UK Living Sectors Investor Survey

2023

The Knight Frank Living Sectors Investor Survey represents the views of 50 institutional investors active in the sector who account for £75 billion in Living assets under management in the UK

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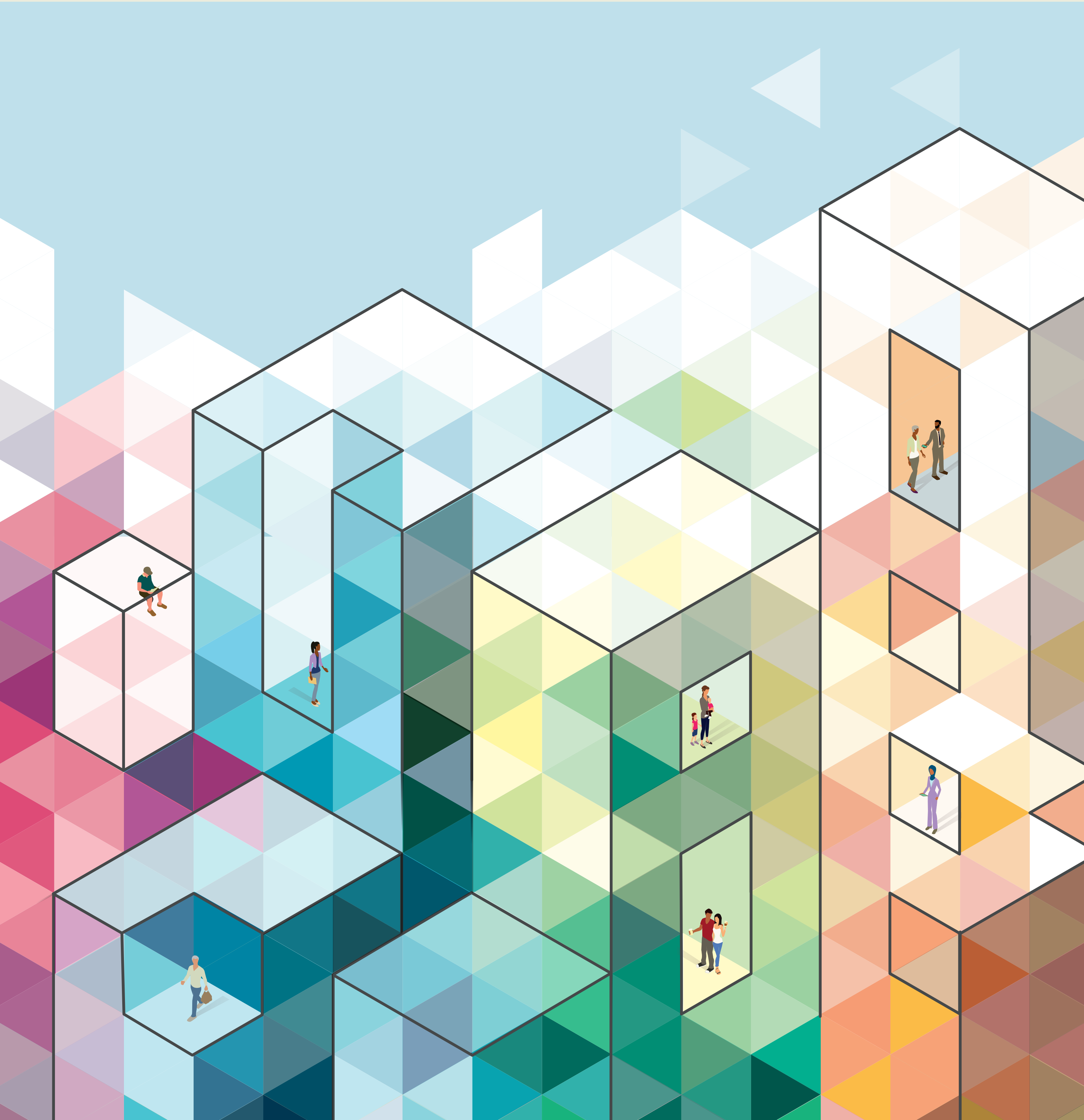


INTRODUCTION

Resilience and evolution

JAMES MANNIX
GLOBAL HEAD OF LIVING SECTORS

The UK's living sectors have experienced a surge in investor enthusiasm and unprecedented levels of growth over the past five years. Established players are expanding aggressively, and global newcomers are seizing opportunities.

Our fourth Living Sectors Investor Survey is a testament to this advancement. It reveals the sector's remarkable resilience and evolution, charting how investors are diversifying across demographics and geographies over time.

The growth of the sector hasn't been without challenges, however – notably surging debt costs and regulatory barriers. But the future of the living sectors is bright: interest rates will peak, and fresh capital will flood the market in Q4 2023. Equally, untapped equity capital hints at a transactional resurgence. Now is a unique moment for investors to acquire living sector assets at competitive prices, while reasonable inflation growth over the next few years will act as a tailwind for savvy investors, enhancing the real income generated from assets and bolstering long-term investment returns.

