PRIVATE RENTED SECTOR UPDATE DECEMBER 2017

REGIONAL FOCUS

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Whilst much of the regional PRS appetite to date has focussed on ‘best in class’ city centre assets in key cities, an increasing number of institutional investors are now looking beyond these, to more secondary cities and to well-connected satellite towns.

This has been due, at least in part, to a significant shift in perception of secondary and even tertiary PRS opportunities and the security of income derived by these.

With increasing amounts of capital to deploy into the sector combined with the positive attributes of these secondary locations and attractive yields, investors are looking beyond regional city centres to satellite hubs and secondary conurbations where superior affordability ratios offer greater potential for rental growth, whilst still providing secure income with strong rental demand. For this reason, we have seen some yield compression and positive sentiment towards these secondary locations.

This is exemplified by our sale of The Rock in Bury, north of Manchester, earlier this year. Within the 233 unit PRS scheme, rents are less than half that of central Manchester, yet it is 30 minutes by tram from Manchester City Centre. The local demographics were generally considered to be good with an expanding population and growing and diverse employment base.

The asset received good depth of interest from institutional investors, and ultimately sold for a stabilised 5% Net Initial Yield.

RENTAL GROWTH

Average rents across the UK rose by 1.46% per cent in the 12 months to October, with rental growth outperforming in some regional cities.

Based on rental performance data from the ONS Rental Index, rents have risen in all regions across the UK on an annual basis. Of particular note is the East Midlands, which saw rental growth of 2.93% in the 12 months to October – continuing the strong rental growth seen over the past two years.

Although having slowed from the previous 12 months, the South East also continues to show strong levels of annual rental growth, while in the North West and the West Midlands, annual growth has remained relatively stable at around 1.3% and 2% respectively.

Rental growth in London has slowed in recent months, although rents are still in positive territory, up 0.78% in the 12 months to October.

In short, the rental performance across the country remains localised, as shown in the map below.

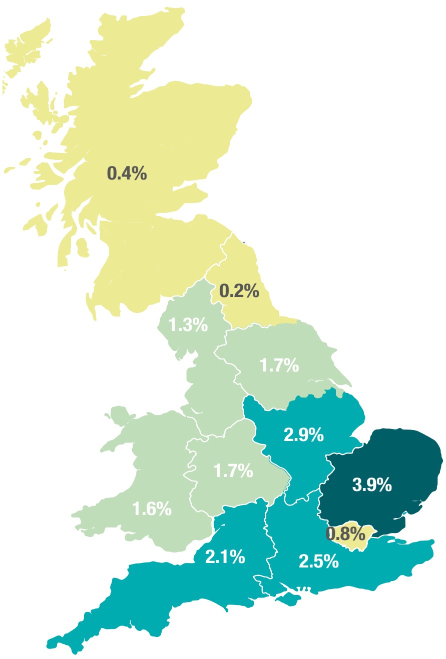
Knight Frank’s Tenant Survey 2017 identified that rental affordability remains a key concern for tenants. The data shows that, on average, Londoners allocate 50% of their monthly net household income to rent, whilst in regional city centres the figure is typically closer to 40%. Affordability often improves further in secondary and satellite towns on the edge of major conurbations.

With the tenant pool increasing exponentially in size as rents reduce, many investors are now viewing the income generated by more secondary lower rent assets with good demographic fundamentals to be highly secure and, in some instances, less exposed to local oversupply.

An example of this is Bury, a satellite town in north Manchester. Average rents in the town are around half those in central Manchester. In Bury, the rental affordability rate, defined as the proportion of local renters who can afford to rent an average priced home, is 62%. If renters who move to Bury from neighbouring cities, where average wages are typically higher, the rental differential will be even greater, underlining the relative affordability of satellite towns.

Rents are forecast to grow by a cumulative 14% over the next five years across the UK, and by 15% in Greater London.

