Single Family Housing Report

2023

Knight Frank's review of the performance and opportunities in the nascent SFH to rent sector.

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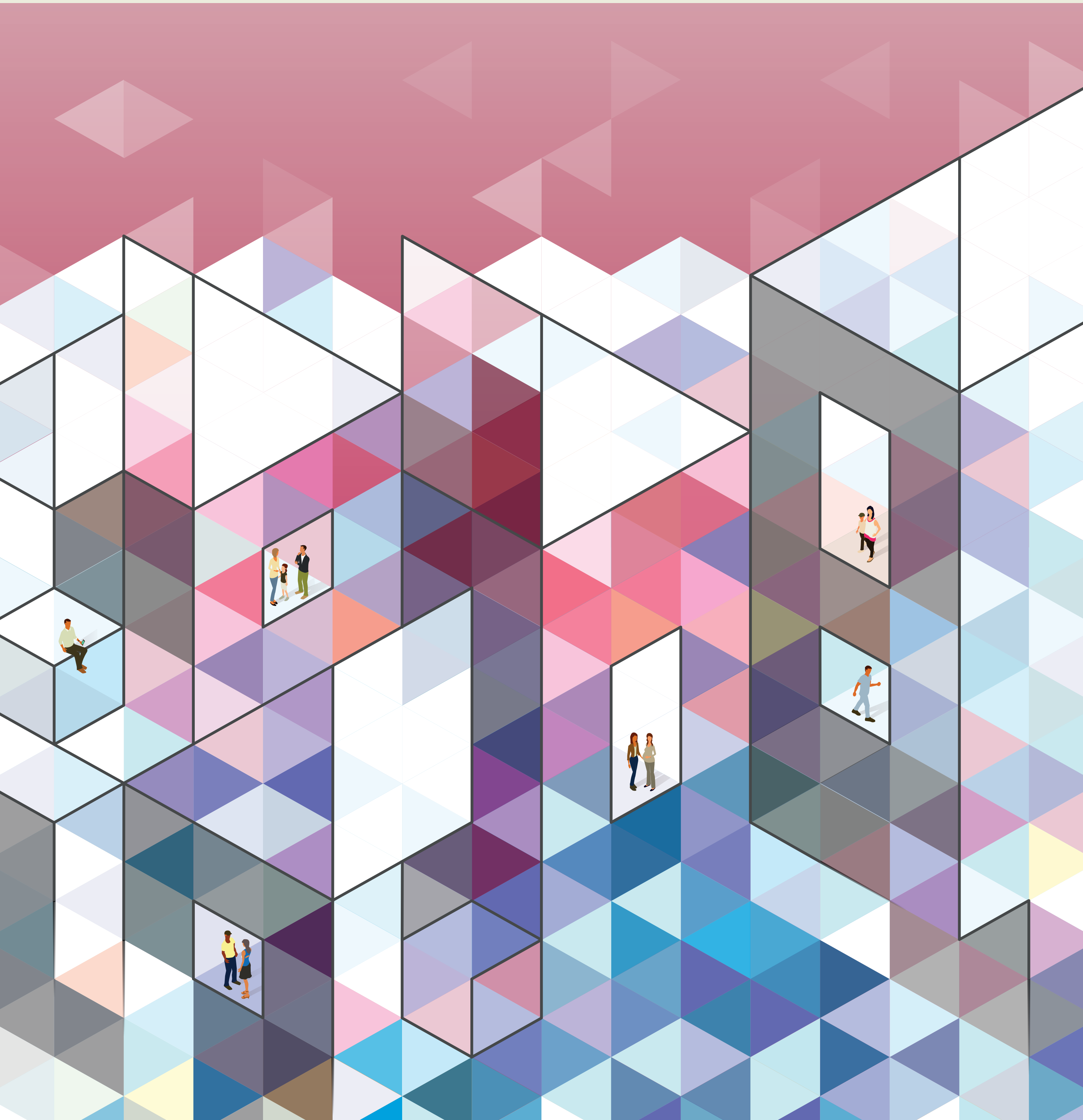


MARKET VIEW

An emerging sector with huge growth potential

FOREWORD
BY JACK HUTCHINSON,
KNIGHT FRANK RESIDENTIAL CAPITAL MARKETS

Single family housing (SFH) remains in the early stages of its evolution in the UK compared with the more mature multifamily market, but it is on a rapid growth trajectory. As the data in this report shows, there is a huge opportunity for funders and developers to capitalise on solid near-term and projected long-term demographic trends, whilst also providing much-needed high-quality and sustainable homes for the rental market.