Knight Frank's mission with this report is simple: gauge investor sentiment, predict sector evolution, and explore the UK living sector's limitless horizons. Dive into our report for market-leading data, unique perspectives, and unmatched insights.

"The future of the living sectors is bright: interest rates will peak, and fresh capital will flood the market in Q4 2023"

The Survey

Our fourth annual Living Sectors Investor Survey represents the views of 50 leading institutional investors currently active across the build-to-rent, purpose-built student accommodation and seniors housing markets. In total, our survey respondents account for more than £75 billion in Living assets under management across the UK.

Key survey findings

£75 billion

current investment in Living assets in the UK by our survey respondents

29%

of investors surveyed expect to at least double their current investment into Living sectors by 2028

£45 billion

set aside by our survey respondents to invest in Living sector assets over the next five years

Build to Rent and PBSA

are the most popular asset classes, with 93% and 62%, respectively, of respondents currently invested in those sectors

67%

of investors plan to be active in the seniors housing market by 2028, up from 40% currently.

Single Family Housing

is another area of significant growth, with 71% of investors planning to invest in the coming five years, up from 45% today

36%

of investors expect their requirement for debt to increase over the coming 12 months

ESG

factors are crucial, with 36% of investors saying they will be the key factor determining investment strategy during the next three to five years

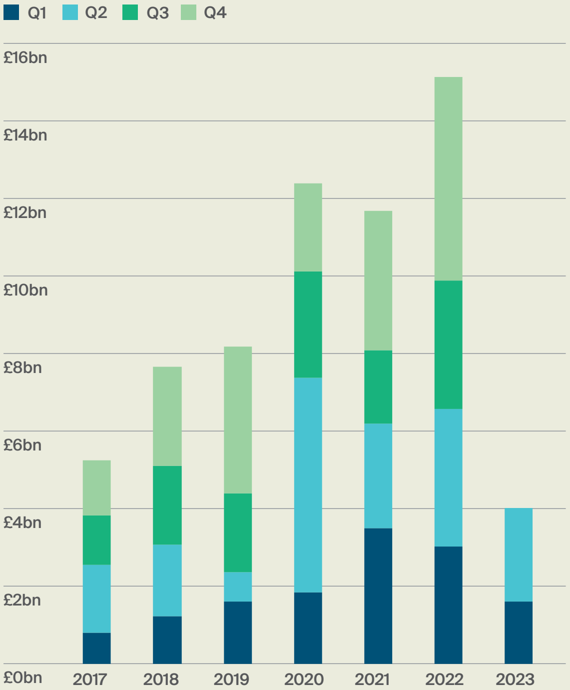
Investors look to increase exposure

The past five years have seen investment into the Living sectors rise across the UK, from £7.6 billion in 2018 (13% of total investment) to £15.1 billion in 2022 (22% of total investment). Figures for 2023 suggest that institutions committed a further £4 billion in the first six months of the year, accounting for a fifth of what was a relatively subdued first half of the year for overall real estate acquisition activity.

The idea that UK Living investment has been robust despite broader macro-economic challenges is as much a reflection of the resilience of the sector as it is of the exceptionally strong operational performance it has delivered over the past few years. Rising interest rates, stubbornly high inflation and elevated build costs all present challenges, but the longer-term view remains positive.

By 2028, close to 71% of investors expect to significantly increase their exposure to the Living sectors with 29% planning to double their current exposure and a further 20% increasing their exposure by between 80% and 100%. In total, our survey respondents alone outlined ambitions to invest a further £45 billion over the next five years.

Institutional investment in UK Living sectors has been rising

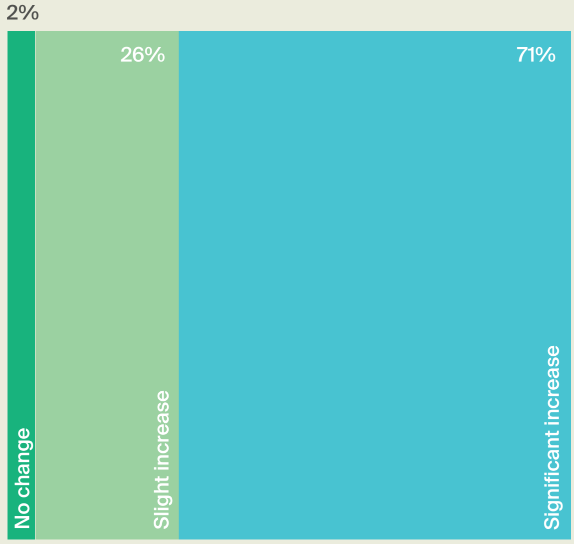


Source: Knight Frank Research

"Just 21% of respondents are currently invested in all three living sectors. This is expected to rise to 52% by 2028"

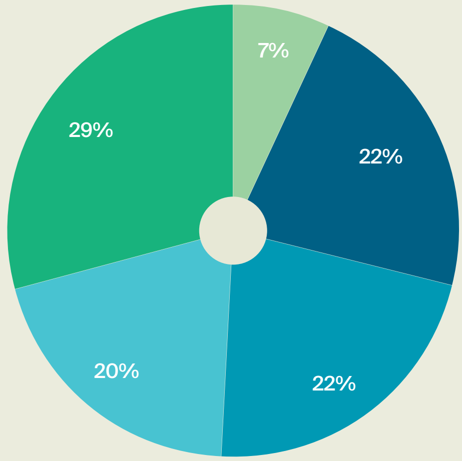
"There is a compelling case for investing in assets that benefit from changing ways of living and which provide strong counter-cyclical features and inflation-matching characteristics."