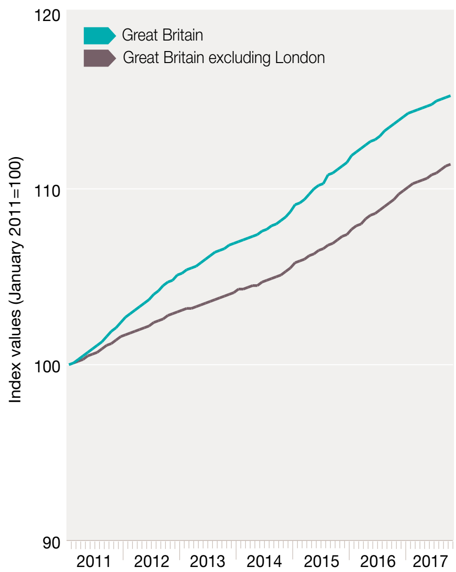
Latest rental performance by region



Source: Knight Frank Research/ONS

Index of Private Housing Rental Prices indices, Great Britain

January 2011 to October 2017



Source: Knight Frank Research/ONS

FIGURE 3

Prime Residential Yield Guide December 2017

Sector	Dec-16	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Market Sentiment
London - Zone 1 (gross yields reported)								
Prime Central London (GIY)*	2.75%-3.00%	3.00%-3.25%	3.00%-3.25%	3.00%-3.25%	3.00%-3.25%	3.25%-3.50%	3.25%-3.50%	STABLE
Zone 1 Prime (GIY) (Outside PCL)*	3.50%-3.75%	3.75%-4.00%	3.75%-4.00%	3.75%-4.00%	3.75%-4.00%	3.75%-4.00%	3.75%-4.00%	STABLE
London and South East								
Zone 2 Prime (NIY)	3.50%-3.75%	3.50%-3.75%	3.50%-3.75%	3.50%-3.75%	3.50%-3.75%	3.50%-3.75%	3.50%-3.75%	STABLE
Zones 3-4 Prime (NIY)	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	POSITIVE
Greater London Prime (NIY)	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	POSITIVE
South East Prime (NIY)	4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	POSITIVE
Prime Regional Cities								
Prime assets (NIY)	4.00-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	STABLE
Birmingham (NIY) (prime assets)	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	STABLE
Bristol (NIY) (prime assets)	4.00-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	4.00%-4.25%	STABLE
Leeds (NIY) (prime assets)	4.50-4.75%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	POSITIVE
Manchester (NIY) (prime assets)	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	STABLE
Secondary Regional Cities								
Prime assets (NIY)	5.00%-5.50%	5.00%-5.25%	5.00%-5.25%	5.00%-5.25%	5.00%-5.25%	5.00%-5.25%	5.00%-5.25%	POSITIVE
Ground Rents								
10 Year RPI Uplifts	2.50%	2.75%	2.75%	2.75%	2.75%	2.75%	2.75%	STABLE
25 Year Doubling Reviews	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%-3.50%	3.25%-3.50%	STABLE
Bonds & Rates								
Libor 3 mth	0.38%	0.30%	0.28%	0.28%	0.34%	0.52%	0.52%	
Base rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	
5 year swap rates	0.95%	1.00%	0.85%	0.85%	1.09%	1.04%	1.12%	
10 yr gilts redemption yield	1.44%	1.35%	1.16%	1.16%	1.40%	1.26%	1.26%	

Based on rack rented properties and disregards bond type transactions. NIY - Where reported we have assumed an appropriate discount for operating costs. This yield guide is for indicative purposes only and was prepared on 4 December 2017. *Our PCL yield is based on tenanted blocks with a minimum of 6 units, covering locations such as Mayfair, Knightsbridge, Kensington etc, situated within Knight Frank's definition of Prime Central London. Yields in the PCL and Zone 1 Prime categories are reported gross in line with market practice and no allowance has been made for operating costs within this yield guide. Yields in the London and South East categories are reflective of income-focused transactions of institutional assets. Regional locations: We have provided an indication of yields in respect of a number of example locations, illustrating the spread of yields in this classification. These yields are reported in respect of institutional quality, stabilised assets.

Source: Knight Frank Capital Markets

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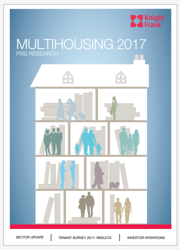

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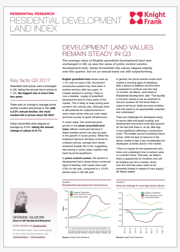

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