Multifamily schemes remain in high demand following their strong performance over the past few years, but there has been an acceleration in interest and activity within the SFH sector. For investors already active in the multifamily market, delivering single family rental housing gives them exposure to different geographies and a diversified demographic. It is a statistic worth repeating: 60% of privately rented properties in the UK are houses. The opportunity for institutional investors to deliver and manage suitable housing options for these households is huge.

The more challenging economic backdrop makes the decision to invest in sectors driven by demographic rather than economic shifts a logical one. Already in 2023, Knight Frank alone has been involved in over £350 million of SFH transactions. In this report we have identified a further £8 billion of committed capital looking to enter the sector, testament to SFH's growing market presence. As such, we expect SFH to establish itself as a key component of housing delivery in the coming years.

20K

GROWING PIPELINE
The number of complete and operational SFH homes currently stands at 9,470 homes. A further 9,520 SFH units are either under construction or have full planning permission granted, taking the total pipeline to nearly 20,000 homes

£8bn

COMMITTED CAPITAL
We have identified nearly £8 billion of institutional capital committed and ready to be deployed in the suburban SFH market over the next five years by leading investors, which would represent approximatively 30,000 homes at today's values

60%

OPPORTUNITY FOR SCALE
More than 60% of privately renting households in the UK already live in houses, equating to over three million households. SFH accounts for 0.3% of that number, highlighting the scale of the opportunity

£450m

RISING INVESTMENT
More than £450 million in SFH deals have been agreed in the first quarter of 2023, already exceeding the 2022 full-year figure

42%

SUPPLY SQUEEZED
According to data from Rightmove, the volume of rental listings for houses across the UK in Q4 2022 was 42.6% lower than the 2017-19 pre-pandemic average

Rapid Growth Trajectory

WORDS: KNIGHT FRANK RESIDENTIAL RESEARCH

The single-family rental housing market in the UK is continuing to grow at pace. This expansion is supported by a search from both traditional housebuilders and urban BTR developers for new ways in which to diversify and tap into the burgeoning institutional investor demand looking to enter the UK's single family rental markets.

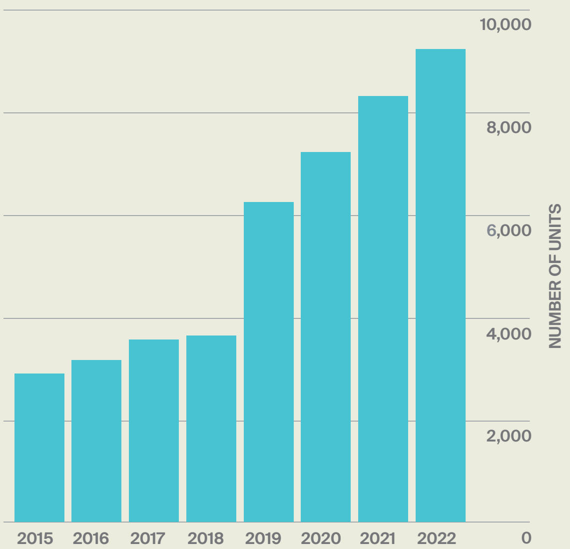
The number of complete and operational purpose-built rental properties in suburban single family housing (SFH) schemes has increased by 11% since 2021 and currently stands at 9,470 homes. A further 9,520 SFH units are either under construction or have full planning permission taking the total pipeline to nearly 20,000 homes.

A slowdown in the private sales market as a result of growing affordability pressures, combined with a structural undersupply of homes in the rental market present significant tailwinds for the sector. Consequently, SFH is anticipated to play a far more significant role in both housing delivery and within institutional real estate portfolios in the coming years.

Already we are seeing a considerable uptick in institutional investment into SFH. We have tracked more than £450 million in SFH deals in the first quarter of 2023, already surpassing the full-year 2022 figure. Outside of the trading of stabilised assets and forward funds, there has also been an uptick in interest of direct development of purpose-built rental product.

