UK BTR market update

Q1 2024

Knight Frank's quarterly review of the key investment themes in the UK Build to Rent (BTR) market

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Record first quarter for BTR investment

Record first quarter for investment

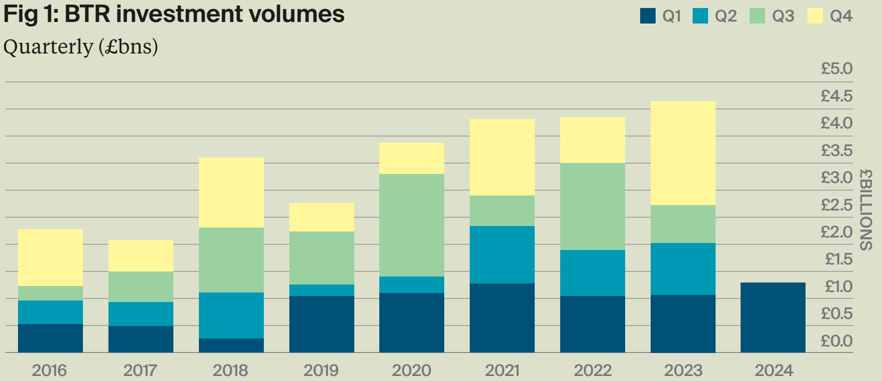
UK BTR investment hit £1.3 billion in the first quarter of 2024, up 21% year-on-year, and the highest figure recorded for a first quarter. Operational deals accounted for 35% of investment flowing into the sector, the highest proportion since Q1 2021. Funding transactions made up the remaining 65% and remain a vital route to market as the sector matures. Investors continued to up their exposure to different sub-sectors of BTR over the course of the quarter, with multifamily representing 53% of total investment in Q1 and co-living accounting for 20% of deals by value, its strongest quarter on record. A robust quarter for multifamily and co-living demonstrates continued confidence from investors in urban markets. Single Family Housing (SFH) investment stood at £345 million in the first quarter (27% of the total), building on a record 2023. A further acceleration in SFH growth is expected. Our survey of 20 leading institutional investors active in the SFH sector confirms an ambition to commit up to £17 billion to the sector over the coming five years.

London calling

London accounted for 52% of total investment over the course of the quarter, a sharp reversal of a slower investment market in the capital in 2023 when viability challenges, especially for larger schemes, impacted volumes. While challenges remain, particularly around changing design requirements which include dual staircases for tall buildings, a softening in yields in London through 2023 has given investors greater confidence on pricing and return metrics which has facilitated investment. Strong operational performance, ongoing investor demand and an expectation that rental growth is moderating to a more sustainable long-term position all support a view that yields will be stable through 2024. In total, the number of deals completed in Q1 across the UK market was up 55% year-on-year, while the average deal size was down 22% to £75.8 million.

Fig 1: BTR investment volumes

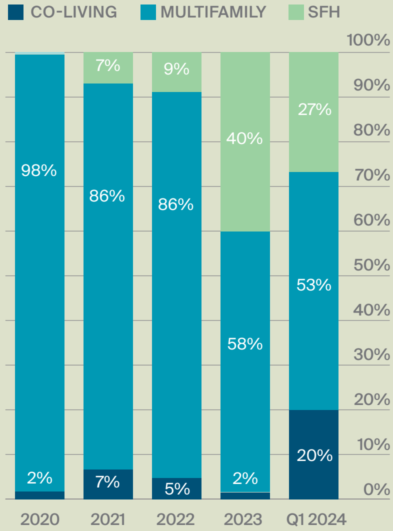
Quarterly (£bns)



