

BUILD TO RENT SCOTLAND

Scottish Market Review
September 2022



The past couple of years have been a sharp wake-up call for the rental sector, and more widely, the property sector in Scotland. Restrictions and changes to the way we live and work have impacted demand and supply across the market. The investment and economic landscapes have been shifting and the short to midterm outlook altering.

However, whilst many factors have been changing, the historic undersupply and demand for new homes in Scotland, especially in key locations, remains ever present.

Homes for Scotland has estimated the need for 25,000 new homes a year in Scotland, across all tenures, to meet current demand. The 10-year average has been 17,000. Against this backdrop, the BTR tenure has the potential to be leading delivery partner for the property sector, if it is given the opportunity.

In the wider rental sector, there has been a sustained and systemic decline in supply across the Scottish market. This has been most acute in urban centres, where there is typically the highest demand.

First there was the rise in short-term lets, then legislative and tax changes, and more recently plans for further regulation.

This increases uncertainty and complexity of the market. All these factors have combined to make it far more onerous for small-scale landlords, who make up the vast majority of the private rented sector, to comply and remain profitable. With a buoyant sales market, it has also been a propitious

time for landlords who were vacillating, to finally sell up and exit the sector. This contraction is a major concern because the private rental sector provides flexibility to accommodate economic migration and households formation flows, and any constriction in the sector has significant consequences for places, people and the economy.

In a political environment that is increasingly hostile to small-scale 'amateur' landlords, there is a need, and opportunity, for institutional investment to fill the shortfall in supply.

Another major challenge facing Scotland is new housing demand across all tenures. Rising construction costs, labour shortages, and supply chain restrictions are challenges for the viability of new housing delivery in Scotland. The delivery of new homes in Scotland has historically been for the owner occupation tenure, which is underpinned by mortgage lending. This focus on the 'for sale' model may face potential headwinds in a higher inflation environment, where rising mortgage costs may lead to a slowdown in activity and affordability constraints in the market.

The different structure and drivers of BTR delivery again make it well placed to step in to the breach, whether this is as an alternative to the 'for-sale' development model or more typically, as a supplementary or complementary and de-risking strategy as part of the wider development.

A further issue emerging from the pandemic has been the use of space in our towns and cities. The