Fig 1: Continued growth in SFH delivery

Completed units, cumulative



Source: Knight Frank Research

"The number of complete and operational purpose-built rental properties in suburban single family housing (SFH) schemes has increased by 11% since 2021 and currently stands at **9,466 homes.**"

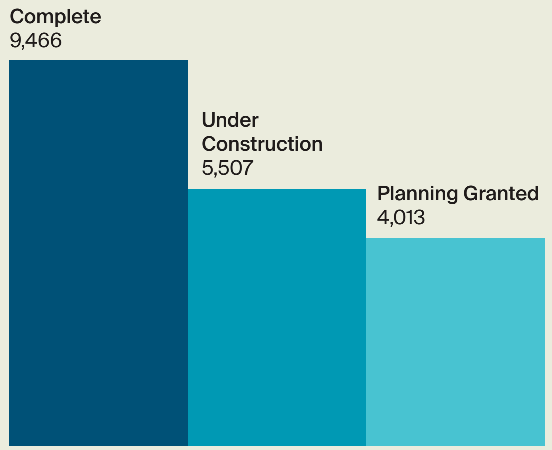
"We have identified a further **£8 billion** of capital set aside to target suburban build to rent housing over the next three to five years either through funds already secured or active fundraises."

We have identified a further £8 billion of capital set aside to target SFH over the next three to five years either through funds already secured or active fundraises. Our calculations suggest that this translates into the potential for more than 30,000 new homes at today's values.

This is still likely to fall short of both short and long-term demand. More than 60% of privately renting households in the UK already live in houses, equating to over three million households. And while SFH delivery is increasing, it accounts for just 11% of overall BTR delivery to date, and only c.0.3% of the total number of privately renting households who live in houses, highlighting the scale of the opportunity.

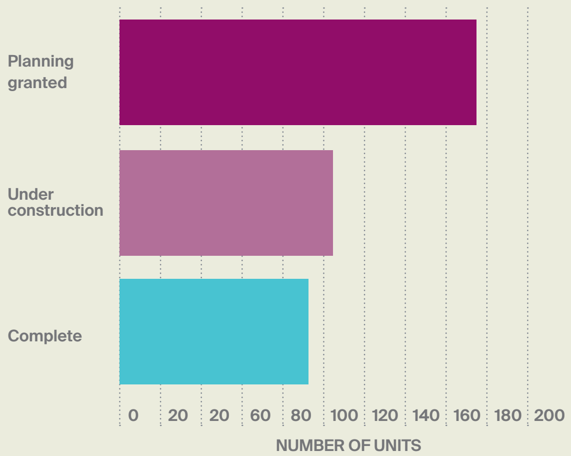
Fig 2: UK SFH supply by status

Number of units



Source: Knight Frank Research

Fig 3:Average SFH scheme sizes are getting larger



Source: Knight Frank Research

SUPPLY OF RENTAL HOMES REMAINS CONSTRAINED

Rising institutional investor interest in the SFH rental market comes at a time when the supply of rental properties across the market is constrained. According to data from Rightmove, the volume of rental listings for houses across the UK in Q4 2022 was 42.6% lower than the 2017-19 pre-pandemic average, while the RICS Market Survey continues to report a fall in landlord instructions.

The rising cost of buy to let (BTL) mortgages, changes to mortgage interest relief and the erosion of capital gains tax allowances are putting individual private landlords under increasing pressure. The net result is that some are looking to rationalise portfolios. Data from the latest English Private Landlord Survey suggests that changes to legislation are the most common reason for landlords choosing to decrease their portfolio size or to leave the sector.

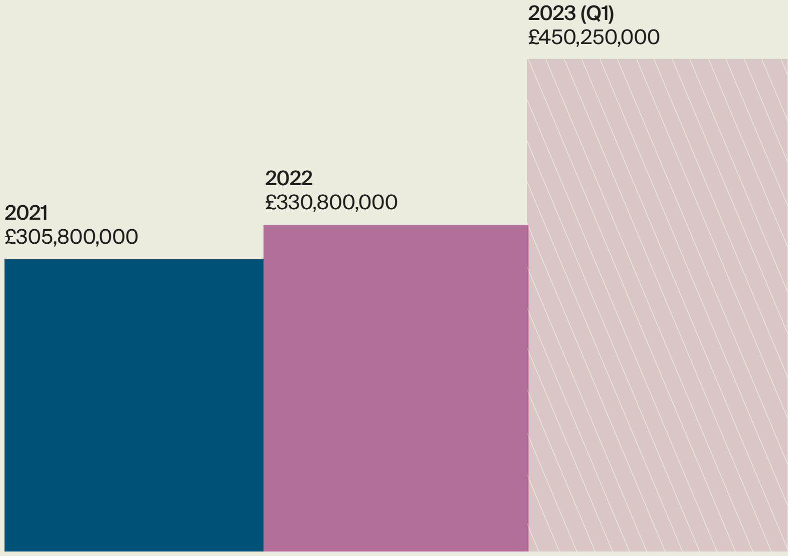
The prospect of further reform impacting the buy-to-let sector, including through potential changes to EPC requirements for rental properties that will require all new tenancies to have a minimum EPC C, could put further pressure on supply. Some 73.8% of houses in the PRS have an EPC rating of D or below. Our analysis of recommended upgrades contained on EPC reports suggests it costs an average of £5,300 per house to make the necessary improvements to bring potentially non-compliant properties up to minimum standards.