How do you expect your total investment into Living to change by 2028?



Source: Knight Frank Research

How much do you plan to invest in Living sectors over the next five years, as a % of total current investment?



0-20%	7%
20-40%	22%
40-80%	22%
80-100%	20%
100+%	29%

Source: Knight Frank Research

Strong fundamentals

Such growth is supported by both long- and short-term tailwinds, including a stark housing supply and demand imbalance. Legislation, taxation, and retirement have prompted some residential landlords to sell up, squeezing the supply of rental properties and driving rental growth to its fastest pace for seven years. At the same time, new development has been constrained by debt costs and build cost inflation, which will further squeeze supply and underpin rental growth over the long-term.

We expect to see an uptick in student numbers in the coming years – often a knock-on effect during periods of economic uncertainty – which will further increase demand for PBSA. In areas with an ageing population, demand for age-targeted seniors housing will continue to grow.

There is a compelling case for investing in assets that benefit from changing ways of living and which provide strong counter-cyclical features and inflation-matching characteristics that can help investors achieve consistent returns during periods of uncertainty. The granular nature of income allows investors to tap in to the reversion immediately making it a good hedge against inflation.

Diversification within living

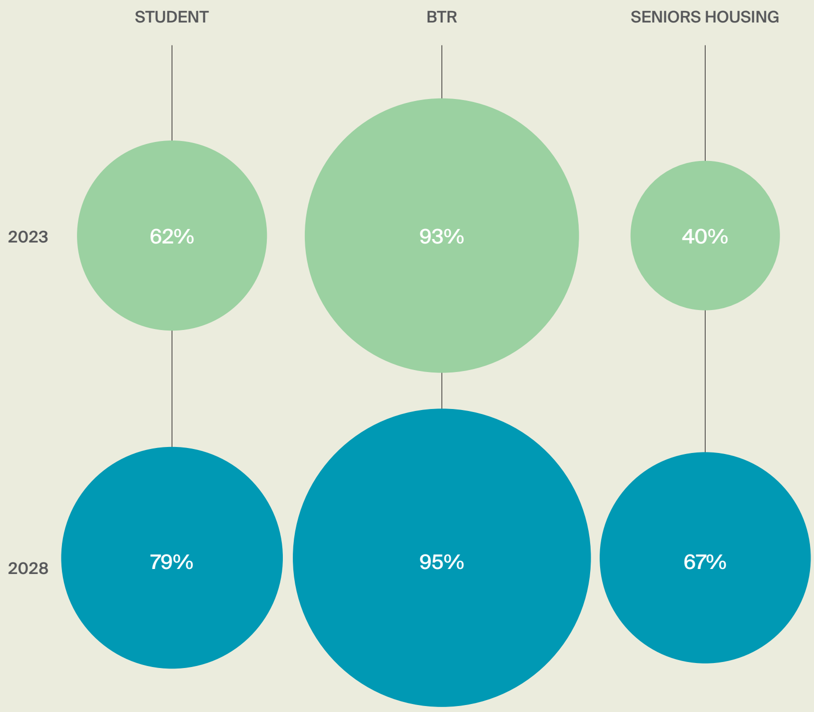
At present, the most common sectors for Living investors to have exposure to are Build to Rent (BTR) and PBSA, with 93% and 62% respectively of our survey respondents currently active in these sectors. This is reflected in transaction volumes, with BTR and PBSA accounting for 80% of capital invested in the Living sectors since 2020.

In comparison, fewer investors are currently active within the Seniors Housing sector (40%). In part, this reflects the specialist nature of the sector. Over time this is expected to change, with 67% of investors planning to be active in Seniors Housing within five years.

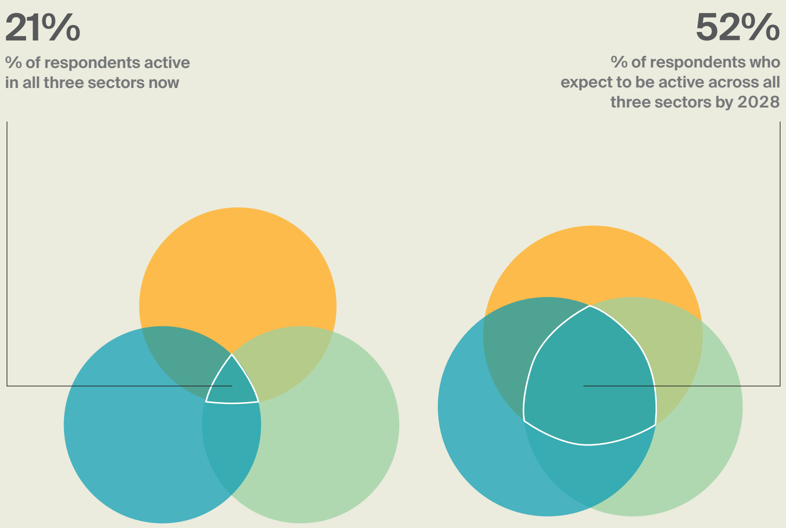
Indeed, whilst just 21% of survey respondents currently invest across all three primary Living sectors, this is expected to rise to 52% by 2028. While there are differences in market drivers, the desire for diversification within the living sectors reflects the fact there are also synergies, particularly with regards to construction and operations.