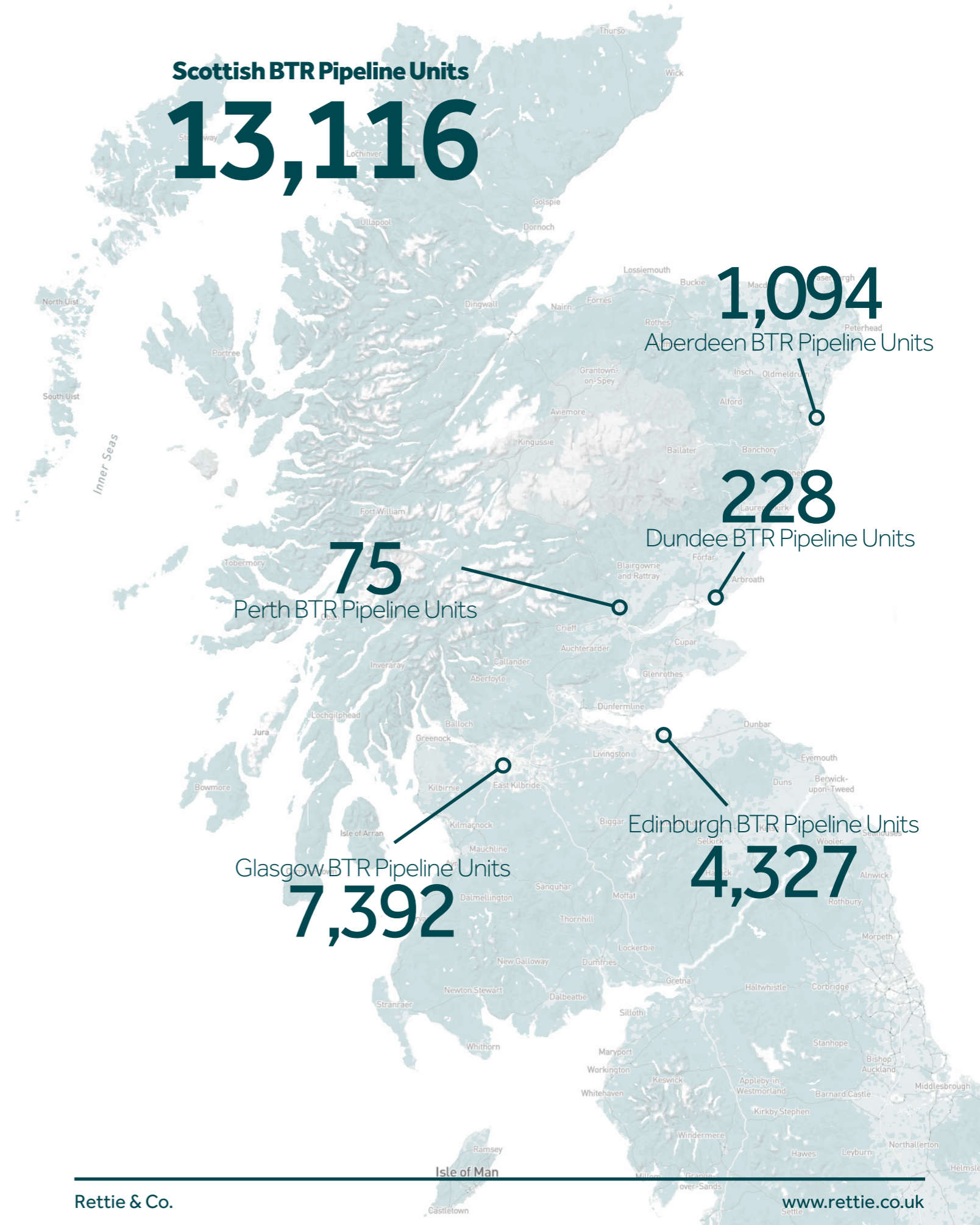
move to online retail and continued slow death of the high street, combined with the reduction of office demand, has seen the 'hollowing out' of local and regional centres that relied on the inflow of workers and visitors to underpin their local economies. This has raised fundamental questions over how we use space and how we create viable and vibrant locations. Introducing, or in many cases, reintroducing residential use into areas that were previously dominated by office and retail, is now being widely explored, often under the banner of the 20-minute neighbourhood.

The BTR approach offers a way to provide locations with a resident population, which can support the retail and recreational offerings that previously relied on a transitory population of visitors and office workers.

In dealing with these major challenges, BTR has the potential to deliver new housing, at volume; to create new vibrant communities; and to enable the viability of sites which otherwise may prove challenging in the emerging economic and market conditions. Hopefully, the BTR sector find the confidence, and support from communities and government, to step in to the breach.



Gillian Mclees
Director of BTR



Supply by City

The BTR pipeline in Scotland has continued to grow despite the pandemic, or potentially, due to the pandemic. Preceding the pandemic there just over 9,000 units in the BTR pipeline in Scotland. There was the result of a significant increase of over 50% between 2018 and 2019. In 2020 the year-on-year rate of increase slowed as a result of the pandemic, only rising by 7%, or 630 units, its lowest rate of growth since 2014.