> "Already we are seeing a considerable uptick in institutional investment into SFH, with some £450 million invested into the sector in 2023 to date."

Pressure on existing landlords is just one factor contributing to falling supply. Upwards pressure on rental values, particularly for new lets, has meant that existing renters are living in properties for longer which is adding to the supply problem. The English Housing Survey (EHS) shows the average length of time a renter stays in a property has grown to 4.4 years, up from 3.5 years in 2014.

Fig 4: SFH investment volumes

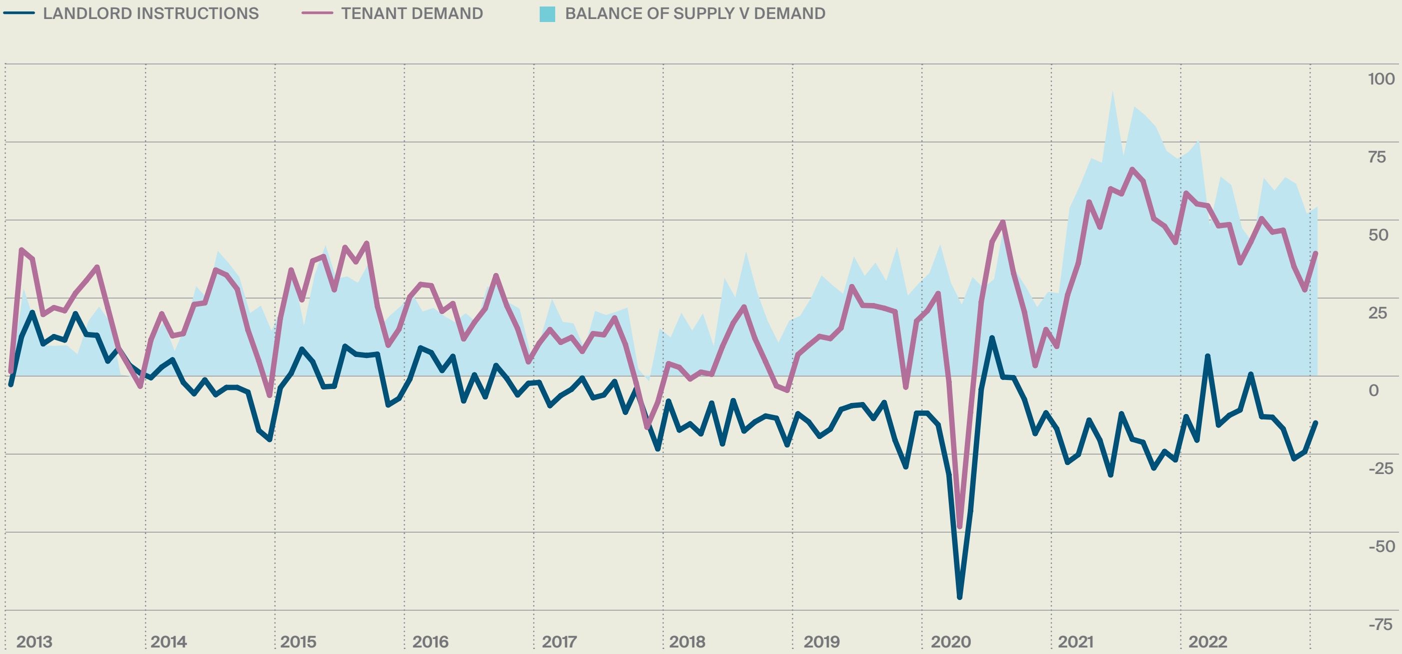
Funding and stabilised transactions (excludes land sales)



