RESIDENTIAL RESEARCH

PRIVATE RENTED SECTOR INDEX

YIELDS HARDEN MARGINALLY IN PRIVATE RENTED SECTOR

The private rented sector index, encompassing key city markets across the UK, shows that initial gross yields hardened slightly in Q4 2014. Activity levels in the market are robust, and this is reflected in the shallower discounts on offer, while capital growth tracked the wider market to come in at 6.5% year-on-year. Grainne Gilmore examines the latest trends in the market.

Key facts Q4 2014

Average initial gross yields in London, Leeds, Bristol, Birmingham, Manchester and Glasgow **at 6.3% in Q4 2014**

Average total returns at 11.2% in Q4 2014

Average capital growth was **6.5%, down from 7.3% in Q2 2014**

Gross yields range from 4.2% in central London to 8% in Leeds

Total returns from PRS investment-grade blocks slipped towards the end of 2014, as a result of slightly more modest capital growth and a moderate slowdown in average rental growth across the six cities monitored by the Knight Frank index.

The trend in capital growth reflects the wider market, with average pace of growth UK residential prices for owner-occupied properties also easing from 11% annual growth in the summer to 7% at the end of the year.

It is interesting to note, however, the shallower discounts on offer on institutional-grade blocks, a reflection of the increasing interest in the PRS sector in some key city markets. In Q4 2013, the average discount on offer for purchase of whole-sale block in Manchester was 13%; this has now fallen to 11%. Likewise, average discounts in Birmingham have fallen from 14% to 12% over the same period.

The fundamentals for private rented sector investment blocks remained regionalised in 2014, with capital growth ranging from 3.2% in Bristol to 11.4% in outer London in Q4. Average rental growth was also spread over a wide range across the UK, not only by region but by type of property. Annual growth in rents in a typical 'secondary block' in London Zones 3-6 rose by 0.96%, while average prime blocks in Manchester saw annual rental growth of 2.99%.

The regions also commanded the highest yields, with average gross initial yields in Birmingham of 7.9%, and Leeds of 8%. In contrast, yields were tightest in central London, at 4.2%.

The index is comprised of rental data collected from large rental single-block properties classed as prime, median and economic. The classification of these blocks takes into account location, monthly rents and also the type of unit on offer – a prime block will have units in the most desirable areas. In contrast, economic blocks are the least expensive for tenants, but their capital value is also lower, indicating higher initial yields for investors.

GRÁINNE GILMORE
Head of UK Residential Research

"The shallower discounts on offer on institutional-grade blocks in some key city markets is a reflection of the increasing interest in the PRS sector."

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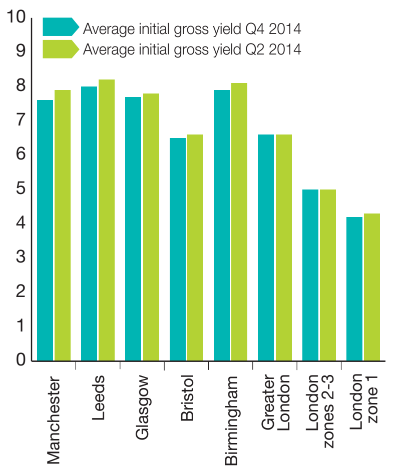
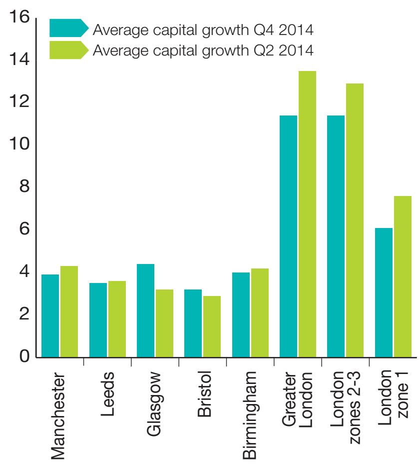
FIGURE 1
Average initial gross yields
Q4 2014 v Q2 2014



Source: Knight Frank Residential Research

FIGURE 2
Average capital growth
Q4 2014 v Q2 2014



Source: Knight Frank Residential Research

FOCUS: MANCHESTER

Lucy Jones, Head of Investment Lettings and Management

Over the past 12 months there has been a sustained increase in momentum within the PRS sector from both large institutional investors and smaller developers. As the investment market becomes increasingly familiar with PRS fundamentals, we have witnessed a notable rise in capital injections within key regional centres such as Manchester. Occupier demand for rental accommodation is strong in these locations, with good take up levels, low void periods and relatively high yields, as our index shows.

Due diligence remains a prerequisite amongst investors, meaning that financial viability modelling for proposed schemes has never been more important. We are also seeing divergence among clients about they type of approach they favour in terms of their investment. They may be planning to be 'hands on', which means we will respond with a different consultancy, lettings and management service to those who prefer a more 'hands off' approach.

One example of a scheme where we let and manage a rental block is Kennedy Wilson's 15 St John's Gardens development ("The Rock") in Bury, Manchester. We have now fully-let the second phase of the scheme. As anticipated, the building has been extremely well received by the market, with young professionals and couples 'Generation Rent' accounting for the majority of lets. The Rock is testament to the fact that the combination of good design, transport accessibility and an intensive marketing campaign really does produce an excellent PRS product. The launch of the final phase of 168 apartments takes place in April this year.

PRS Index

City	Average rental growth	Average capital growth	Average initial gross yields	Average discount
London zone 1	1.5%	6.1%	4.2%	7%
London zones 2-3	2.3%	11.4%	5.0%	8%
London zones 3-6	2.6%	11.4%	6.6%	10%
Bristol	1.7%	3.2%	6.5%	13%
Birmingham	2.5%	4.0%	7.9%	12%
Manchester	1.9%	3.9%	7.6%	11%
Leeds	2.2%	3.5%	8.0%	15%
Glasgow	1.8%	4.4%	7.7%	16%

Source: Knight Frank Residential Research

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