Residential Investment Report 2022

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RESILIENCE AND REINVENTION

Investment into residential assets has become a core strategy for institutional investors seeking stable income streams

Institutional investment into residential assets, encompassing student housing, co-living, multifamily, single-family rental and seniors housing, accounted for 15% of all institutional UK real estate spend last year and 22% in 2020, only behind offices and a resurgent logistics sector. Ten years ago, residential accounted for just 8% of all acquisition activity.

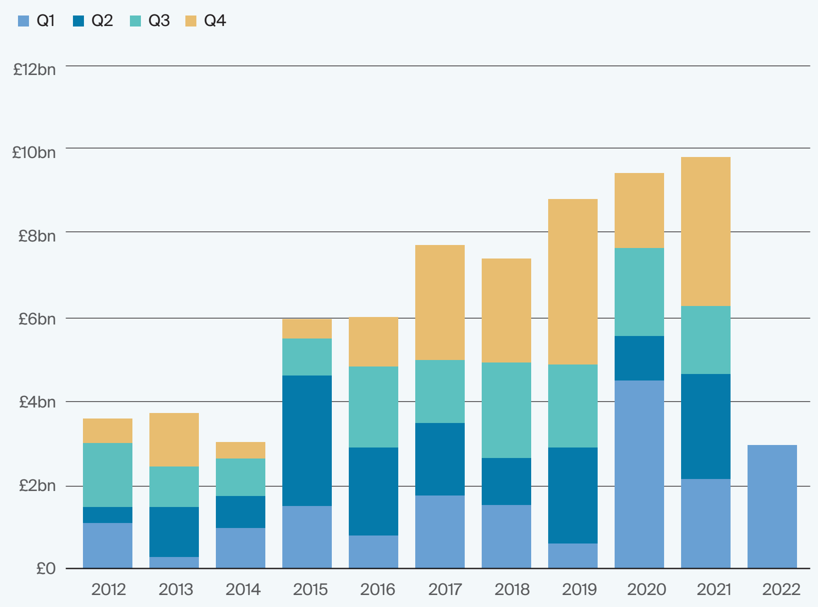
Figures for Q1 2022 suggest that investor demand remains strong. Institutions have committed a further £2.9 billion in the first three months of the year, which is higher than the level achieved during the same period last year and in line with the quickening pace of investment activity over the past 12 months.

Demand is driven by a combination of strong structurally supportive market dynamics, an evolving service-focussed product, as well as an expanding and more discerning occupier base. There is little doubt, as well, that Covid-19 has transformed the way global institutional investors look at real estate. The residential investment sector has proven resilient by delivering secure income in uncertain economic conditions.

As well as existing investors looking to build scale, activity is being fuelled by a deepening pool of capital looking to target residential. Some 23% of institutional investment in the BTR market last year was from new entrants to the UK market, for example, while for seniors that figure was 48%. For student, even as the most mature market, 22% of deals last year went to new capital.

Based on the level of investor demand – and supported by our survey of 54 leading institutional investors who, combined, account for £76 billion in residential assets under management across the UK (which we estimate accounts for c.60% of the total current investable market) – further growth is expected. Some 80% of our survey respondents are expecting to 'significantly increase' their exposure to residential assets over the next five years.

Institutional investment in residential assets rising



Source: Knight Frank Research

£75bn

earmarked by our survey respondents alone to deploy across residential investment sectors over the next five years, equivalent to a doubling of their current committed capital.

80%

of institutional investors responding to our survey are expecting to 'significantly increase' their exposure to residential assets over the next five years.