Source: Knight Frank Research

Fig 5: Widening gap between new tenant demand and supply

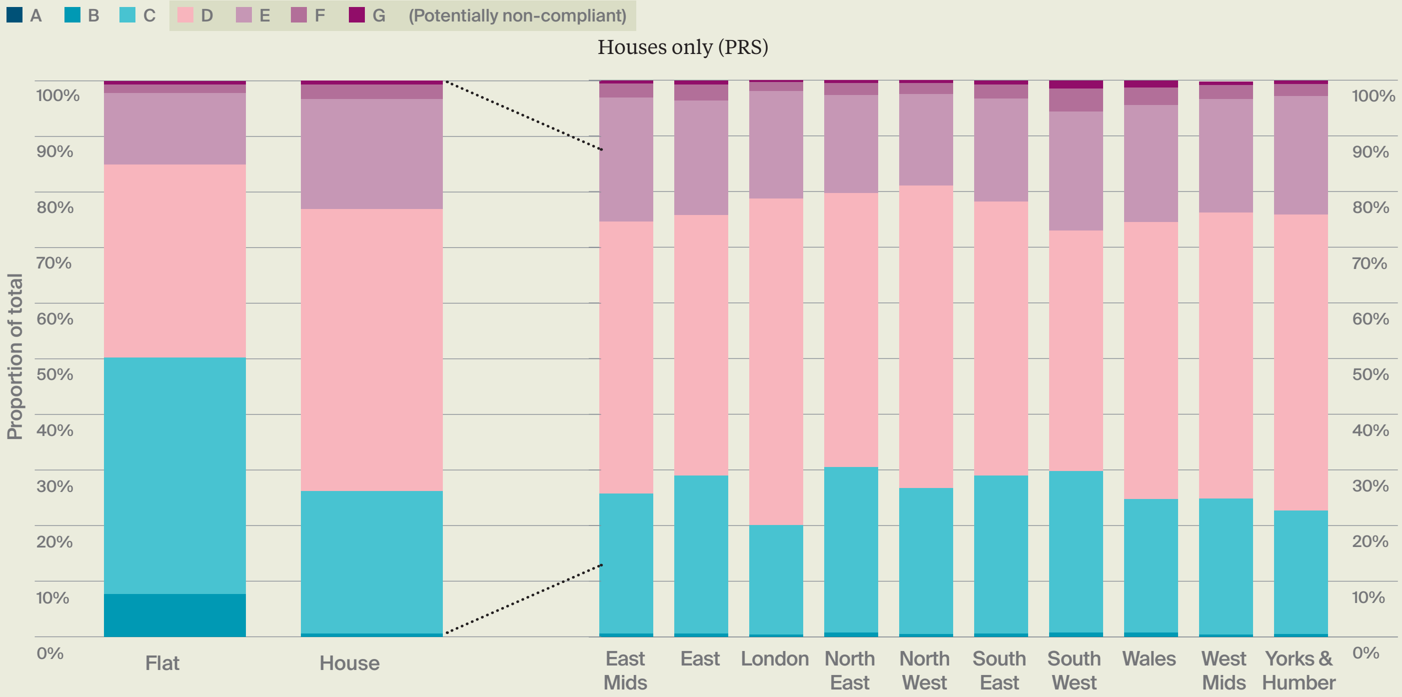
Net balance 50 = no change on previous month



Source: Knight Frank Research, RICS

Fig 6: Estimated EPC rating

Privately renting households, by property type



Average cost to upgrade (houses only)

Current band to C band

D	£4,007	C
E	£6,543	C
F	£8,390	C
G	£10,205	C
ALL	**£5,315**	**C**

Source: Knight Frank Research, EPC

NB. Based on an analysis of repeat EPC certificates for houses in the PRS where the latest EPC has moved from a D, E, F or G band to a C. Costs for works are the mean of the lower and upper bounds provided by EPC.