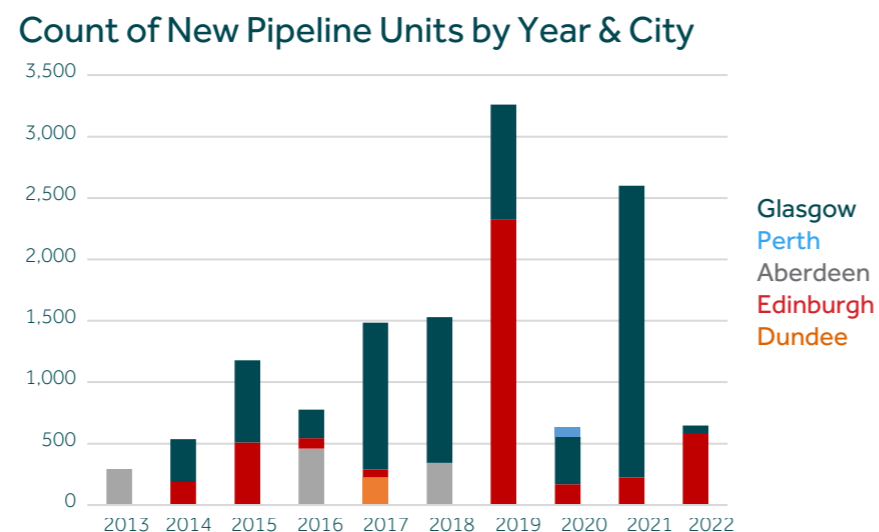
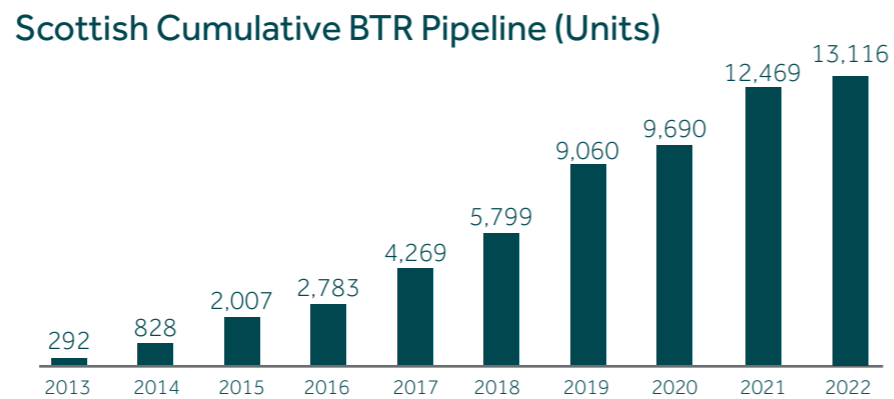
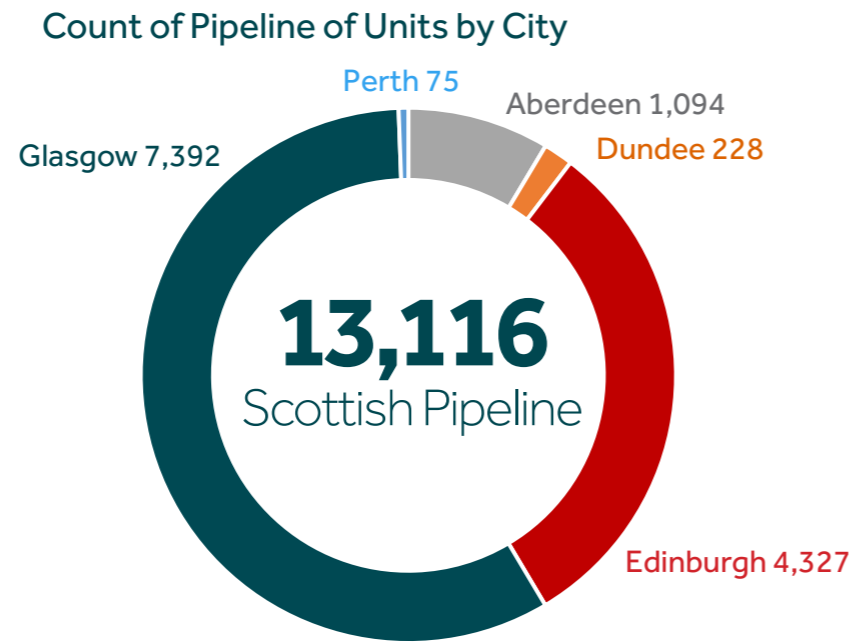
However, in 2021, over 2,500 units were added to the pipeline, which was an increase of over a quarter year-on-year. This bulk of this increase has come from major planning applications in Glasgow, although the number of units in Edinburgh has also continued to rise and is now over 4,300 units.

The concentration of supply in Scotland remains resolutely focused in the two largest cities, with half of the pipeline in Glasgow and a third in Edinburgh.

