UK BTR market update

Q3 2023

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

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Investment volumes have slowed after a strong start to the year, but activity is ahead of the historic average for the first nine months of 2023. Deal structures are shifting to account for challenges in the debt market, with investors still keen to tap into a market which offers some hedge against inflation and strong rental growth.

BTR investment

The third quarter of 2023 saw £698 million transact in UK Build to Rent, taking year-to-date investment to £2.7 billion. While activity remains in line with historic trends, the quarter was 57% below the bumper £1.6 billion transacted in Q3 last year. So far this year, volumes are 22% lower than the same nine-month period of 2022. This reflects the fact that both deal numbers and the average deal size are down 14% on last year. Some 24% of investment in Q3 was to fund operational deals, up from 19% in 2022. The total has been boosted by the strong performance of Single Family Housing (SFH) which has made up 29% of total investment in 2023 so far.

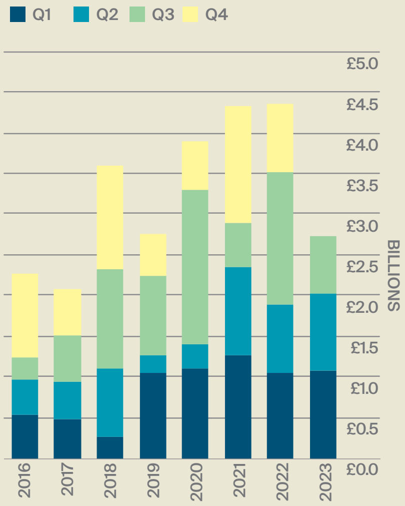
Deal structures shifting

While investors continue to seek exposure to the market, the increased cost of debt continues to put pressure on deal structuring, particularly in the forward funding market. Consequently, we are seeing more forward commit opportunities. We also expect joint venture strategies to increase in popularity as the year progresses. Joint ventures offer an attractive route into the market for new entrants as well as a way for existing investors to diversify risk. The change in deal structures is also opportunity-led, with the uptick in housebuilder opportunities limiting the need for up-front development funding. Our agency and valuation teams are tracking a further £1.6 billion of 'under-offer' transactions which we expect will trade by year-end or in early 2024.

Past the peak?

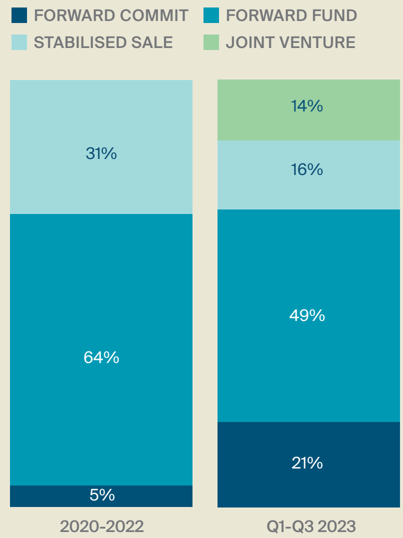
The UK's headline rate of inflation held steady at 6.7% in the year to September, unchanged from August when it declined by 0.1%, down from 6.8% in July, according to official figures. While that's a small decline, economists had expected a rise to 7%. Better than expected inflation figures contributed to the Bank of England's decision to leave the base rate unchanged at 5.25%, following 14 consecutive rate rises. The decision probably marks the end of this tightening cycle. As a result, we expect a far more competitive pool of buyers in Q4 and next year as the market enters

Fig 1: BTR investment volumes
Quarterly



Source: Knight Frank Research

Fig 2: Increase in forward commit deals
As a proportion of the total investment

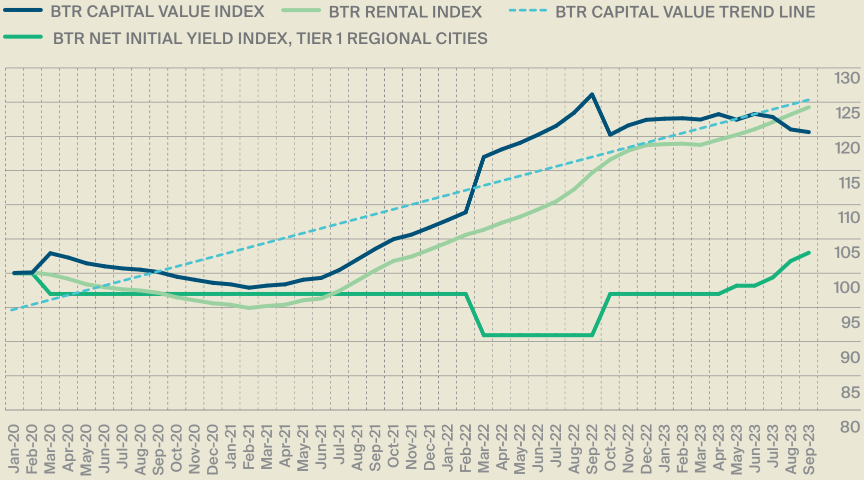


Source: Knight Frank Research

what should be a period of greater stability with a more predictable flow of economic data. Inflation, while slowing, is likely to remain above target in the near-term which will enhance the real income generated from assets. The transactional evidence supports a view that yields have softened by between 50bps and 75bps since Q3 last year. Capital values, meanwhile, have generally held firm thanks to ongoing strong rental growth.