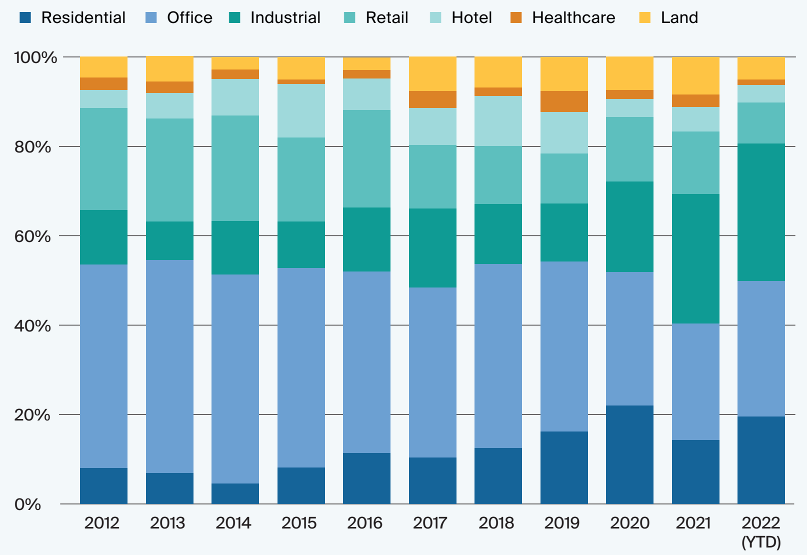
Set for another record year

In the short term, our survey respondents alone said they plan to invest a record £16.5 billion in 2022. This would represent a 65% increase from the £10.2 billion spent in 2021. Based on the assumption that our survey represents the views of 60% of the total residential investment market, that suggests there is more than £23 billion of institutional capital targeting the sector this year. In total, an additional £75 billion has been earmarked by the investors we surveyed to deploy across residential investment sectors over the next five years, a figure which rises to more than £100 billion when we account for the whole market.

Nonetheless, as our survey suggests, there remain challenges for investors to achieve their ambitions. A lack of

Residential takes a larger share of institutional capital

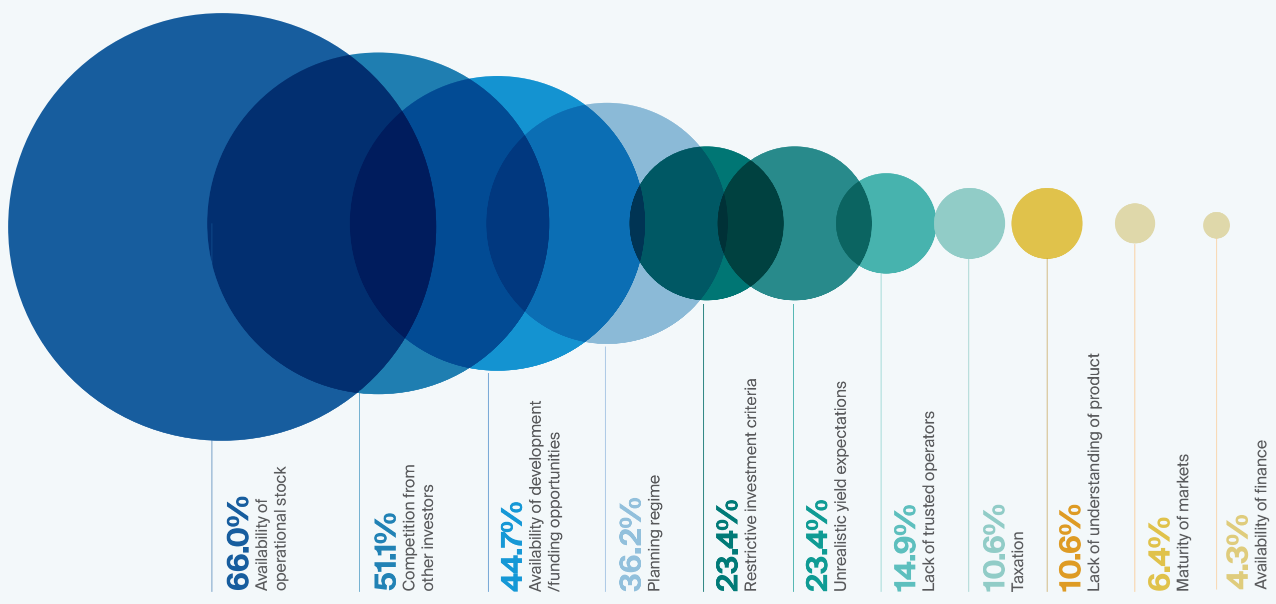
As a proportion of total institutional investment



Source: Knight Frank Research / RCA

What do you see as the key challenges to deploying capital?

% of respondents



Source: Knight Frank Research

operational stock was the most cited barrier for increasing investment, followed by competition from other investors, and the availability of development and funding opportunities. Currently, just 42% of our survey respondents said they are targeting land deals, with the majority looking for income producing assets, or forward funding opportunities. Consequently, we expect to see even more investors move up the risk curve into development funding.

In the short-term, increasing construction and operational costs, rising land values and fire safety were flagged as the top three concerns.