Aberdeen remains the only other location with any volume of BTR supply due to Dandara's pioneering work in the sector and continuing residential development in the city.

Sigma Capital's partnership with Springfield at Perth was an early bellwether of the growing interest in the Single Family sector in Scotland. While there are a number of masterplans currently musing the delivery of volume single family housing, only a few schemes are now confirmed to deliver open market suburban family housing, with fewer than 500 units in the pipeline.

This figure could dramatically change if some of the current proposals, which consider BTR as a component of major masterplans, come to fruition.

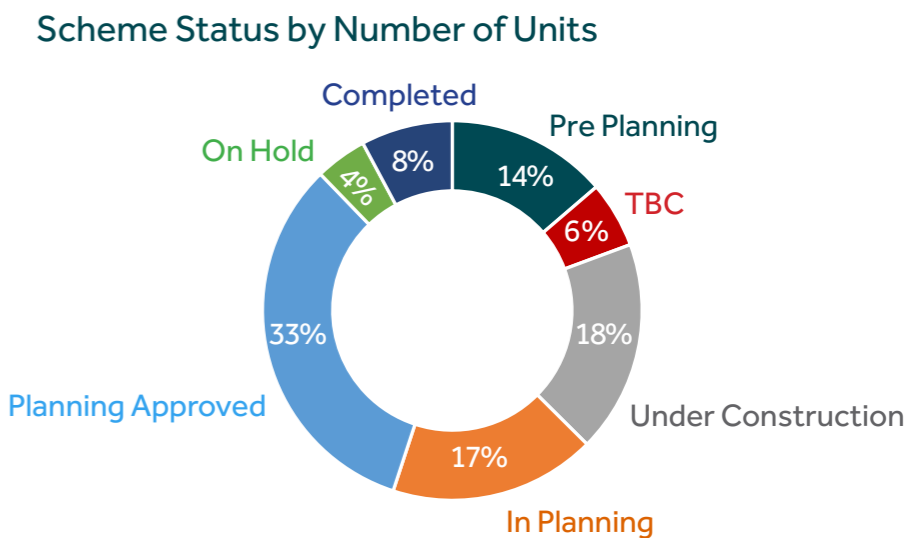
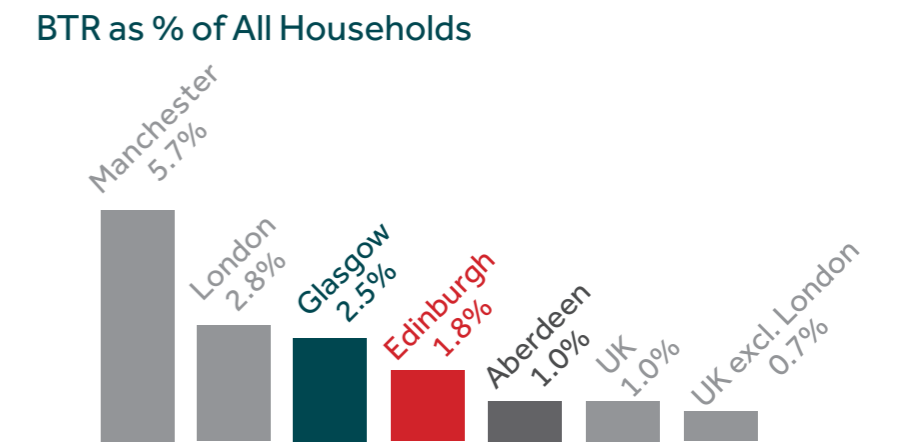
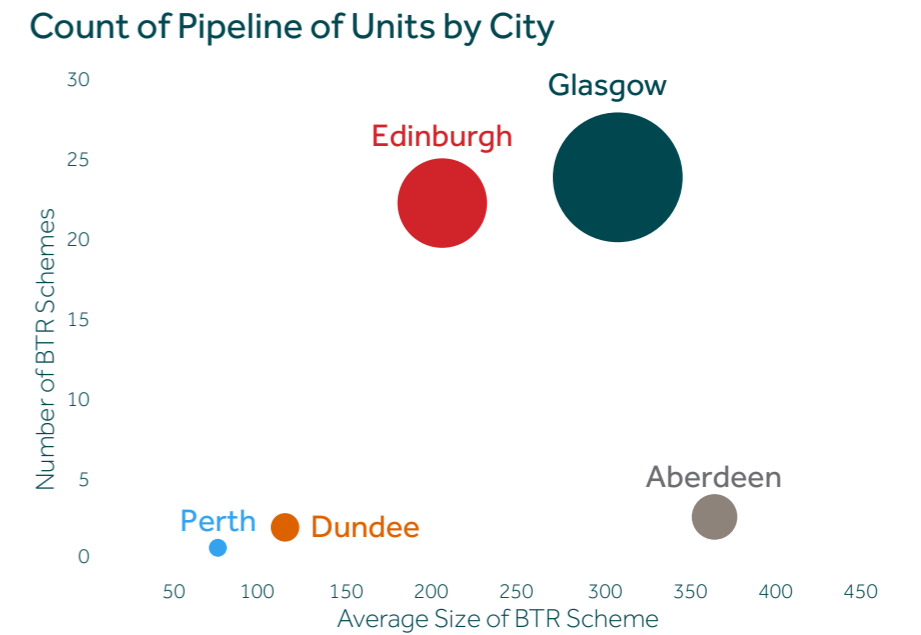