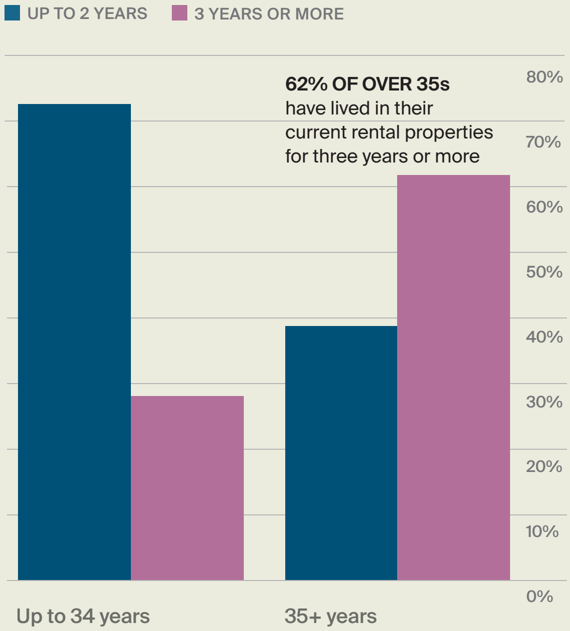
This also reflects the fact that renters are getting older, with over 35s being the fastest growing group of private renters over the last decade. Older households tend to stay in their rental properties for even longer. Data from the EHS shows that 62% of private renters aged over 35 have lived in their current property for three years or more. For under 35s this proportion is just 27%. This feeds into a key investment driver for single family rental, with tenants tending to be less frequent movers – given their ties to local schools, employment, and support networks. That means a lower turnover of tenants, longer tenancy terms and fewer and shorter void periods, all of which help maintain more secure income streams. Longer tenancies and fewer voids also help materially reduce operating costs compared with multifamily schemes.

With the supply of homes for private rent shrinking and investor interest growing, the development of more SFH can play a key role in helping to meet demand, particularly for families, and help reduce the significant supply shortages in the rental market.

"Some **73.8% of houses** in the PRS have an EPC of D or below."

Fig 7: Average time in current property

By age, private renters



Source: Knight Frank Research, English Housing Survey

WILL HOUSEBUILDERS SEEK MORE DEALS WITH SFH INVESTORS?

One of the biggest challenges for the nascent single-family home market has been gaining access to oven-ready sites and building platforms of a meaningful scale.

Aside from housebuilders who have set up dedicated "partnerships" businesses to strike deals with BTR investors, housing associations and others, widespread housebuilder interest in bulk sales to SFH investors has been limited. A strong sales market, supported by the presence of Government support for first-time buyers in the form of Help to Buy, and rapidly rising house prices, has supported transaction volumes and viability.

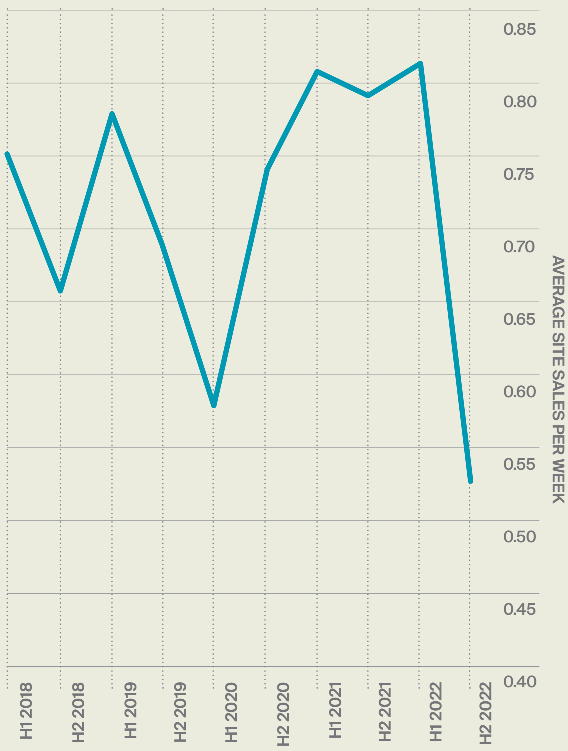
But as the market starts to slow and Help to Buy is withdrawn that is beginning to change. Recent trading updates from the listed housebuilders suggest that while headline pricing has held steady, sales rates have dropped.

In some ways, these current market dynamics could be a win-win for the SFH market and for housebuilders; helping investors grow portfolios and providing an exit route for developers as the market slows.

"Recent trading updates from the listed housebuilders suggest that while headline pricing has held steady, **sales rates have dropped.**"

