UK Build to Rent Market Update

The second quarter of 2023 saw a marked improvement in the amount of capital invested into UK Build to Rent (BtR). This resulted in the highest Q2 on record, at £1.26bn.

6,000 homes have been funded since the start of the year but this will not shift the dial on the UK's supply-demand imbalance. With fewer homes to rent, and record private sector wage growth, rents grew by 10.4% in the year to May 2023.

Meanwhile, interest rate rises have reduced the profits of Buy-to-Let landlords and future growth is unlikely to come via this route.

Eyes have turned to BtR to plug the supply gap and the sector is already taking an increasing share of new housing delivery. BtR still makes up less than 1% of privately rented homes but we expect this to grow as new entrants emerge.

Investors already in the market are learning to operate schemes efficiently and can offer their residents superior levels of service. These lessons will be invaluable as operators seek to differentiate themselves in the market and generate superior levels of returns.

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Rising wages are supporting rental growth as supply-side challenges persist

The UK rental market continues to grapple with a supply-demand imbalance. Annual growth for new lets has been over 10% for 16 consecutive months, bringing into focus the pressing need for supply. Around 40% of the rental market is owned by mortgaged Buy-to-Let landlords and in periods of rising mortgage costs, reliance on this group for new supply raises concern. We estimate their profits (net of tax) fell to 3.9% in Q2, down from 25.7% five years ago. With limited prospects for capital value growth and rents scarcely covering interest payments in some cases, new supply is unlikely to come via this avenue. Some have already decided to sell up and exit the market.

Consistent rental growth

One feature of recent rental growth is a reduction in tenant turnover. Tenants are opting to renew leases rather than move, shielding themselves from a substantial jump in their monthly rent. This, in turn, is reducing supply, and those with no choice but to move are bearing the brunt of the rental increases.

That said, wage growth has been supportive. Average weekly earnings (ex. bonuses) hit an annual growth rate of 7.3% in the 3 months to May, equalling the highest level on record. Growth in the Private sector and Finance & Business sector has been even stronger at 7.7% and 9.0%, respectively, helping to ease affordability pressures (Figure 1).

Recent commentators suggest that rent controls are unlikely to be a Government priority. This is encouraging as attempts at rent control in Scotland and Ireland have deterred institutional investors, removed the incentive for Buy-to-Let landlords to invest in their properties and unintentionally fuelled further rental growth.

More supply coming from Build to Rent

Build to Rent (BtR) is taking an increasing share of new home sales, particularly in London. In Q1 2023, BtR schemes made up nearly half of new housing sales in the capital, according to Molior data. However, delivery will need to scale up to support housebuilding given Help to Buy has ended and some Registered Providers are prioritising improvements to their existing stock over developing new stock.

Alongside supporting construction, the case for investing into existing operational assets is compelling. We have also reached a point where the early movers in the first wave of BtR development in London have come to the end of their business plans and are looking to crystallise their gains.

Assets in London represent a unique proposition given Multifamily makes up less than 1% of privately rented homes in the capital. With new supply inevitable, there is a window of liquidity before the next wave of capital enters the market.

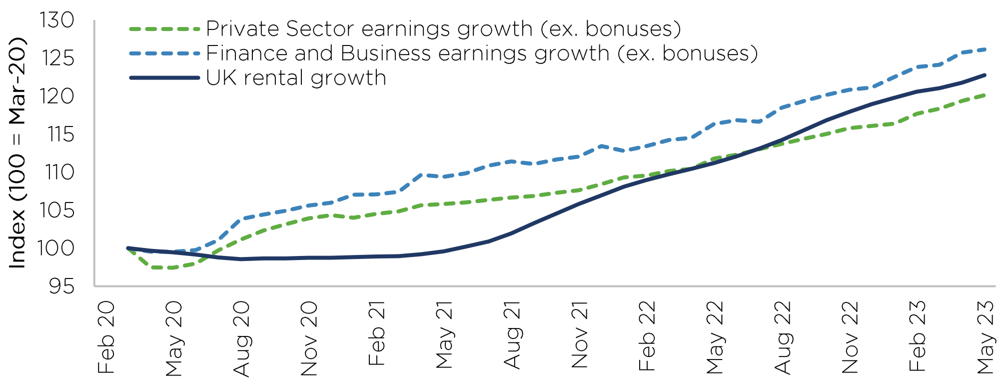
Benefits of operating Multifamily today

Operators in the current market are learning a number of valuable lessons when it comes to operational efficiencies. This will be a fundamental lesson for the next phase of growth.

The day-to-day running of schemes provides access to valuable operational data, ultimately enabling operators to run their assets more efficiently over time and limit gross-to-net losses.