While the Scottish BTR sector is continuing to gather pace, diversify and mature, there remains significant capacity within the market for increased delivery, especially compared with the level of established provision elsewhere in the UK. In Manchester, the current BTR pipeline accounts for around 5.7% of all households in the city, while in London this is around 2.8%. In recent years, the increase of supply in Glasgow has edged the city closer to these comparators, with the current pipeline representing c.2.5% of households. While closer to London levels, it is still well below the levels seen in Manchester. Despite Edinburgh's rising pipeline, Scotland capital has a pipeline equivalent to 1.8% of all households.

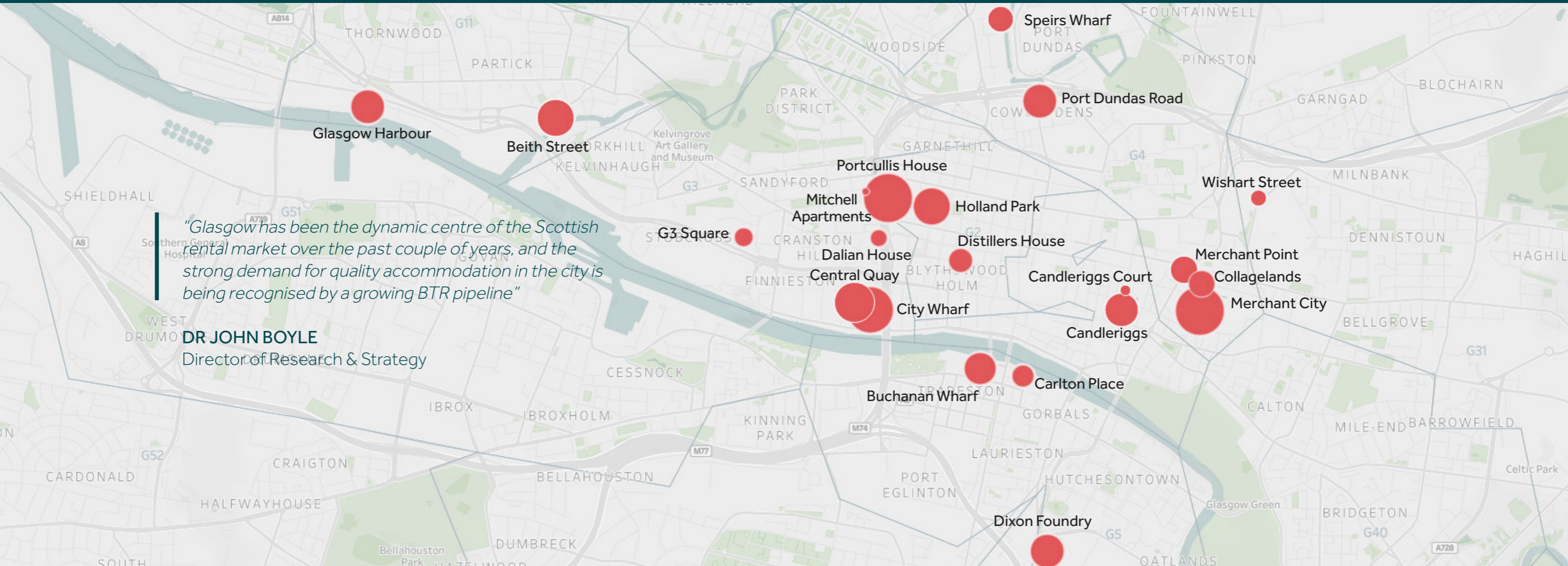
It is worth noting that while Edinburgh and Glasgow both have a similar number of BTR schemes planned, the average scheme size is over a 100 units different on average. In Edinburgh, the average BTR scheme size is just over 200 units, whilst in Glasgow the average scheme size is over 300 units.