ESG to shape investment

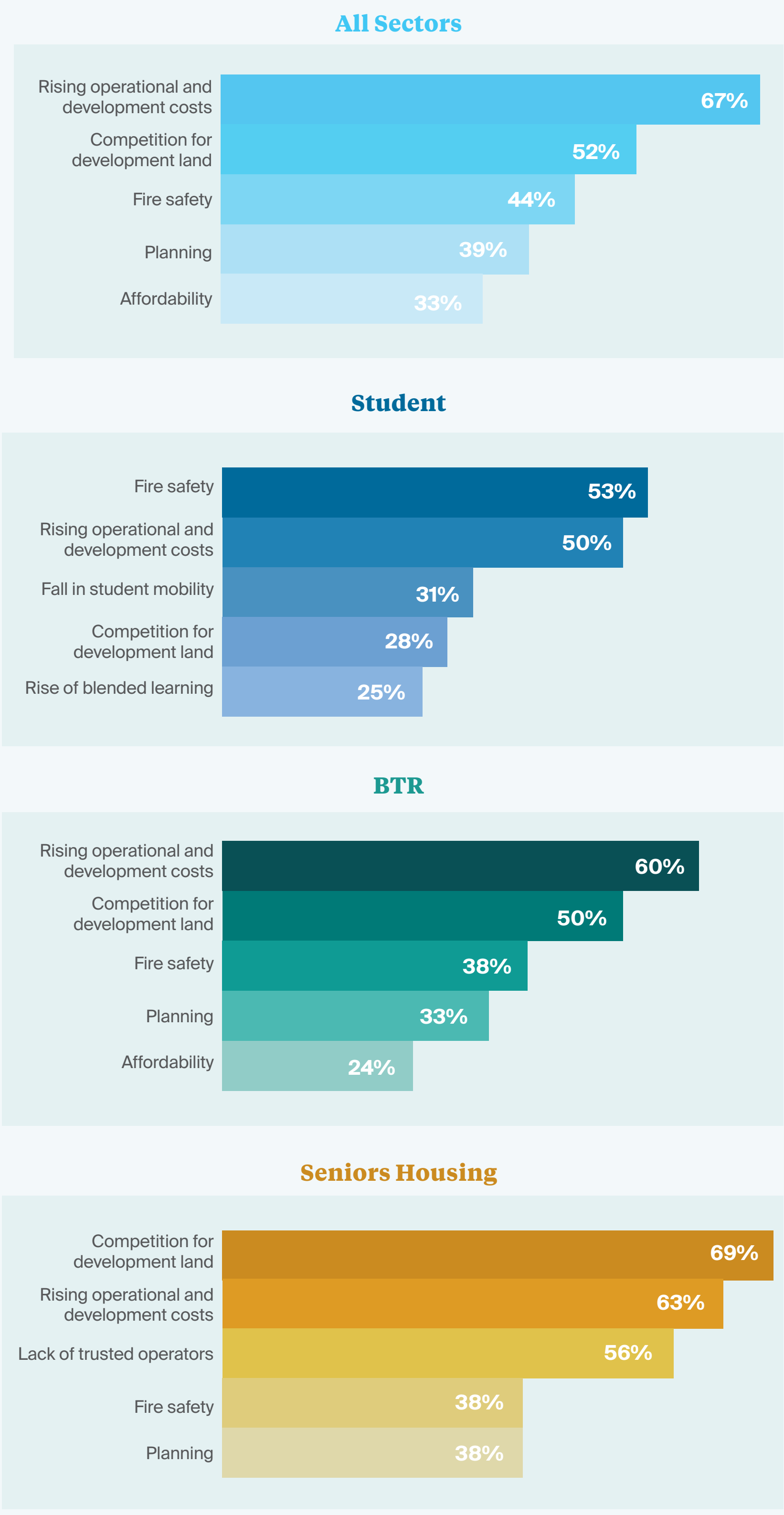
Longer-term, there is an expectation that ESG will shape investment. Some 38% of respondents to our survey believe sustainability considerations will be the key influence determining investment strategy over the next three to five years. The remaining 62% said it would be somewhat influential.

New development in 2026 and beyond has the potential to be very different to current operational stock. In support of this, respondents have identified several opportunities including diversifying product, exploring new markets in a broader range of locations, and responding to occupiers needs with technology, amenity and service.

38%

of respondents to our survey believe sustainability considerations will be the key influence determining investment strategy over the next three to five years.

What are the top short term challenges for the market?
% of respondents (respondents were asked to pick their top three)

