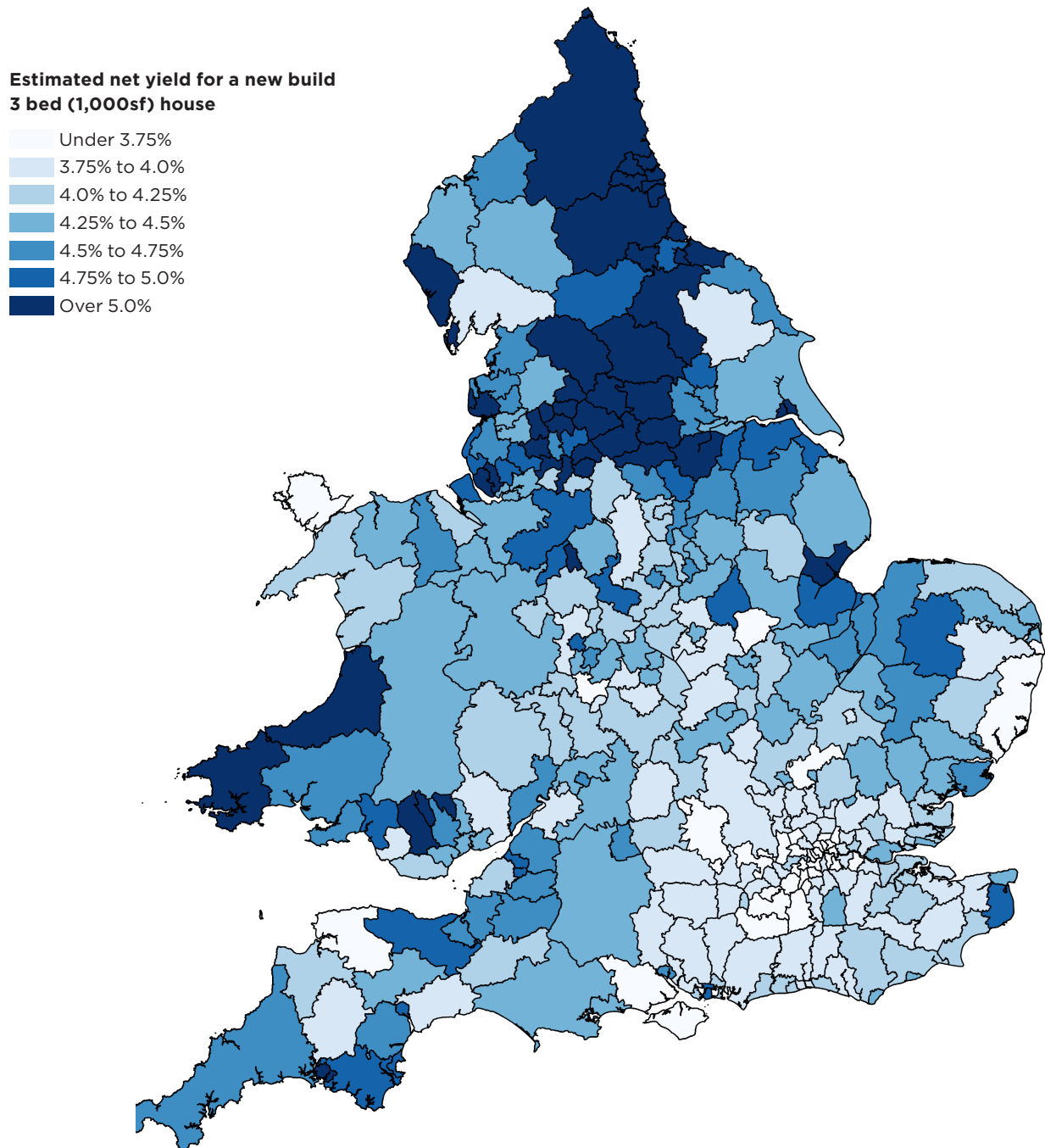
The biggest challenge investors currently face in building their suburban BtR portfolios is deploying the volume of capital that has been raised to specifically target this sector, due to the limited availability of 'oven-ready' sites and pipeline land opportunities.



Goldman Sachs' Thistle Portfolio

Yield Map

The map below provides an indication of the potential net yields for a new build 3 bed house across different areas of England and Wales



These indicative yields have been calculated by assuming a 10% discount can be achieved from average new build sales values (£psf), with upper quartile rents for higher value regions and upper decile rents for lower value regions, for a 3 bed house sized 1,000 sq ft

Source Savills using Land Registry, EPCs, Rightmove

“ The US market may hold clues as to how the suburban BtR sector will develop in the UK ”

US Comparator

To understand how the suburban BtR market in the UK might evolve over the coming years, we can look to more mature markets, such as the US

The US is in many ways a similar housing market to the UK: there is a similar cultural desire to own, as well as a comparable proportion of renters and homeowners.