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

% of respondents



Cross sector investment



Source: Knight Frank Research

Growth of new sub-sectors

Multifamily and PBSA are set to remain at the heart of most investors' strategies over the next five years. More than 95% and 79% of investors expect to target, or continue to target, these sectors respectively.

Additionally, Single Family Housing has been flagged by investors as the third most likely sector to target, with nearly three quarters (71%) looking to invest by 2028, followed by Seniors Housing and Co-Living at 67% and 45% respectively. This demonstrates the maturity of these sectors, and the opportunities for growth that they offer.

Asked which criteria they consider most important when making investment decisions, institutional investors rank return profile (93%) and risk profile (64%) top, followed by the shortfall of supply against demand (43%) and the potential for income growth (31%).

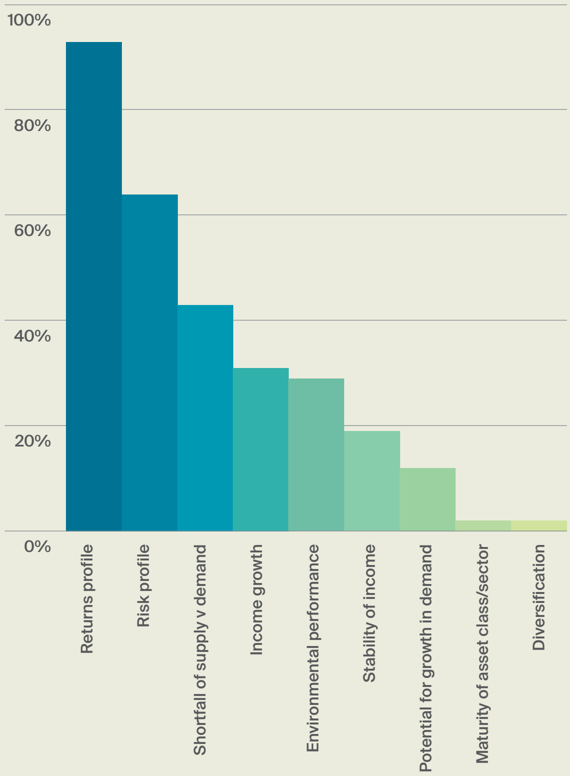
71%

of investors plan to invest in single family housing by 2028

"More than 95% of investors expect to target, or continue to target, the multifamily sector over the next five years."

Which of the following criteria are most important to your investment decision making?