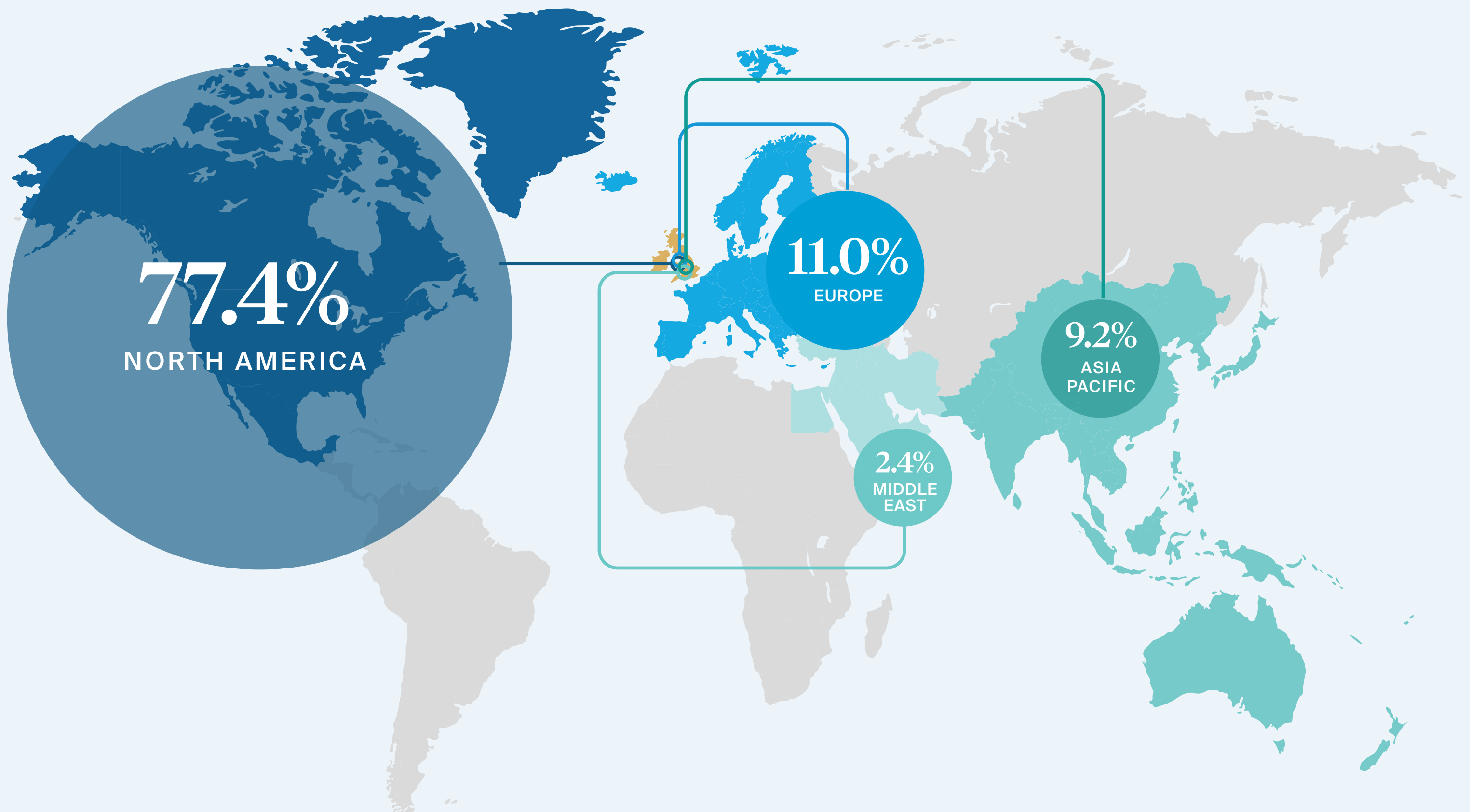


Source: Knight Frank Research

GLOBAL CAPITAL FLOWS

£5.5bn

of cross- border capital invested into UK residential assets in 2021



Source: Knight Frank Research / RCA

The amount of cross-border capital invested into UK residential assets totalled £5.5 billion last year. Over the last two years, cross-border investment into UK residential has contributed 61% of the total volume of capital deployed. In Q1, £1.1 billion of investment was from overseas, adding to the trend. This has been led by North American investors and, to a lesser extent, by European and Asian funds.

As investors seek security of income, yield stability, rental appreciation, we expect to see further global capital look to target residential investments.

BLENDED AND MORE DIVERSE STRATEGIES

Currently just 17% of our survey respondents invest across all three residential sectors

Echoing our expectations for increased diversification and a blending of strategies within the residential investment market, this is expected to have risen to 42% by 2026 as investors spread exposure across age groups.

Such an approach reflects the fact that, while there are significant differences in market drivers, there are synergies – particularly with regards to construction and operations – which makes the decision to move across sectors more appealing.

Scale is also a critical factor in the success of investor's long-term strategies, with the pursuit of efficiencies of scale having significant potential to drive outperformance across a portfolio.