Based on the status of the schemes, just under a third of units are currently in the planning system, with another third having achieved planning. Just under a fifth of units in the pipeline are currently under construction, with only 8% of the pipeline now being complete and active.

The fact that less than 10% of the pipeline in Scotland is now completed reflects how nascent the sector remains. However, with over 50% of units either with planning approved or under construction, the BTR sector will soon make a material impact on the rental markets of Edinburgh and Glasgow. It will be at this point a true measure of the sector's potential and viability will be more clearly demonstrated.



Glasgow Pipeline



City Wharf
Dandara
603 Units



Buchanan Wharf
Drum
324 Units



Merchant Point
Structured House
231 Units



Merchant City
Get Living
727 Units



Glasgow Harbour
Dandara
348 Units



Portcullis House
Watkin Jones
750 Units



Distillers House
Brickland Ltd
182 Units



Carton Place
Third Line Studio
155 Units



Speirs Wharf
Hoxton Securities
203 Units



Collagelands
Vastint
221 Units



Candleriggs Court
Kelvin Properties
36 Units



Central Quay
PLATFORM_
498 Units



Holland Park
MODA
433 Units



Candleriggs
Drum
346 Units



Beith Street
KR Development
424 Units



Mitchell Apartments
Kelvin Properties
20 Units



G3 Square
EDR Reim / Drum
114 Units



Dalian House
Calmont
92 Units



Wishart Street
Calmont
79 Units



Dixon Foundry
Craighead
356 Units



Edinburgh Pipeline

"BTR is increasingly being considered as a prime use case for schemes in the East of Scotland, with many developers looking to the tenure to comprise part, or all, of site delivery solutions. This is welcomed given the weight of investment demand looking to find a home in Scotland's Capital."

The supply that the BTR sector is providing is unlikely to be built by house builders. Long-term patient capital from pension funds can work in the space vacated by some house builders on large-scale urban blocks. In this context, BTR should be seen as additional new housing."