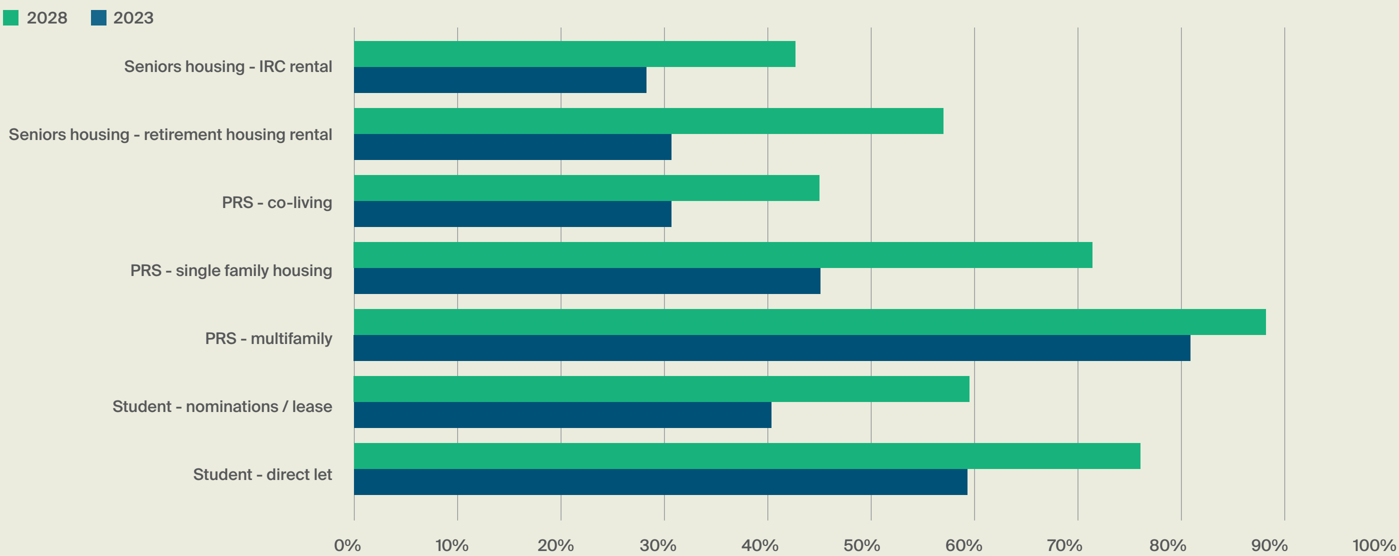
Respondents selected top 3



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

Barriers and challenges

Some 62% of investors highlighted the cost of finance as a major challenge to deploying capital into the Living sectors, reflecting the sharp rise in debt costs over the past 12 months which has resulted in some investors temporarily pressing pause.

Investors are also facing challenges around planning, with 57% highlighting this as an issue, up sharply from 36% in last year's survey. The availability of operational stock (50%) was also cited as a challenge. This is unlikely to change in the near term given the nascent nature of some of the Living sub-sectors which are still in their growth phase. More investment into development projects is expected as a result.

Looking specifically at operational challenges across the Living sectors potential new regulation was flagged by 68% of respondents. Encouragingly, recent comments from both main political parties suggest that rent controls are unlikely in England.

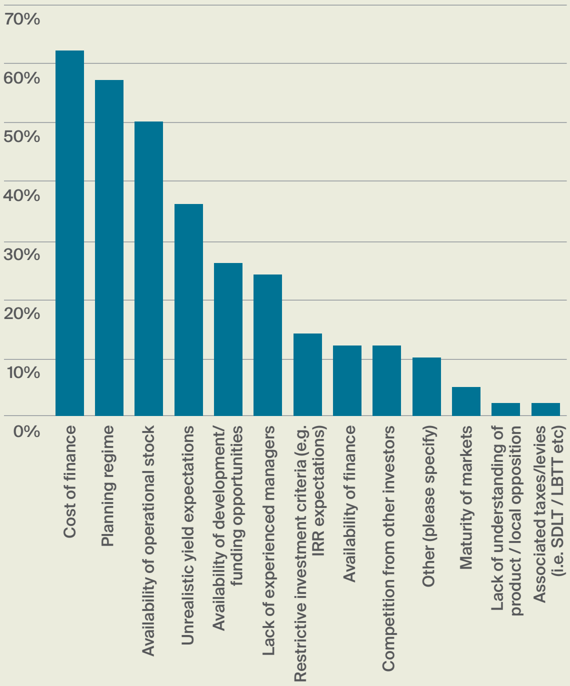
However, investors are mindful of the constraints faced by tenants across age-groups, with affordability highlighted as a concern by 60% of respondents, up from just 33% in last year's survey. The jump this year is likely to reflect the strong cross-sector rental growth seen over the last 18 months which has largely been the result of severe imbalances between supply and demand.

Rising operational costs (58%) and fire safety requirements (42%) were additional challenges shared across the Living sectors. Concerns around the overreliance on Chinese students were more specific to the student sector. While for seniors housing a lack of experienced managers, and challenges surrounding staff recruitment, training, and retention reflect its more specialist nature.

"Investors are facing challenges around planning, with 57% highlighting this as an issue, up sharply from 36% in last year's survey."

What are the key challenges to investors deploying capital into Living sector assets?

Respondents selected top 3

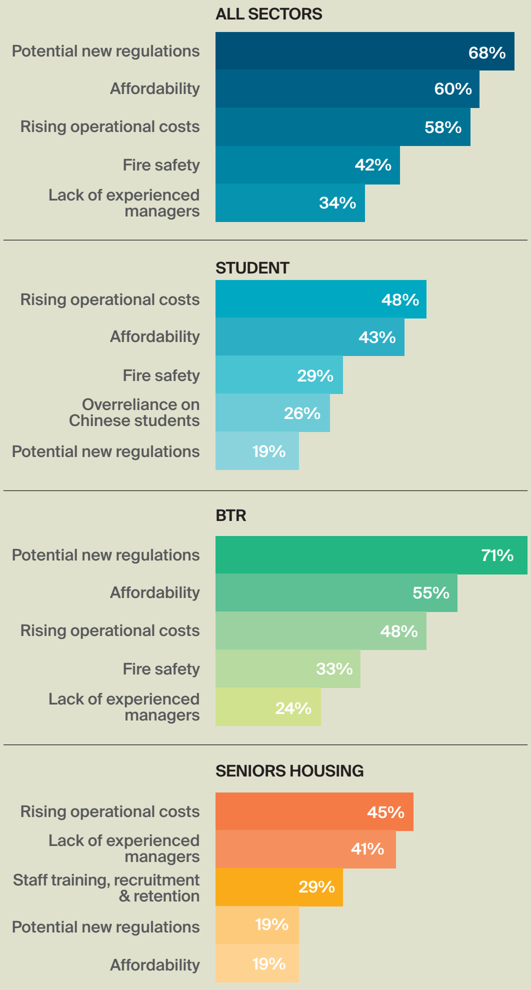


Source: Knight Frank Research

"Affordability was flagged as a concern by 60% of respondents, up from 33% in last year's survey."