Source: Knight Frank Research

Fig 2: BTR Investment by sub-sector

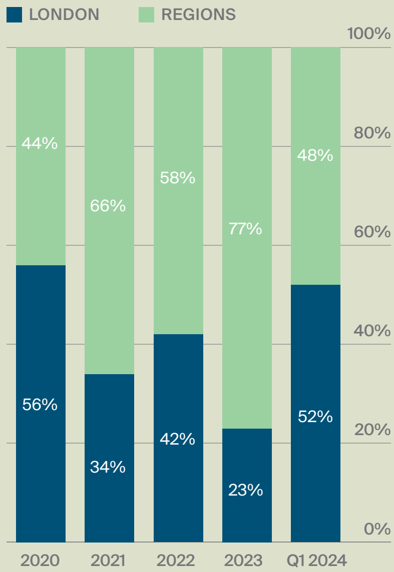
% of total investment (by value and sub-sector)



Source: Knight Frank Research

Fig 3: London v the regions

% of total investment (by value)



Source: Knight Frank Research

Economic backdrop brightens

Inflation dropped to 3.4% in February, the latest figures from the ONS show, down from 4% in January and below market expectations of a fall to 3.6%. While the Bank of England opted to keep interest rates at 5.25%, eight members of the Bank's rate-setting committee voted to hold while one voted to cut. Last month, two voted for a rise, which shows their stance is softening. Money markets are betting on three cuts of 0.25% by December, with June looking more likely for the first cut than May. The SONIA forward curve confirms financial markets are expecting a sizable fall in the cost of debt through 2024 and 2025. As the cost of debt comes down, we expect transactional activity levels will pick up further with more forward funding opportunities emerging.

Regulatory challenges for investors in Scotland

Following the introduction of a temporary rent freeze (and subsequent 3% cap on renewals) in Scotland in October 2022, the Scottish government has put forward plans to introduce rent caps to apply both during and between tenancies. The proposals have been put forward at a time when a lack of available supply of good rented accommodation has put upward pressure on rental values, leading to affordability concerns. Undoubtedly, the best way to improve affordability is to boost the supply of rental housing. BTR investors can play a key role here yet, for most, the unpredictable nature of government intervention has given them no choice but to pause their investment in Scotland and focus their acquisitions elsewhere. Since the rent freeze was introduced, there has been minimal transactional activity, despite the presence of large young, professional populations in several key cities. Reflecting this, prior to government intervention, the BTR sector in Scotland had been growing. We have tracked 2,702 complete homes, with 4,849 under construction and 4,308 with full planning granted. At a time when supply is falling across the rental sector, the need to support delivery and investment in new high-quality, professionally managed rental homes is vital.

253k homes complete or in the development pipeline

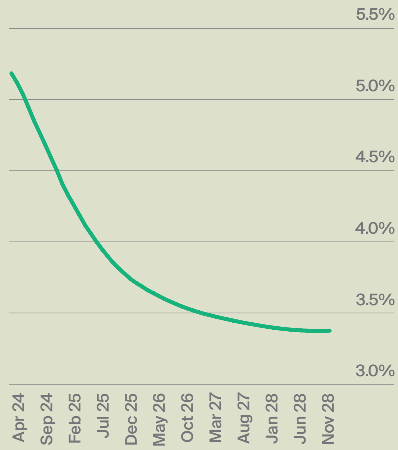
The UK's BTR stock now stands at 109,803 completed homes with a further 63,240 homes under construction and 80,400 with full planning permission granted. This brings the total size of the sector to 253,443 homes completed, in development or with planning.

What does scale look like?

There are 5.7 million privately renting households across the UK. Current operational BTR supply caters for just 1.9% of that number, rising to 3.0% when you include what is currently under construction, highlighting the scale of the opportunity for investors and developers. This supports a view that the UK has

Fig 4: Financial markets expecting falls in debt costs

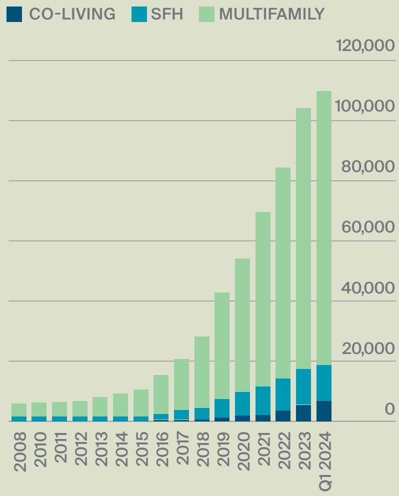
3-month compounded SONIA forward curve



Source: Chatham Financial (4th April 2024)