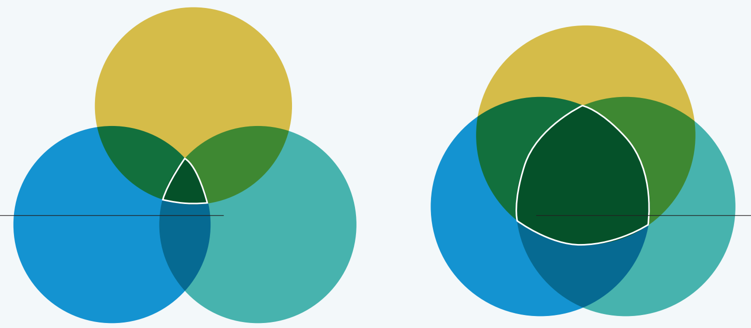
30,000

of purpose-built student-bedrooms completed in 2021 – more than double the previous year.

Cross sector investment

17%

% OF RESPONDENTS ACTIVE IN ALL THREE SECTORS NOW



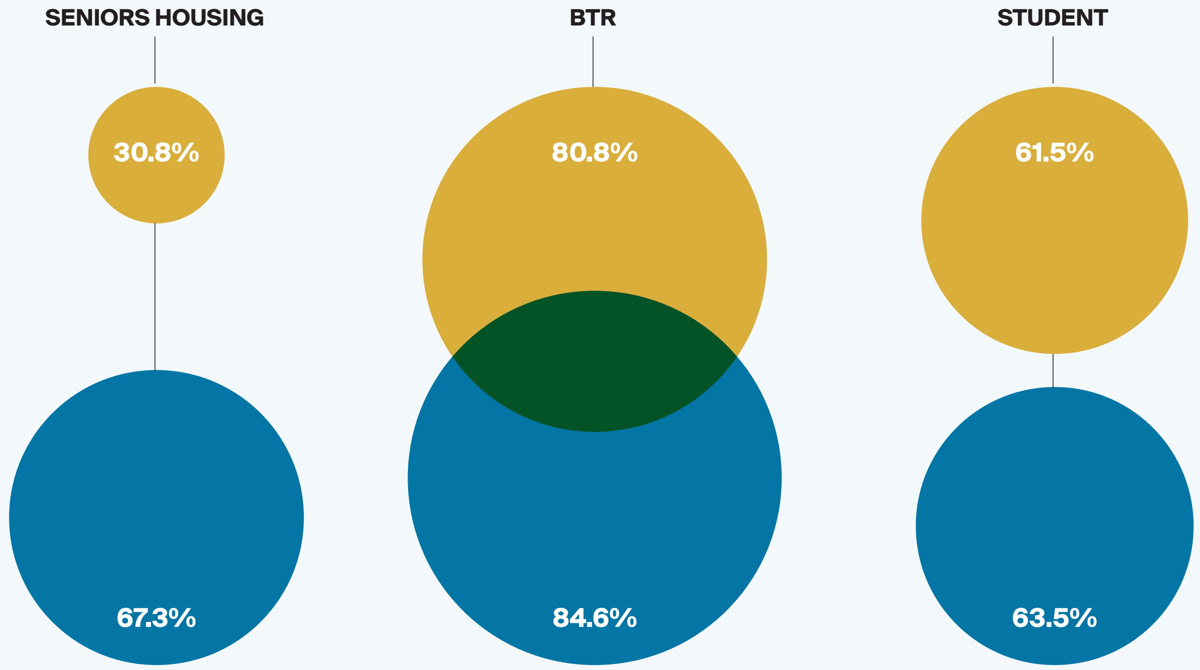
42%

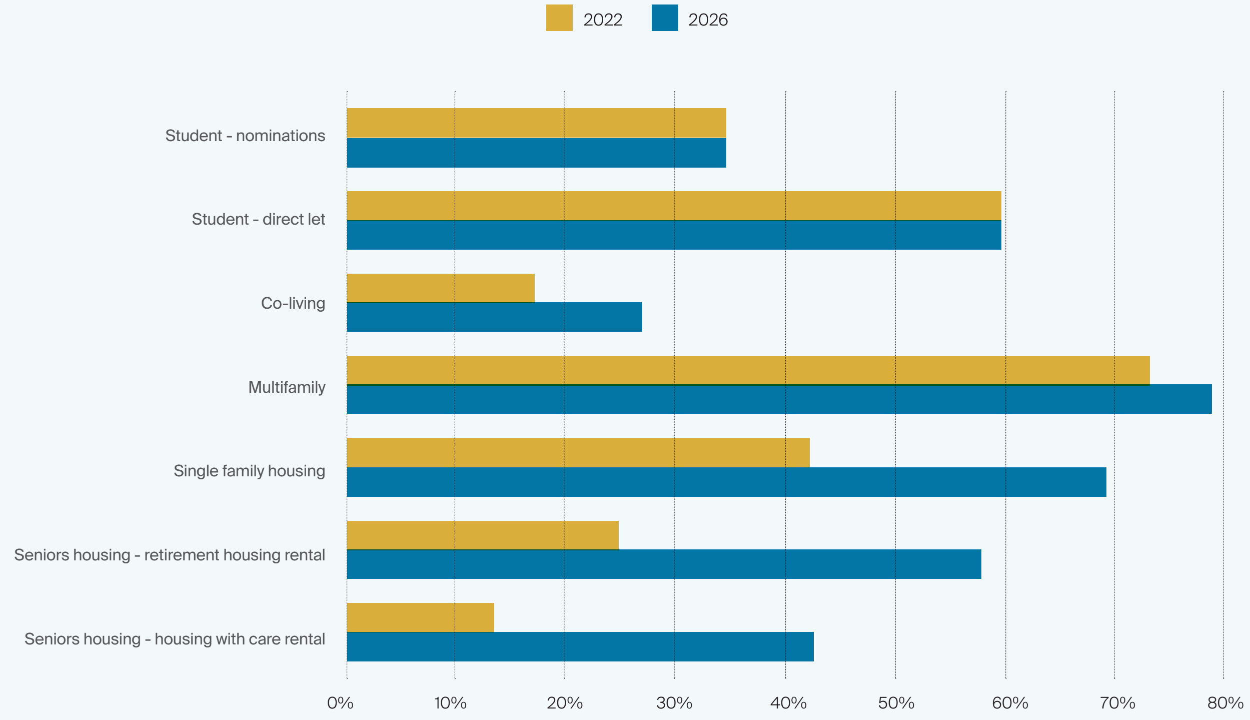
% OF RESPONDENTS WHO EXPECT TO BE ACTIVE ACROSS ALL THREE SECTORS BY 2026

Source: Knight Frank Research

In which sectors are you active currently and which do you anticipate being active in within five years?

% of respondents





Source: Knight Frank Research

NB. BTR encompasses co-living, multifamily and single family housing

Doubling down on PBSA

Purpose-built student housing is the most mature of the sectors. It is a proven counter-cyclical asset class and, despite the disruption imparted on the 2020/21 academic year by Covid-19, it remains attractive thanks to the promise of income-producing assets with defensive, counter-cyclical qualities. Our survey demonstrates continuing commitment from investors with little evidence of a change in sentiment.

Investors have been prepared to look beyond any short-term instability to focus on the market's long term growth prospects. The latest applications data from UCAS suggests student numbers have recovered to higher than pre-covid levels, for example, with accepted applicants from outside the EU up 3% year-on-year. Recent reports on occupancy and rent collection also point to a strong recovery as students – both domestic and international – return to campuses in greater numbers.

240,000

forecast increase in full-time undergraduates

Longer-term, a coming demographic jump in the UK among university-age students is expected to increase the number of 18-year-olds in the UK by more than 100,000 over the next decade, according to ONS forecasts. Total full time undergraduates, including international students, are forecast to increase by over 240,000.

Development volumes are increasing to meet expected demand. The number of purpose-built student bedrooms completed more than doubled last year to 30,000, lifting the total number to 700,000. A further 21,000 beds are in the pipeline for the year ahead, which would take the total value of the market to £72 billion.