What are the short-term operational challenges for the market?

Respondents selected top 3



Source: Knight Frank Research

Investors look to increase financial leverage

The cost of debt was pushed up substantially last year, making it more expensive than the income it could cover in many cases. Asset prices were pushed down to cover the increased cost of debt, while investors using core capital or all-in equity increased. Meanwhile, fewer private equity firms have been active in Living markets because the returns are lower, and it has become harder to accelerate returns on investment.

Reflecting this, some 71% of our survey respondents said that access to the debt market was either very important or important to their investment strategy.

There are signs some of these pressures are easing, however; UK inflation continues to ease, with the Consumer Prices Index slowing to 6.8% over the 12 months to July, down from 7.9% the previous month. While it remains a long way from the 2% target, an easing will improve sentiment and bring interest rate expectations down. Swap rates have already eased from recent highs. As the cost of debt comes down, transactional activity levels will pick up in the final quarter.

This is reflected in our survey responses, with some 36% of investors saying they expect their requirement for debt to increase over the coming 12 months. Just 27% are expecting their requirement for debt to decrease and 37% reporting no change. Of those investors planning to increase their financial leverage, 56% are planning to use debt to fund new development and 44% plan to use it for acquisitions.

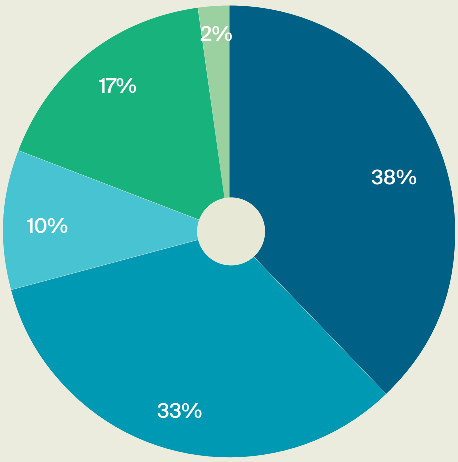
> "UK inflation continues to ease, with the Consumer Prices Index slowing to 6.8% over the 12 months to July, down from 7.9% the previous month."

> "As the cost of debt comes down, transactional activity levels will pick up."

36%

of investors saying they expect their requirement for debt to increase over the coming 12 months

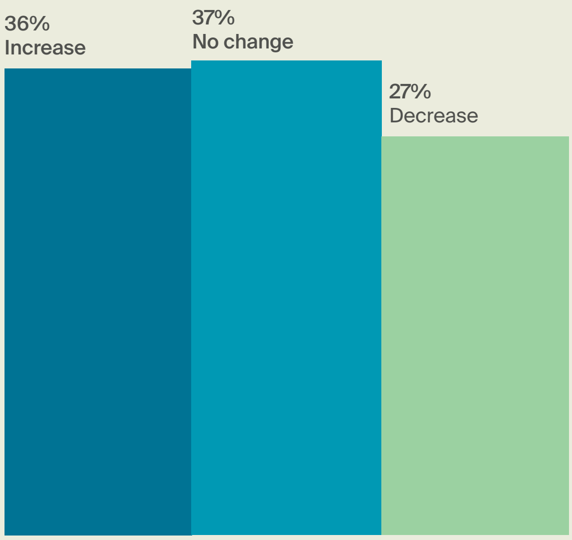
How important is access to the debt market to your investment strategy?



●	Very important	38%
●	Important	33%
●	Moderately important	10%
●	Slightly important	17%
●	Don't know	2%