Fig 5: Cumulative BTR supply

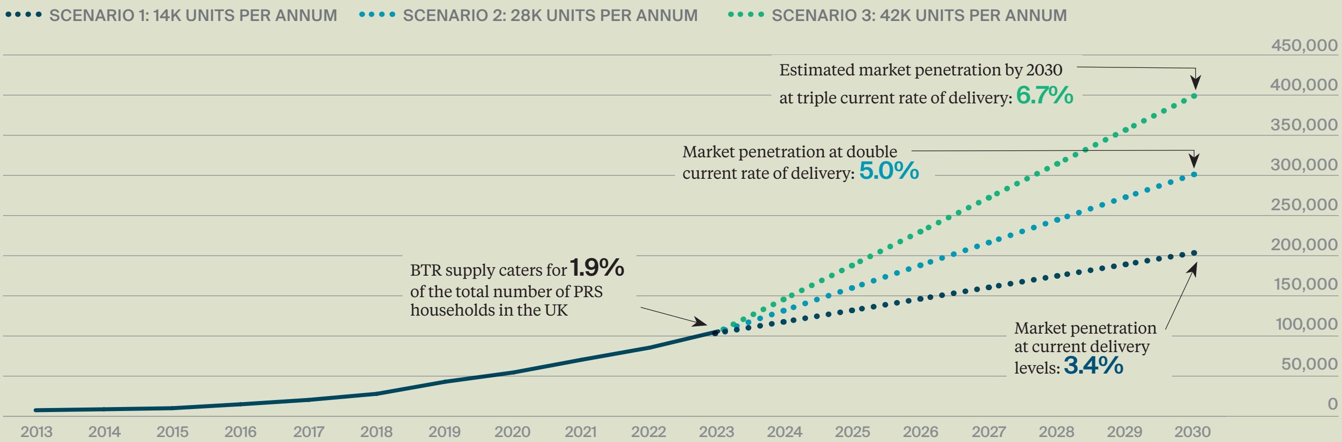
# of complete units (000s)



Source: Knight Frank Research

Fig 6: What does scale look like?

Estimated BTR delivery and UK market penetration rates under different supply scenarios



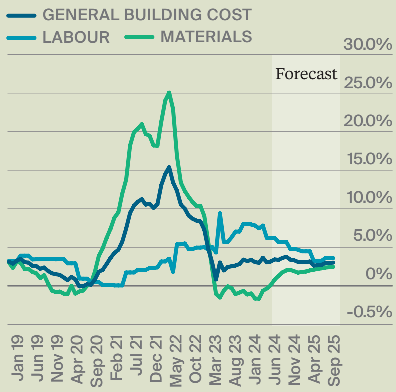
Source: Knight Frank Research, ONS

NB. Market penetration rate is calculated by looking at the number of complete homes relative to total size of the PRS and accounts for estimates of household growth considerable scope for growth. Based on current household growth projections, we estimate there will be an additional 263,000 privately renting households by 2030. If the BTR sector continues to add around 14,000 homes each year, as it currently does, the provision rate would only increase from 1.9% today, to 3.4% by 2030, underscoring both the need and the potential for significant continued growth in the sector. If the UK's provision rate were to reach 5% by 2030, the BTR sector would need almost triple to 300,000 homes at a pace of 28,000 units per year, double current delivery.