Diversifying within BTR

Build to Rent has become central to investor strategies, with 81% of investors saying they currently invest in the sector and will continue to do so. But as investors search for scale and grow their exposure to the private rental market strategies are evolving.

For many, that means switching their attention to single family housing schemes, as well as co-living. Almost 70% of respondents to our survey expect to be invested in Single Family Housing (SFH) in the next five years (from 42% currently), whilst 27% expect to be invested in co-living (up from 17%).

The results mirror our separate research which identified £8 billion in capital waiting to be committed to the SFH market. For investors already active in the multifamily market, SFH offers exposure to different geographies and a diversified demographic, made up predominately of families rather than young professionals. Well-connected city fringe locations will offer development opportunities for this type of product, as could parcels of land within larger mixed-use developments.

Growth is also expected in multifamily PRS. Some 31% of respondents share the view that multifamily PRS will provide the best returns of all residential investment sectors in 2022.

Rising investment has supported a rapid increase in development volumes, with more than 180,000 BTR homes in the pipeline, though operational stock still only accounts for 1.2% of the total private rental market, rising to 2.2% when you include stock under construction. Using the more mature student sector as a benchmark, we estimate that the UK BTR sector could account for 30% of the private rented sector at full maturity, highlighting the scale of the investment opportunity.

Higher inflation presents a challenge to affordability and rental growth in the short term, though higher consumer prices are expected to be transitory. The longer-term outlook for rental growth is supported by a positive outlook for earnings, which are expected to grow in real terms over the next five years.