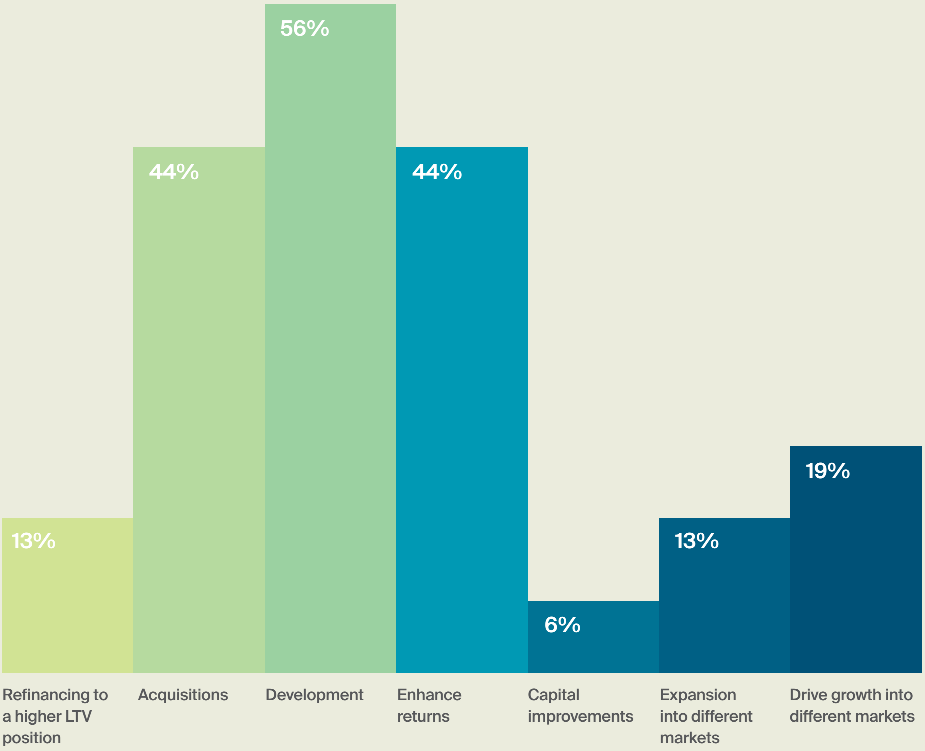
Source: Knight Frank Research

To what extent do you expect your requirement for debt to change over the next 12 months?



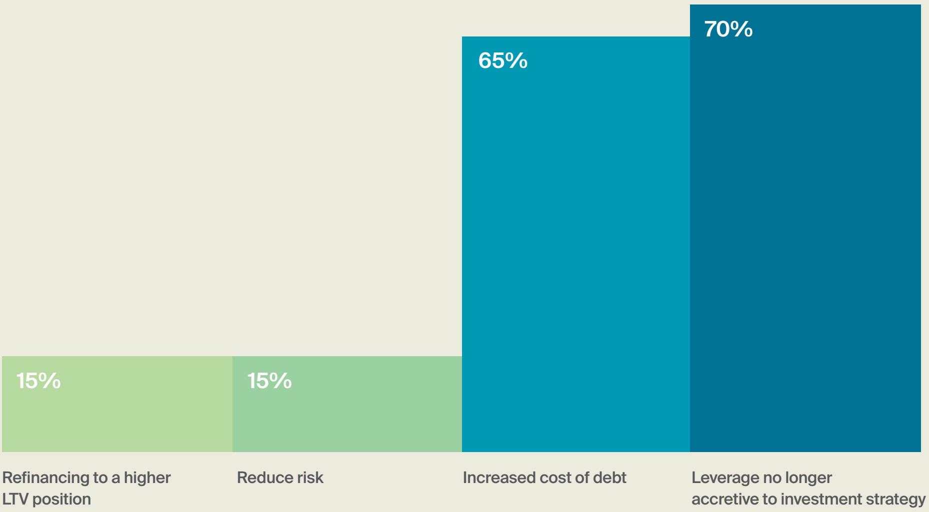
Source: Knight Frank Research

Which of the following best describes the purposes of increasing your financial leverage?



Source: Knight Frank Research

Which of the following best describes the purposes of decreasing your financial leverage?



Source: Knight Frank Research

MARKET VIEW

Living remains a focus for lenders

LISA ATTENBOROUGH
HEAD OF DEBT ADVISORY

A feature of unsettled times is that lenders are more risk averse about the assets they're willing to lend against. We have undoubtedly seen a flight to quality in the market as a result. Lenders have increased their due diligence and are being more selective on which assets they take forward.

Real estate sectors that have performed well in recent years, particularly those which have demonstrable track record of robust fundamentals remain a focus to all lenders. PBSA, Build to Rent and Seniors housing are among the sectors viewed as being well positioned to deliver strong income in the medium-term.

This means that, when compared to other commercial real estate assets, there is greater liquidity, LTVs are higher and margins are cheaper. The undeniable interest in living assets from all lenders also means there is an opportunity to capitalise on lender liquidity to optimise terms.

For those investors looking to increase financial leverage over the coming 12 months, whatever the situation, creative thinking is key. We are working with clients on a variety of solutions such as portable debt, blend and extends, fund facilities, and commercial ground leases, all of which can release value whilst retaining leverage.

Source: Knight Frank Research

Future plans

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 Glasgow, Leeds and Cambridge were also mentioned.

When asked which Living sector offers the most opportunity for investors over the next five years, our survey respondents suggested that single family housing would narrowly beat multifamily and direct let student accommodation.

Top target cities for investment

Ranked by number of respondents who selected each city

	Student	BTR	Seniors	All Sectors
1	London	London	London	London
2	Manchester	Bristol	Bristol	Bristol
3	Bristol	Manchester	Cambridge	Manchester
4	Edinburgh	Birmingham	Manchester	Edinburgh
5	Glasgow	Edinburgh	Edinburgh	Birmingham

Source: Knight Frank Research

Thinking specifically about the Living sectors, which do you think offers the most opportunity for investors over the next five years?

Source: Knight Frank Research

ESG at the fore

"Some 95% of our respondents agree that ESG credentials will create a value premium for assets, while 81% indicated that they would pay a premium for schemes with strong environmental and sustainability credentials."