Fig 3: Rental growth supports BTR capital values

Indexed (January 2020 = 100)



Note: BTR Capital Value Index is based on an implied model. Source: Knight Frank Research

Supply/demand imbalance in the rental market persists

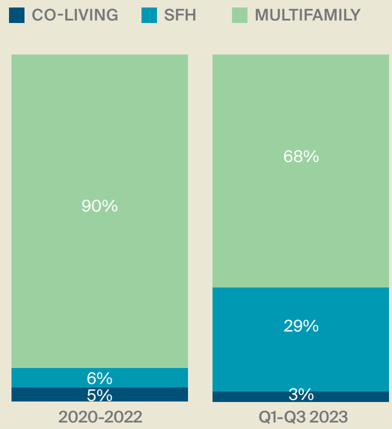
The UK rental market continues to grapple with a supply-demand imbalance. Annual rental growth for new build-to-rent lets was 8.4% in September, according to the Knight Frank BTR Rental Index, compared with 5.7% for the wider private rental sector (PRS). Against this backdrop there is an urgent need to boost new supply, with the expansion of the BTR sector representing a key opportunity. Demand for rented homes continues to be driven by multiple factors. The strength of the labour market and job creation is a key driver, as are higher mortgage rates, which are keeping more would-be buyers in the rented sector. Nationwide data points to a 25% fall in leveraged first-time buyer numbers in 2023 compared to pre-pandemic levels. The net result is that the current supply-demand imbalance shows no sign of reversing. This is one of the key factors underpinning our forecast rental growth of 6.5% in 2023 and 5.0% in 2024 for the PRS.

BTR supply is increasing, but not fast enough

There are currently 90,000 completed BTR homes across the UK in schemes with at least 75 units. A further 67,000 are under construction and 74,000 have full planning permission granted, taking the total size of the sector to 230,000 homes. The Single Family Housing (SFH) market continues to expand – there are now more than 20,000 SFH homes complete or in the planning pipeline, making up 9% of the total BTR pipeline. Of these, 9,800 are complete, 6,500 under construction, and 4,400 with planning granted. The number of SFH units is expected to increase rapidly as housebuilders look to diversify exit routes in light of a weaker sales market. Our recent Investor Survey flagged SFH as an area of significant growth, with 71% of investors planning to target the sector in the coming five years, up from 45% invested today.

Fig 4: SFH taking a larger share

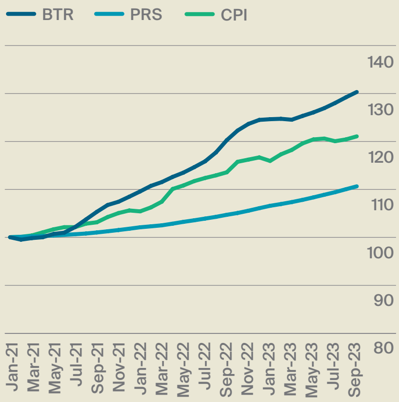
As a proportion of the total investment



Source: Knight Frank Research

Fig 5: Rental growth slows but stays ahead of trend

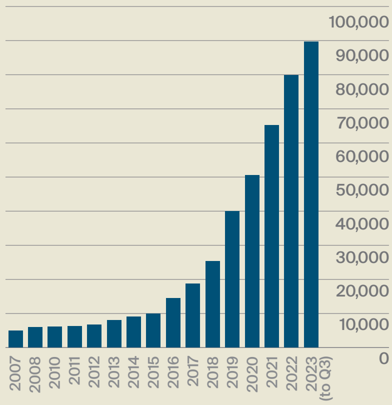
Indexed (January 2021 = 100)