70%

of respondents to our survey expect to be invested in Single Family Housing (SFH) in the next five years

Seniors Housing: The next wave

The case for seniors rental is compelling. Rental is a small but growing part of the wider expanding seniors housing market. Given the significant imbalance of supply and existing demand, on top of the ageing population, and requirement of flexibility from this demographic, this presents a significant opportunity for institutional investors.

Our research supports this view, with 67% of respondents to our survey expecting to be invested in the sector within the next five years, up from 31% who are currently investing. We note some 25% of the record £1.4 billion invested in the UK seniors housing market last year was for rental product.

This has coincided with an increase in the delivery of rental within the sector, with more operators offering rental – predominately pepper-potted within for-sale schemes. Our latest research supports this, with two thirds of private operators currently offering rental as a tenure option. There has also been a pivot to fully BTR platforms being delivered.

67%

of respondents to our survey expecting to be invested in the sector within the next five years, up from 31% who are currently investing.

With backing from institutional investors further growth is expected, particularly given the prospect of higher yields while the sector matures.

Consequently, the number of private seniors rental properties in the UK is expected to increase by a huge 166% over the next five years, from almost 5,000 currently to more than 13,000. However, while there is clearly a strong appetite from investors for seniors housing, the lack of specialised operators poses a challenge, and was identified as such by 56% of survey respondents. But with the backing of an increasing number of global investors, and a greater understanding of the proposition, we expect this will change.

URBAN OPPORTUNITIES

Our survey respondents identified the cities where they saw the biggest opportunities in each sector. When examining the top five cities in each market, London, Bristol, Manchester, Edinburgh and Birmingham emerge as opportunity areas across all three sectors.

This suggests an overlap of the different drivers for each sector to provide a favourable investment environment – from strong student demand, large-scale city regeneration and development as well as strong employment conditions, and a lack of seniors housing units.

Suburban markets, and other city locations which boast strong economic and rental demand fundamentals including Leeds and Coventry, were also mentioned.

Top target cities for investment

% of respondents

STUDENT	BTR	SENIORS HOUSING	ALL SECTORS
London	London	London	London
Bristol	Bristol	Manchester	Bristol
Manchester	Birmingham	Edinburgh	Manchester
Edinburgh	Manchester	Bristol	Edinburgh
Birmingham	Edinburgh	Birmingham	Birmingham

SUSTAINABILITY WILL DICTATE INVESTMENT STRATEGIES

Investors have historically built strategies around the risk return profile of projects, the stability of income those projects might offer, local demographics and the potential for scalability.

ESG (Environmental, Social and Governance) considerations were of lesser importance only a few years ago. The term didn't get a mention in our 2019 report, for example.

Yet four in ten investors now say that sustainability considerations will be the key factor determining their investment strategy during the next three to five years. The remaining 62% say the metric will be 'somewhat influential'.

Competition for green buildings is already fierce and is set grow. We expect a steady divergence in the values and viability of green and so-called brown buildings, similar to the theme playing out in the commercial property sectors. Some 87% of our respondents agree that ESG credentials will create a value premium for assets, while 72% indicated that they would pay a premium for schemes with strong environmental and sustainability credentials.

Investors are dictating the approach to ESG, according to 81% of our respondents, more than regulatory change (51%), or tenants (32%).

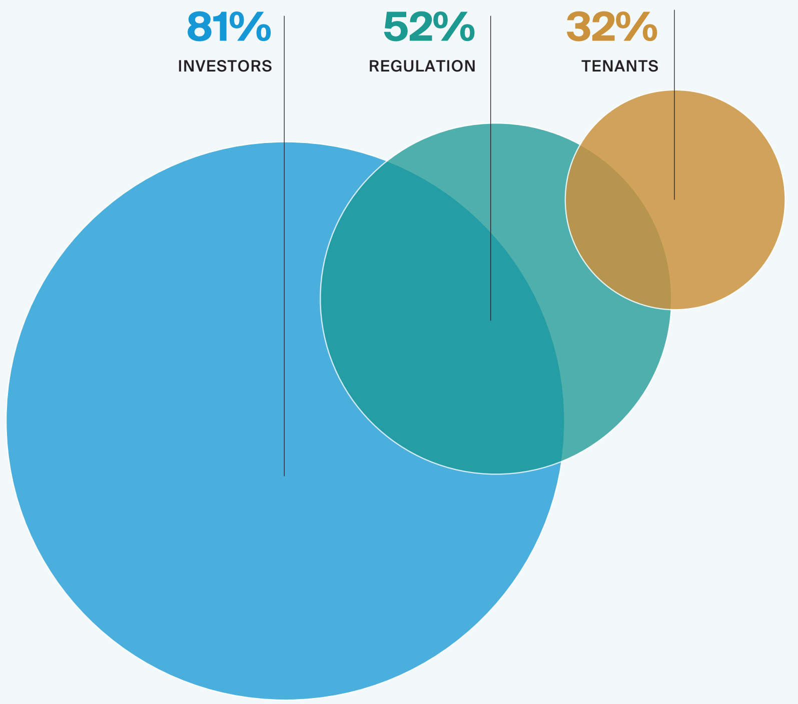
Investment committees are imposing increasingly strict standards in order to future proof assets, guaranteeing liquidity in the years ahead. Central to that is a push reduce the risk of obsolescence triggered by regulatory changes or shifts in tenant sentiment and preferences.