As rents increase, tenants become increasingly discerning. Operators that can deliver superior levels of service will be able to differentiate themselves in the market. We believe this to be the next wave of segmentation, with those operators offering the highest levels of service generating the greatest returns, as has been the case in the hospitality sector for decades.

Figure 1 – Private sector wage growth in England is supporting rental growth



Source: Savills Research using ONS, Zoopla Rental Index – Powered by Hometrack

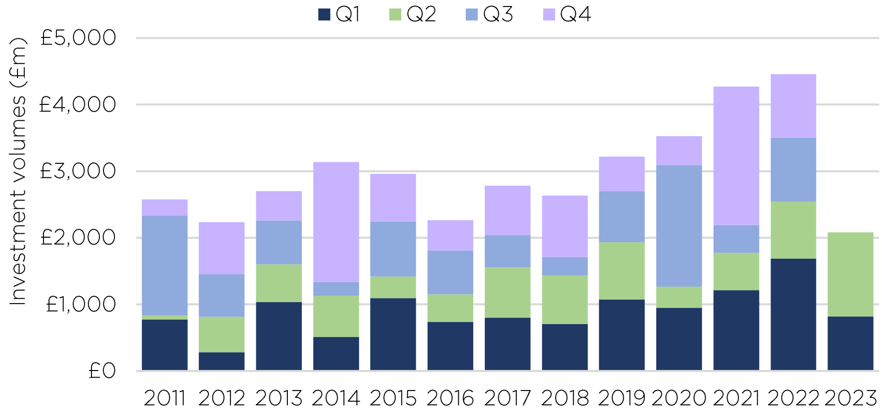
UK Build to Rent Investment

The second quarter of 2023 saw 18 deals transacting, a marked improvement on a subdued Q1. Investment picked up with a record-breaking Q2 figure of £1.26 billion deployed. This brings the half year total to £2.1bn, between the equivalent figures of 2021 and 2022. The underlying fundamentals of the sector remain strong and continue to attract investment.

Multifamily, making up 58% of investment over this period, saw major transactions such as the forward fund of Lower Essex Square, Birmingham between Apsley House Capital/Galliard Homes and OutPost Management/Blackrock; L&G completing on two major regional transactions including Whitehall Riverside, Leeds with Glenbrook; and the entrance of Aware Super to the UK BtR market by purchasing Qatari Diar's 22% stake in Get Living - this transaction has not been included in the overall investment volumes shown below.

The most notable single family transaction was a portfolio sale of 604 units by Barratt Developments Plc to Citra Living, further building on Citra's already substantial pipeline with Barratt.

Figure 2 – £1.26 billion of investment in Q2, a marked improvement on Q1



Source: Savills

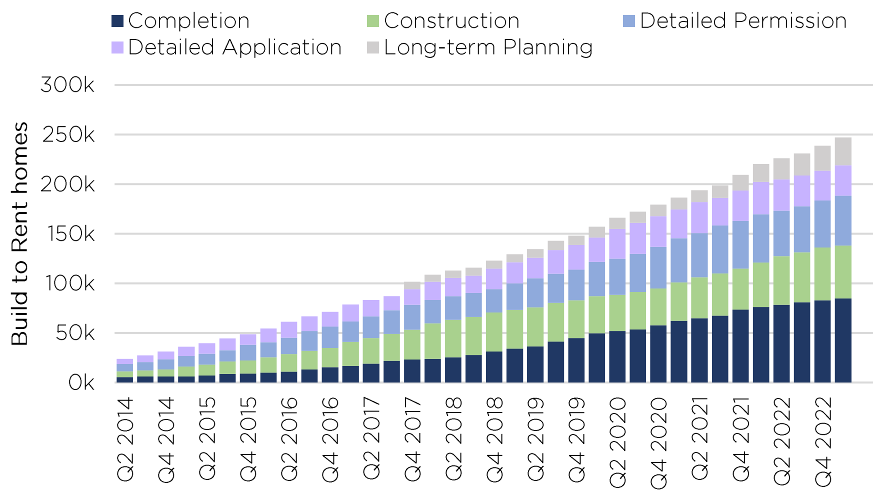
UK Build to Rent Development

The UK's BtR stock now stands at 88,100 completed homes, with a further 53,500 homes under construction. In addition, there are 111,800 homes in the planning pipeline, including those in the pre-application stage. The total size of the sector is 253,400 homes.

Starts in London remained subdued in Q2 as the heightened cost of debt impacts the viability of many cash-intensive projects. The regions saw starts rebound (3,157 starts) after a modest Q1, supported by an increase in Single Family Housing starts.

In tougher economic conditions, delivery of individual houses offers diversification of investment strategy and unit by unit handovers meaning operations can often commence faster than larger apartment blocks which have longer delivery timescales.

Figure 3 – Over 88,000 homes operational with 53,000 more underway



Source: Savills, British Property Federation, Molior

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