Fig 8: Site sales per week slowing

Major UK housebuilders

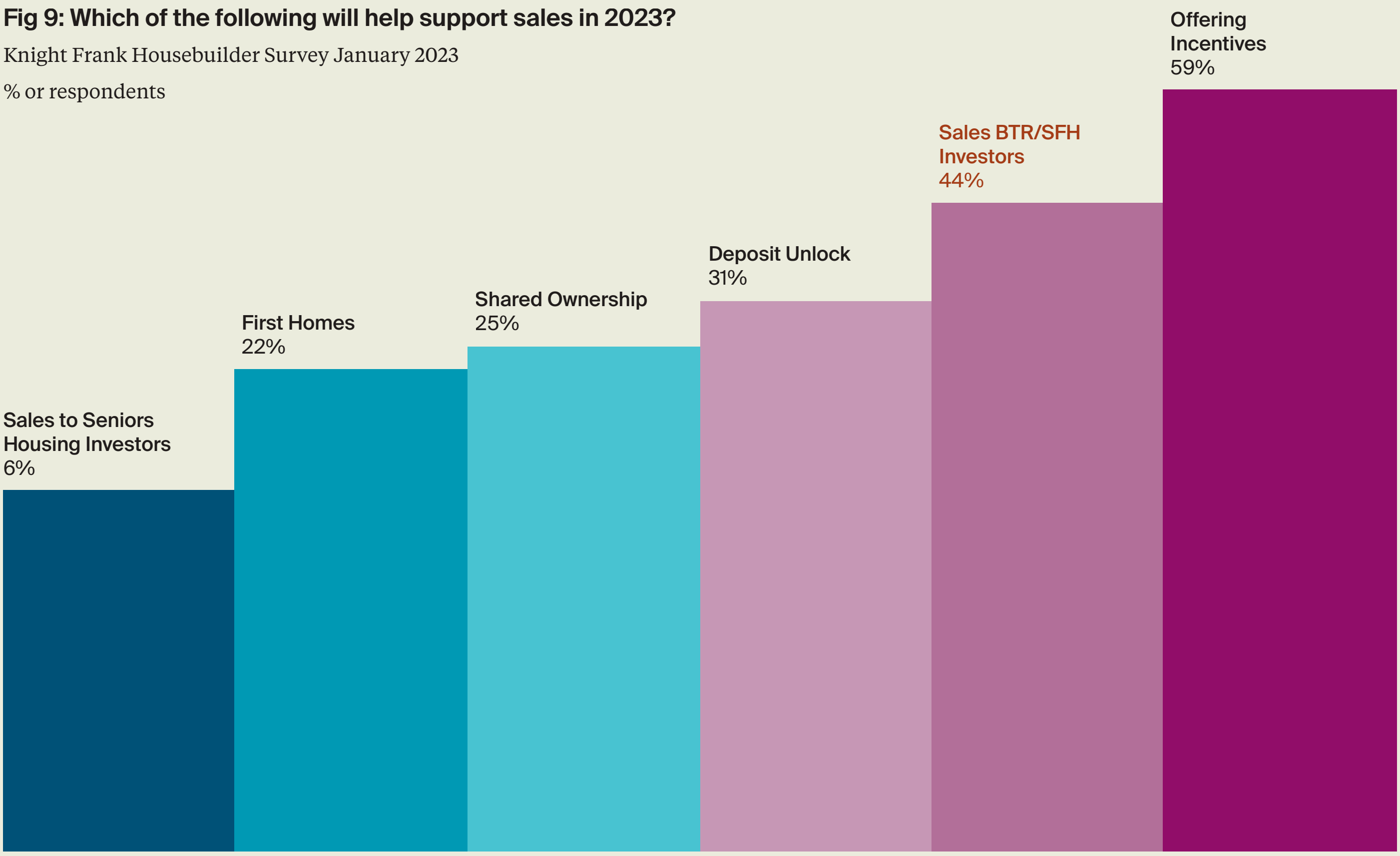


Source: Knight Frank Research, Housebuilder Reports

Fig 9: Which of the following will help support sales in 2023?

Knight Frank Housebuilder Survey January 2023

% or respondents



Source: Knight Frank Research

Our latest quarterly survey of volume and SME housebuilders supports this view, with 44% of survey respondents stating that sales to BTR investors (of both apartments and houses) will play a greater role in the market this year, up from 17% in Q2 2022. Consequently, we expect to see more partnership agreements and bulk sales between housebuilders and SFH investors as they look for new exit routes.

However, getting deals agreed will not be without challenges. Investors will require a discount-to-market value, currently typically in the region of 5-10%, to improve rental returns on investment and to compensate for the more uncertain economic outlook. At the same time, housebuilders will have an eye on maintaining their already squeezed margins.

SITE SIZE AND UNIT MIX

Investors are also increasingly discerning with regards to potential sites and unit mix. Easy workplace connectivity, proximity to good schools and access to green space are all important for the viability of schemes. This sets SFH apart from multifamily where key amenities can be included in the development and public transport infrastructure is usually more developed.