72%

indicated that they would pay a premium for schemes with strong environmental and sustainability credentials.

How important are the following in driving your approach to ESG

% of respondents saying 'very important'



Source: Knight Frank Research

Indeed, whether or not ESG matters to tenants has been a source of uncertainty, though that appears to be changing. More than 60% of investors believe good ESG credentials will help improve occupancy and tenant retention.

Driving social value

While we increasingly expect the green credentials of buildings to resonate with tenants during the years ahead, the sector is uniquely positioned to drive social value and support tenant wellbeing. Our previous research into the student market has highlighted the importance of accommodation in supporting student wellbeing, but it is undoubtedly a factor across residential asset classes.

This was particularly evident during the pandemic, as BTR operators held events spanning wine tasting to virtual fitness classes in order to retain a sense of community while residents were unable to travel or see family and friends. The process highlighted the benefits of purpose-built, flexible, actively managed accommodation in helping to create diverse, integrated and engaged rental communities, while it also highlighted the role accommodation can play in supporting seniors.

These issues are increasingly influencing scheme design and business strategy. Some 81% of respondents said "nurturing a sense of community" was either important or very important – the overwhelming favourite of the options on offer. Delivering more green space, incorporating more work and study spaces, incorporating new technologies and boosting the amenity provision were also selected as important or very important by most respondents.

81%

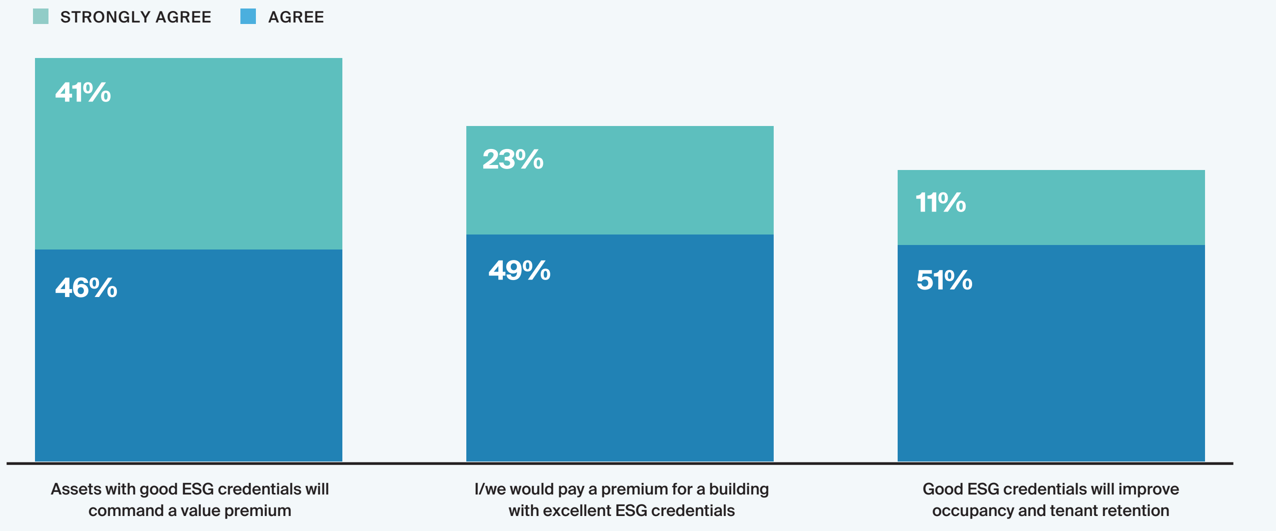
of respondents said "nurturing a sense of community" was either important or very important.

To what extent do you agree with the following statements?

% of respondents who 'agree' or 'strongly agree'

62%

of respondents believe good ESG credentials will improve occupancy and tenant retention



Source: Knight Frank Research

View online at
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