Source: Knight Frank Research, ONS

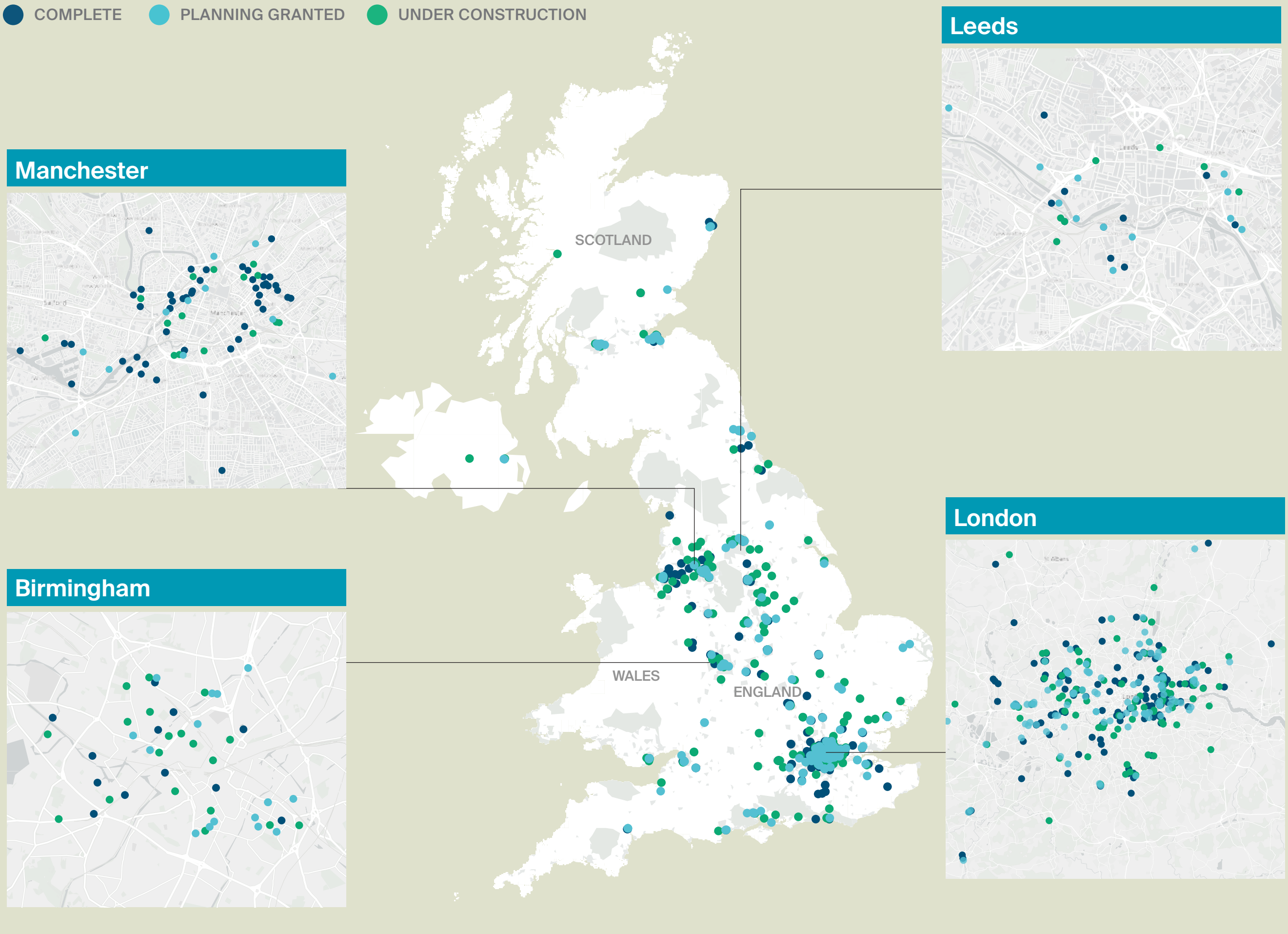
Fig 6: BTR supply triples over five years

complete units



Source: Knight Frank Research

Fig 7: UK BTR supply
By status

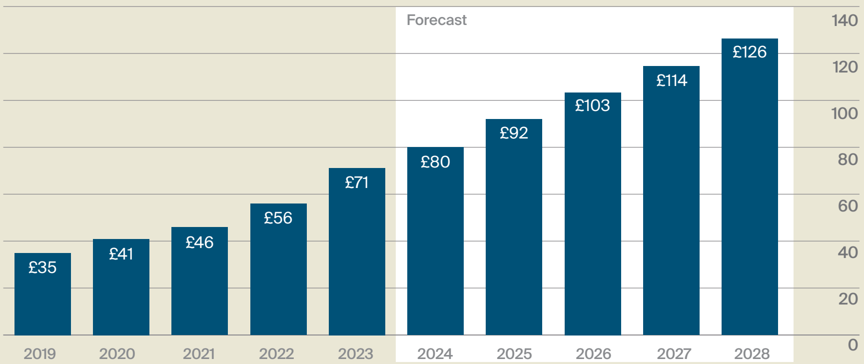


Source: Knight Frank Build to Rent Transactions and Development Database

BTR market doubles in size

Based on our analysis of current operational BTR stock, and stock under construction, we estimate that the value of the market for professionally managed rental accommodation in the UK is £71 billion, doubling from £35 billion in 2019. Looking at the pipeline of future development, we believe this figure has the potential to increase to £126 billion by 2028.

Fig 8: Value of the UK BTR Sector
£ billions



Source: Knight Frank Research

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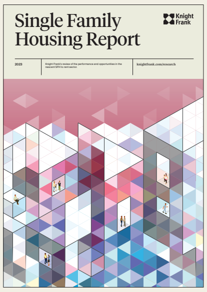

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