Construction costs levelling off

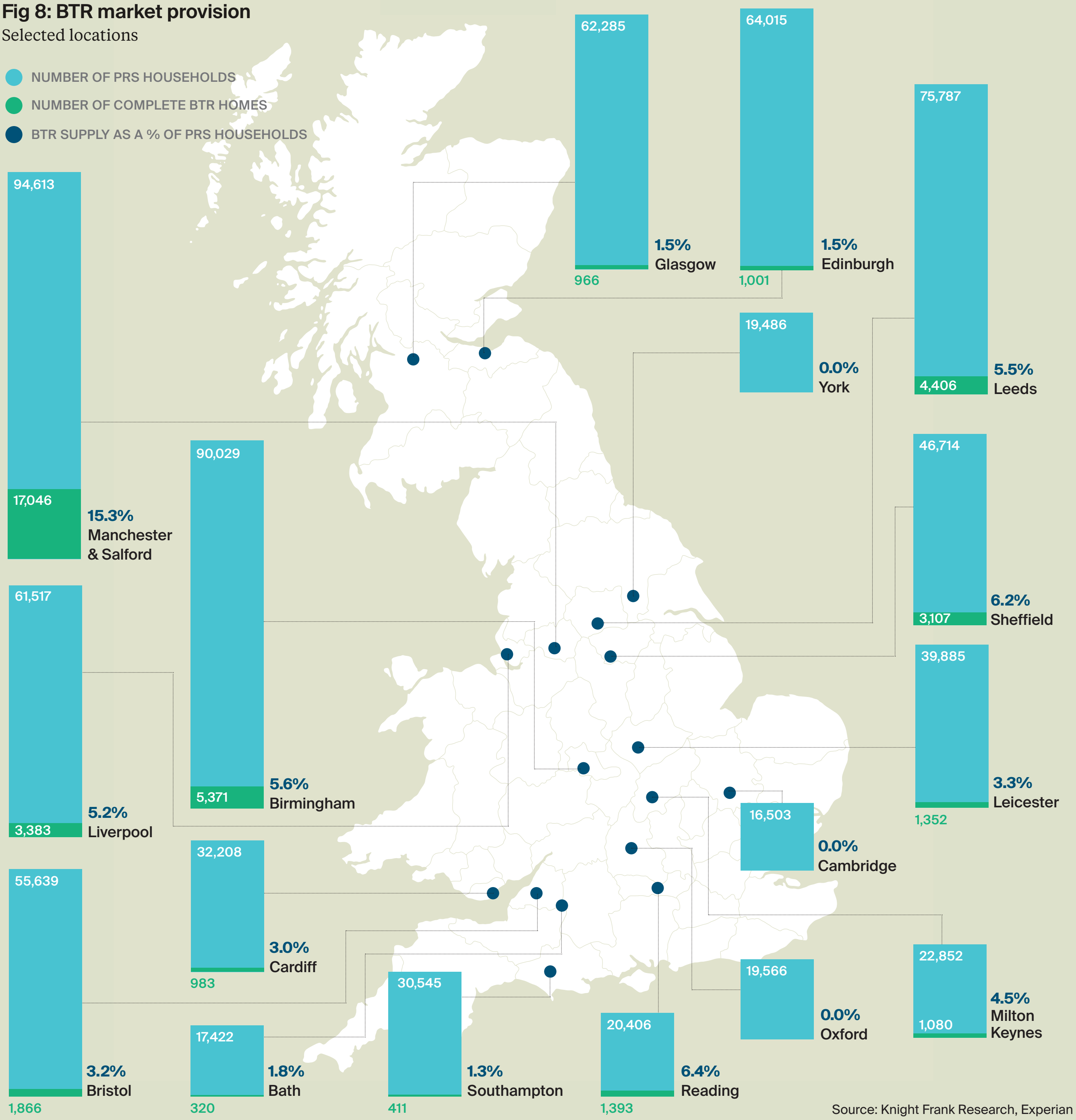
Weak construction activity over the last year means inflation in material and labour costs is likely to be close to zero for the next year or so, which will support viability and reduce pressure on margins. That, in turn, will give investors and developers more incentive to take new or stalled projects forward providing a boost to development volumes, notwithstanding incoming regulatory changes. Build cost inflation has already been moderating, down to 3.1% in 2023, from a peak of 15.5% in 2022, according to the BCIS. More stability is anticipated in 2024. Tender pricing is forecast to drop to 1.5% this year, from 3.5% in 2023. Materials and labour costs are also expected to come in notably lower than recent peaks.