SANDY GILMOUR
Associate Director - Land & Development



Newbridge Village
3H York / Mac Mic
242 Units



Edinburgh Park
Parabola
906 Units



Skyliner
Goodstone Living
253 Units



The McEwan
MODA
461 Units



Lochrin Quay
Aberdeen Standard
113 Units



Freer Street
Vastint
175 Units



Stead's Place
Drum
110 Units



Iona Street
Watkin Jones
Units



Embankment
Spindlehawk Ltd.
85 Units



Saughton
Manbay Homes
31 Units



New Waverley
Artisan REI
62 Units



Broughton School
Kingsford
75 Units



Bonnington
PLATFORM_
339 Units



India Quay
Edinburgh Living
259 Units



New Town North
Ediston
150 Units



New Market Road
Watkin Jones
434 Units



Beaverhall House
HUB
205 Units



Dunedin Street
HUB
30 Units



Rowan Green
Dandara
162 Units



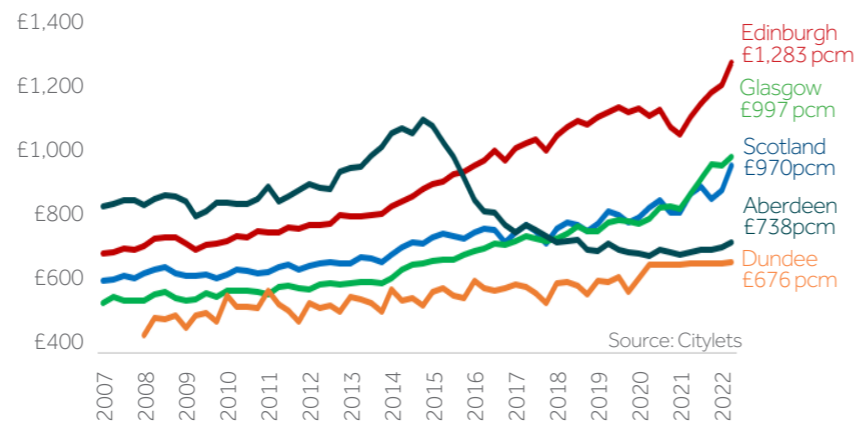
Rennie's Isle
VRS / Union Property
180 Units



The Scottish Rental Market

Rents in Scotland have been on an upward trend over the past decade, with the exception of Aberdeen, whose economy is closely tied to the fortunes of the volatile oil sector. Historically, Edinburgh has often seen the strongest growth, with the economic and cultural dynamism of the capital driving demand. This has meant that over the past 5 years, average advertised rents in the capital have risen by almost a quarter, which equates to a compound annual growth rate of 4.3%. This upward trajectory of the capital was dented during the pandemic, when restrictions on economic migration, short let demand and student demand, reduced rental market activity. At the same time, landlords sought to minimise voids, leading to a downward pressure on rents.

Average Advertised Rents



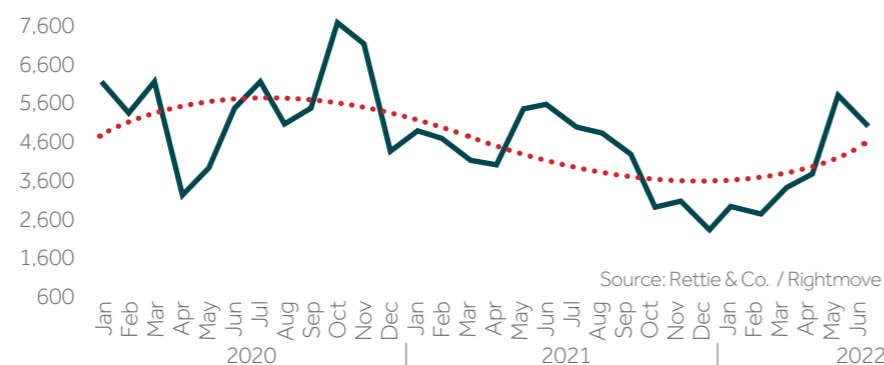
	Edinburgh	Glasgow	Scotland	Aberdeen	Dundee
Annual Change %	15%	13%	10%	4%	1%
5 Year Change %	24%	32%	23%	1%	10%
5 Year CAGR	4.3%	5.7%	4.2%	-1.3%	2.3%

Source: Citylets

Since lockdown eased growth has recovered in the Edinburgh market, with average rents jumping 15% in the past year. Over the past 5 years Glasgow has seen strong and consistent growth, outperforming Edinburgh, with average advertised rents rising by 32%. This equates to a 5.7% CAGR.

Rental Supply

Monthly lettings listings are on a clear downward trend since early 2020. New Monthly Lettings Listings & 6-Month Rolling Total of Scottish Rental Listings