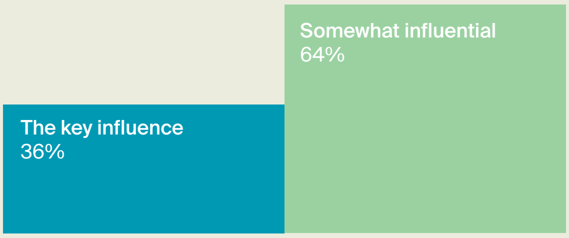
ESG factors continue to drive investor decisions. Some 36% of survey respondents say that sustainability considerations will be the key factor determining investment strategy during the next three to five years. The remaining 64% say the metric will be 'somewhat influential'.

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 95% of our respondents agree that ESG credentials will create a value premium for assets, while 81% indicated that they would pay a premium for schemes with strong environmental and sustainability credentials.

According to 81% of our respondents, investors are dictating the approach to ESG. That's more influence than regulatory change (56%), or tenants (24%). 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.

Indeed, whether ESG matters to tenants has been a source of uncertainty, though that appears to be changing. More than 75% of investors believe good ESG credentials will help improve occupancy and tenant retention, with 54% agreeing that green buildings will be able to charge premium rents.

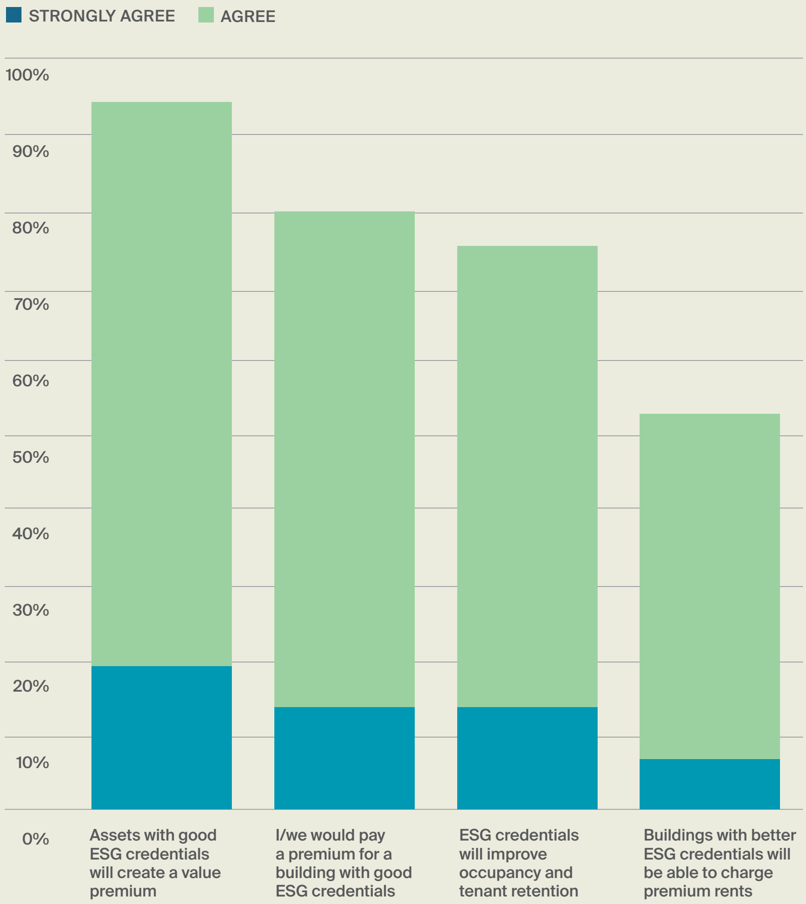
How influential will sustainability considerations be in determining your investment strategy over the next 3-5 years?



Source: Knight Frank Research

To what extent do you agree with the following statements?

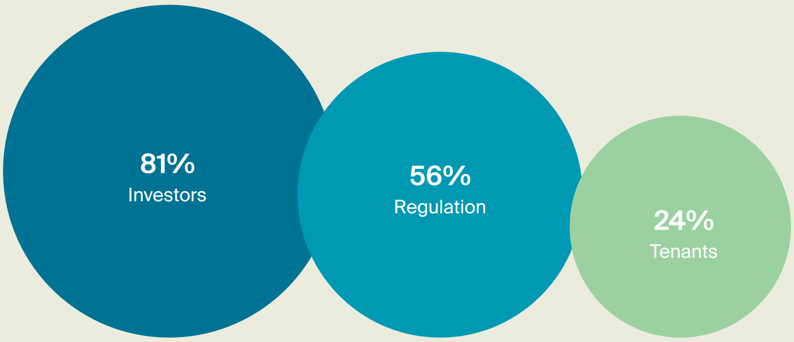
% of respondents who 'agree' or 'strongly agree'



Source: Knight Frank Research

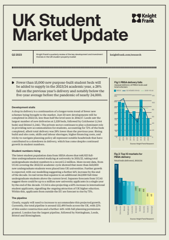
How important are the following in driving your approach to ESG?

% of respondents saying 'very important'



Source: Knight Frank Research

Recent Research



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Build to Rent Market Update - Q2 2023

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