Fig 7: Build cost inflation eases from peaks Annual % change



Source: Knight Frank Research, BCIS

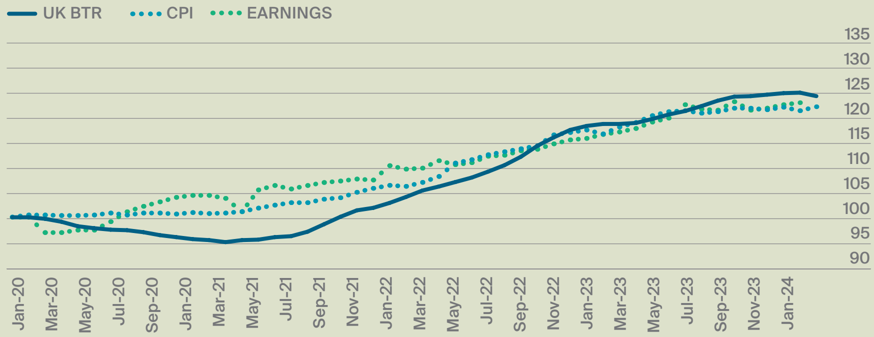
Fig 8: BTR market provision
Selected locations



Source: Knight Frank Research, Experian

Fig 9: BTR rental growth

Indexed 100 = Jan 2020



Source: Knight Frank Research, ONS

> "Our current expectation is that UK rental inflation will be 5% in 2024, with a lack of supply relative to demand keeping rental inflation at a level above the long-term average."

Supply/demand imbalance will ensure above average rental growth

Annual BTR rents rose by 4.7% in the year to February 2024, according to the Knight Frank BTR Rental Index. The data points to a return to more sustainable levels of rental growth having eased from a peak of 15.4% in 2022. However, while rental inflation is cooling, year-on-year rental growth remains historically high compared to the pre-pandemic years. Our current expectation is that UK rental inflation will be 5% in 2024, with a lack of supply relative to demand keeping rental inflation at a level above the long-term average and supported by ongoing wage growth. Any further rationalisation of landlord portfolios in the face of higher mortgage rates, alongside growing regulation, will deepen the existing shortfall, and offset any rise in rental supply coming from the BTR sector.

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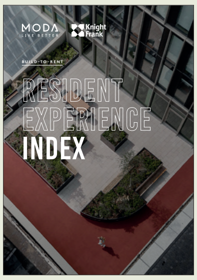

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Research

Oliver Knight
Head of Res Dev Research
+44 20 7861 5134
oliver.knight@knightfrank.com

Lizzie Breckner
Head of BTR Research
+44 20 3640 7042
lizzie.breckner@knightfrank.com

Irene Pastor
Senior Analyst
+44 203 871 3862
irene.pastor@knightfrank.com

BTR

Nick Pleydell-Bouverie
Head of Residential Investment
+44 20 7861 5256
nick.pleydell-bouverie@knightfrank.com

Jonny Stevenson
Head of BTR Funding
+44 20 3909 6847
jonny.stevenson@knightfrank.com

Guy Stebbings
Head of Operational BTR
+44 20 7861 5413
guy.stebbings@knightfrank.com

Valuation and Capital Advisory

David Shapland
Head of Residential Investment Valuations
+44 20 7861 5455
david.shapland@knightfrank.com

Lisa Attenborough
Head of Capital Advisory
+44 20 3909 6846
lisa.attenborough@knightfrank.com

Emma Winning
Head of Equity Advisory
+44 20 7861 1509
emma.winning@knightfrank.com