We know from our list of active requirements, past deals and our survey results, that the current 'sweet spot' in terms of scheme size is around 125 units. Both larger and smaller requirements exist and will be dependent on the supporting nature of the local market demographics and an investors' specific strategy. Indeed, while some investors are happy to deal in smaller lot sizes, the majority of current demand is for larger lot sizes as investors look for scale and to drive operational efficiencies.

> "We know from our list of active requirements, past deals and our survey results, that the current 'sweet spot' in terms of scheme size is around **125 units**"

On average, the investors we spoke with as part of our survey are targeting gross-to-net income leakage of 20%. This reflects the operational efficiencies present at suburban housing schemes (compared to multifamily schemes) with lower levels of communal services and amenity required and longer tenancy terms with fewer voids.

Due to the nascent nature of the SFH sector, with little access to stabilised assets, investors are predominately looking to forward fund new developments to aggregate portfolios. Such structures can also benefit investors by enabling a level of input on their required specification, unit mix and design. As the weight of capital chasing SFH rental housing stock continues to grow, we expect to see more deals conducted through varying avenues, from strategic landowners through to housebuilder framework agreements.

20%

Gross-to-net income leakage targeted

Fig 10: Number of SFH homes targeted in a single location
Average of survey respondents

Source: Knight Frank Research

MARKET OUTLOOK

Whilst the underlying drivers for investment into SFH remain strong and the weight of capital looking at the sector is substantial, the more challenging economic backdrop and higher financing costs for buyers reliant on debt resulted in a slight softening of yields towards the end of last year.

Strong operational performance, ongoing investor demand and an expectation that rental growth is going to remain robust over the coming years all support our view that longer-term we will see a return to further yield compression.

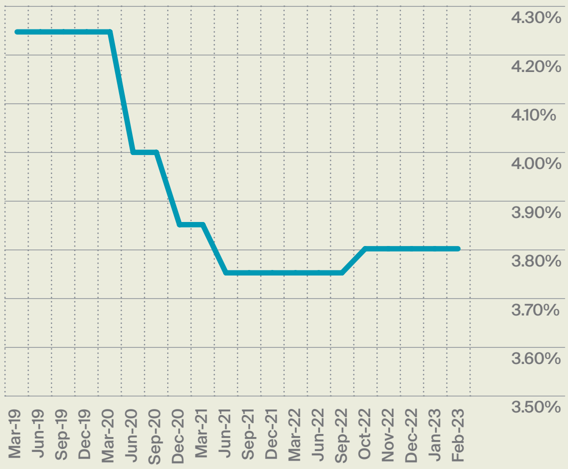
On the latter point, across the UK, there is little sign of the supply/demand imbalance ending in the short-term. New housing delivery remains short of expected housing need and population growth, while regulatory pressures on private landlords continue to mount. Meanwhile, affordability challenges in the sales market are likely to underpin demand for rental properties. This will maintain upwards pressure on rents.

Along with expectations for relatively robust wage growth in the near term, this supports our expectation for cumulative rental growth of 18.2% across the UK over the next five years across the private rented sector.

"Yields are reflective of income-focussed transactions of prime, stabilised institutional-grade assets and are provided on a NIY basis."

Fig 11: SFH yields

South East



Source: Knight Frank Research

Rental forecast Mar 23	**UK**
2023	4.0%
2024	4.0%
2025	3.5%
2026	3.0%
2027	2.5%
5 year Cumulative	**18.2%**

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

Residential Capital Markets
Nick Pleydell-Bouverie
+44 20 7861 5256
nick.p-b@knightfrank.com

Jonny Stevenson
+44 20 3909 6847
jonny.stevenson@knightfrank.com

Jack Hutchinson
+44 20 3866 7842
jack.hutchinson@knightfrank.com

Charlotte Leahy
+44 20 3967 7181
charlotte.leahy@knightfrank.com

Hannah Badger
+44 79 7023 0866
hannah.badger@knightfrank.com

Capital Advisory
Emma Winning
+44 20 7861 1509
emma.winning@knightfrank.com

Joe Otterburn
+44 20 3826 0609
joe.otterburn@knightfrank.com

Land and Planning
Mark Evans
+44 121 233 6410
mark.evans@knightfrank.com

Chris Benham
+44 20 7861 1289
chris.benham@knightfrank.com

Research
Oliver Knight
+44 20 7861 5134
oliver.knight@knightfrank.com

Lizzie Breckner
+44 20 3640 7042
lizzie.breckner@knightfrank.com

Matt Bowen
+44 79 7023 0866
matt.bowen@knightfrank.com