The US multifamily sector has had a major influence on the emergence and evolution of the urban BtR market in this country. This influence reflects the USA's well established institutional investment market for residential. In the US, initial institutional involvement in the sector was focused on investment in multifamily, before entering the single family housing sector.

At a macro level it is estimated that institutional investors own around two fifths of all rental units across the US. Although the majority of this is focused on the multifamily sector, the scale of investment in the single family housing sector is rising fast.

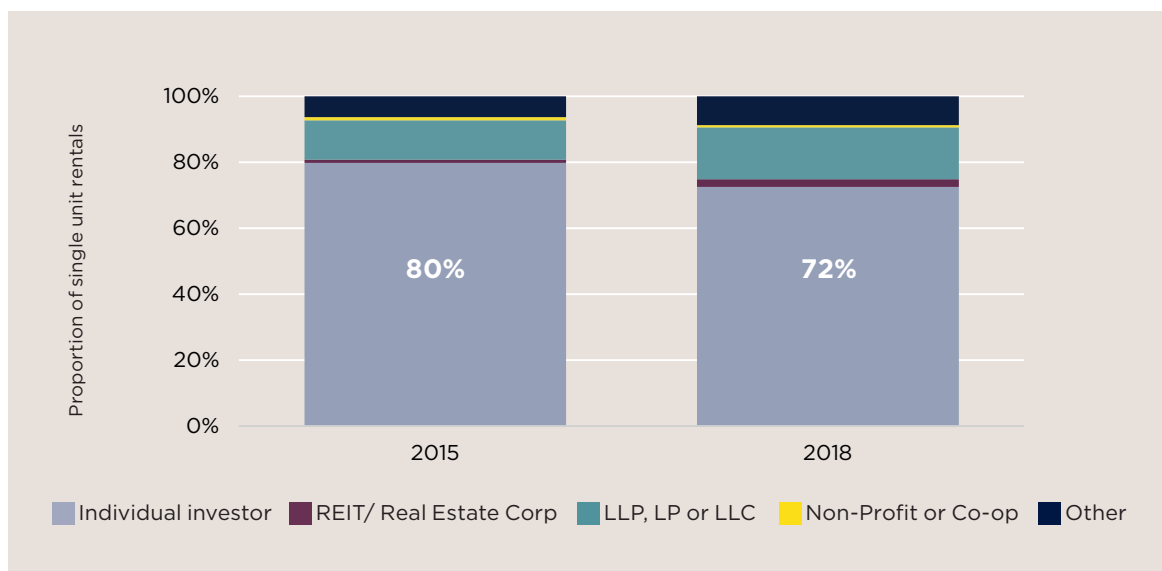
The emergence of institutional single family housing

The single family housing sector in the US is dominated by small 'mom and pop' landlords. These are investors who own a handful of properties in their own neighbourhood, in many ways like the UK BtL sector. While they remain the cornerstone of the single family housing market, there is a growing presence of REIT's and corporate owners in the sector.

According to data from the US Census Bureau's Rental

Housing Finance Survey, individual investors owned 72% of single family units in 2018, down from 80% in 2015. While REIT's have increased their share to 2% of the market and corporate owners (LLP/LP/LLC's) control 16% of the sector, compared with 12% in 2015. This contrasts with the multifamily sector where over half of properties are owned by institutional investors.

Ownership of single family rental homes in the USA 2015 & 2018



Source US Census Bureau

Institutional investment in single family housing didn't really emerge until the collapse of the US housing market during the Global Financial Crisis, as investors saw the opportunity to acquire significant number of homes that were foreclosed.

Early investors in the sector included Blackstone (Invitation Homes), Starwood Capital, Silver Bay, American Homes 4 Rent and Colony Capital. During the early 2010s these investors amassed large portfolios of single family housing properties, mainly in the South and West, where

foreclosures were the highest. The scale these portfolios reached in a short period of time was staggering. Invitation Homes built a portfolio of 48,000 homes in the early years. American Homes 4 Rent built up a portfolio of 52,000 homes between 2013 and 2018.

Given the origins of single family housing, the majority of homes in these portfolios have come from foreclosures in the second-hand market, rather than bulk buying of new build developments. This is in contrast to how the sector is emerging in the UK.