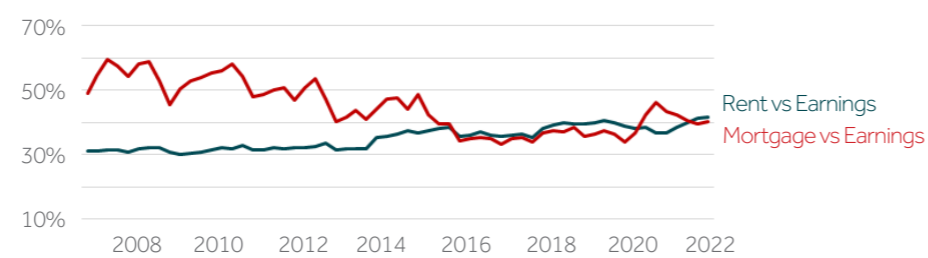


Source: Rettie & Co. / Rightmove

A key issue in the market has been the falling supply of stock. In the 5 years from 2014 to 2019, the number of new listings fell by c. 15% and this trend has, on the whole, continued in the post-pandemic market. The increasing complexity and regulation of the sector has made profitability for small-scale landlords more difficult. Combined with a buoyant sales market, many have rationalised their portfolios. Against this falling supply, demand remains strong, and as interest rates rise and the cost of house purchasing increases, we are likely to see the number of households electing for the flexibility of the rental sector increase.

Comparison of Cost of Mortgage vs Rental

Cost of Average Rent as % of Average Earnings in Edinburgh vs Cost of Mortgage for Average House Price as % Average Earning, 2007-22



Source: Rettie & Co. / ASHE / Citylets / Registers of Scotland

Scotland adopts a rent freeze across Social and Private Rental Sectors

"Somewhat unexpectedly and while we were completing this Briefing, the Scottish Government announced an immediate rent freeze on 6 September to last to the end of March 2023. A ban on evictions was also introduced for this time period. The Government stated that this was due to the cost-of-living crisis and the need to protect tenants from increasing hardship.

While welcomed by tenant and consumer advocacy groups, it has met a hostile reception from housing providers and institutional investors, who were not forewarned and believe that the effects of such an intervention on future levels of supply and investment could be very damaging. This has been made clear to the Scottish Government in very blunt terms.

While a 6-month rent freeze and eviction ban will likely have limited impact, especially if wider measures by the UK Government and Scottish Government can be put in place to deal with the cost-of-living crisis, an extension of this emergency legislation will have consequences for investor participation in the sector. While the further loss of small-scale PRS housing providers could create more room in the market for institutional investors, the unpredictable nature of government intervention in Scotland may cause some reflection among larger scale investors.



As we have outlined in the Briefing, Scotland and its main cities are well-placed to benefit from BTR expansion, but if the Scottish Government wants a thriving BTR, and sees it as part of the solution for the housing crisis, it needs to quickly re-assure institutional investors looking to fund this significant increase in the supply of homes that this is purely temporary measure. It will not be lost on the Scottish Government that the long term, "patient capital" investors hoping to support the Government in meeting ambitious new housing targets are often Pension Funds looking after the hard-earned savings of their pension holders."

- Dr John Boyle, Director of Research & Strategy at Rettie & Co.

"It is too early for us to understand what the impact of this measure will be on our operational neighbourhood in Edinburgh at this stage. However we remain unwavering in our commitment to Scotland, despite this policy which puts businesses like ours, which are delivering new homes at scale to alleviate the pressure on its housing market, in the crosshairs.

"Scotland is crying out for high quality, professionally managed new homes for rent, with major long-term opportunities to deliver homes that put wellbeing first and control back in the hands of the residents. We look forward to continuing to work with local authorities in Scotland on how we can deliver these."

- Richard Smith, MD of Operations at Moda Living



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Our Build to Rent (BTR) team is at the heart of the private rented sector in Scotland, with almost £1bn in assets under management. We provide a comprehensive range of BTR services and have the research expertise, experience and network to make Build to Rent work north of the border.

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Our Consultancy & Research team is the largest in the Scottish Private Sector and provides a broad range of services to both private and public sector clients. Covering all parts of the Scottish residential market, the team provides clients with in-depth, reliable and up-to date information that enables evidence-based decision making.

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Our Structured Finance team provides innovative funding solutions for both private and public sector developments. We are expert in all project stages including: initial financial modelling; JV/contract structuring; sourcing and securing short- or long-term funding; legal negotiations; public sector procurement; and asset management and rental.

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Our Land & Development team advises on land and property development projects, on residential investments and Build to Rent. We cover residential, non-residential and mixed-use development sites and advise on every stage of the project cycle, from early appraisals and funding through to site disposals.