🗨️ Covid-19 has accelerated trends that drive single family housing: a desire for space and the rise of remote working 🗨️

Searching for scale

The early phases of the sector saw a large number of active investors. But during the mid to late 2010s the sector went through a period of consolidation, as investors sought to drive management efficiencies through increased scale.

This resulted in American Homes 4 Rent merging with American Residential Properties and Invitation Homes merging with Starwood Waypoint. The resulting companies controlled over 50,000 and 80,000 homes respectively,

putting them on par with some of the largest multifamily owners in terms of scale.

These mergers and rapid growth in units in single family housing meant that it took only a few years for the sector to achieve what it had taken multifamily over two decades to achieve in terms of scale.

Resilience during the pandemic

For a sector that had grown out of the last crisis, the Covid-19 pandemic presented its first major test, but it was one that the sector passed with flying colours. Both Invitation Homes and American Homes 4 Rent reported occupancy levels over 97% throughout 2020, as the sector benefited from many of the same drivers seen in the UK – increased desire for space and rising remote working, allowing people to easily relocate out of city centres.

The sector has seen very strong rental growth as the US emerges from lockdowns. As demand has continued to rise, both American Homes 4 Rent and Invitation Homes announced they had increased the rent of vacant properties by over 10%. This compares with apartment rental growth during 2020 of 0.7%.

Increasing investor interest

2021 has seen a flurry of activity in the sector. So far this year a number of investors have sought to enter, or re-enter, the sector. These include KKR who are launching My Community Homes, Blackstone who are acquiring Home Partners of America (16,000 homes) for \$6bn, Transcendent Investment Management and Electra America who are looking to deploy \$3bn over the next years, and Allianz and Centrebridge who have launched a partnership with Lennar Corp (Upward

America Venture) to build up a single family housing portfolio.

The last of these is the most interesting from a UK perspective. Lennar are one of America's largest house builders, which will provide the venture with access to a nationwide housebuilding programme. This is a model that is emerging in the UK as investors seek ways to access scale quickly.

Differences with the UK

The major difference between the established US single family housing sector and the emerging market in the UK is that the former has grown out of amassing scale in the second-hand market - initially through foreclosures but now primarily through the open market. This is something that we have yet to see at scale in the UK. Instead investors are focused on delivering new homes through developer partnerships or forward funding schemes. As a result, it will likely take longer for single family housing to achieve a similar scale in the UK.

However, what the US has shown is the importance of ensuring management and the operational efficiency of large portfolios. Even as investors have built very large portfolios, these have remained surprisingly concentrated in their geographical spread. This shows that in the UK investors should be looking to create geographic clusters, that can then be managed from local/regional hubs.



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Andrew Brentnall

UK Board Director - Head of Residential Investment and Development
+44 (0) 207 409 8155
abrentnall@savills.com

Piers de Winton

Director, Residential Investment & Development
+44 (0) 207 016 3816
pdewinton@savills.com

Rebecca Trueman

Associate Director, National Development Consultancy
+44 (0) 207 758 3890
rebecca.trueman@savills.com

Craig Langley

Head of OCM Valuation
+44 (0) 207 409 8093
clangley@savills.com

Davina Clowes

Director, Residential Investment & Development
+44 (0) 207 016 3838
dclowes@savills.com

Polly Simpson

Director, Residential Investment & Development
+44 (0) 207 016 3791
psimpson@savills.com

Anna Hwang

Director, Residential Investment & Development
+44 (0) 7929 735 598
anna.hwang@savills.com

Andrew Wood

Associate Director, Residential Investment & Development
+44 (0) 203 107 5474
andrew.wood@savills.com

Peter Allen

Executive Director - Head of Operational Capital Markets
+44 (0) 207 409 5972
pallen@savills.com

Joe Guilfoyle

Head of Corporate Finance
+44 (0) 207 016 3767
joe.guilfoyle@savills.com

Andrew McMurdo

Head of Debt Advisory
+44 (0) 203 810 9889
andrew.mcmurdo@savills.com

Peter Blake

Head of National Development Consultancy
+44 (0) 207 0163 707
pblake@savills.com

Research

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.

Jacqui Daly

Director
+44 (0) 207 016 3779
jdaly@savills.com

Lawrence Bowles

Director
+44 (0) 207 299 3024
lbowles@savills.com

Richard Valentine-Selsey

Associate Director
+44 (0) 203 320 8217
richard.valentineselsey@savills.com

Guy Whittaker

Research Analyst
+44 (0) 797 003 3630
guy.whittaker@savills.com