RESIDENTIAL RESEARCH

PRIVATE RENTED SECTOR INDEX

PRIVATE RENTED SECTOR TOTAL RETURNS RISE IN Q2 2014

The private rented sector index, encompassing key city markets across the UK, shows that initial gross yields have fallen slightly but capital growth has stepped up, resulting in higher total returns in the year to Q2 2014. Grainne Gilmore examines the latest trends in the market.

Key facts Q2 2014

Average initial gross yields six key cities of Leeds, Bristol, Birmingham, Glasgow, Manchester and London **at 6.4% in Q2 2014**

Gross yields range **from 4.3% in central London to 8.2% in Leeds in Q2 2014**

Average rental growth was **2.6% in year to end of June 2014, while average capital growth was 7.3%**

GRÁINNE GILMORE
Head of UK Residential Research

"Yields in the regional cities are outperforming those in London. With the pace of capital growth stepping up, total returns are rising."

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There has been a recovery in residential property prices across the UK over the last year. The pick-up in demand across the market is also reflected in our private rented sector (PRS) index, with the pace of capital growth for investment-grade rented blocks advancing to 7.3% in the year to the end of Q2 2014, up from 6.4% in the year to the end of Q4 2013.

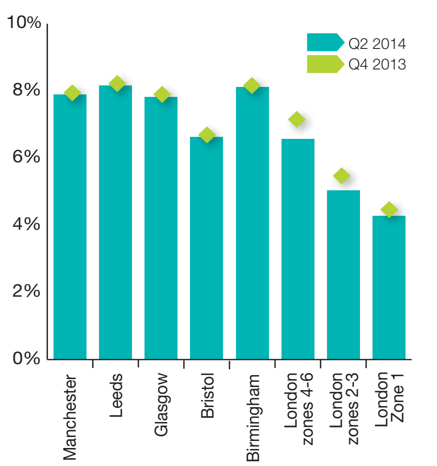
Capital growth has accelerated in every area we monitor over the last six months, with the exception of central London, where annual growth slowed from 9.5% in Q4 2013 to 7.6% in Q2 this year. However the outer zones of London experienced the biggest growth in capital values, with an average 13.5% rise in zones 3-6 rising in value by 13.5% and blocks in zones 2 and 3 rising by an average of 12.9%. (chart 1)

Rental growth has not quite kept pace with the rise in capital values however, with average rents increasing by 2.6% in the year to Q2. This is down from a rise of 2.9% in 2013. However the regional picture varies. London has seen rents picking up over the last six months from a low base. While there has been a slight moderation in regional rental growth, these city markets are still far outperforming the capital in terms of annual rental increases.

As a result, gross yields have been compressed slightly across the sector, falling to 6.6% in Q4 2013 to 6.4% in Q3 2014 taking the net yield from 4.9% to 4.8%. Returns are also regionalised, with the average gross yield in Manchester and Birmingham at 8.2% and 8.1% respectively, compared to a gross yield of 4.3% in central London (chart 2). The average net yield across the index is 4.8%, while the total return is 12.1%, up from 11.3% in Q4 last year.

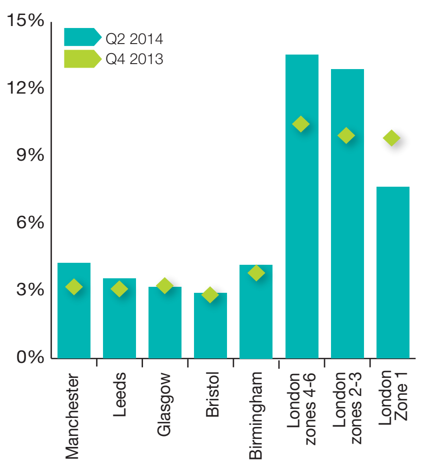
The index is comprised of rental data collected from large rental single-block properties classed as prime, median and economic. The classification of these blocks takes into account location, monthly rents and also the type of unit on offer – a prime block will have units in the most desirable areas.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

FIGURE 1
Average initial gross yields
Q2 2014



Source: Knight Frank Residential Research

FIGURE 2
Average capital growth
Year to end of Q2 2014



Source: Knight Frank Residential Research

LONDON FOCUS

Nick Pleydell-Bouverie, Partner, Residential Capital Markets

The market for tenanted residential investment blocks in London has been incredibly strong over the last 12 months. During this period, Knight Frank Residential Capital Markets has sold blocks varying in size from 3 units to 45 units worth more than £350 million to 14 different nationalities. Domestic demand from institutions has also stepped up this year, a further example of how the private rented sector is being seen as an increasingly attractive investment option. This trend is exemplified by the following Knight Frank deals:

56-60 Lancaster Gate, Central London

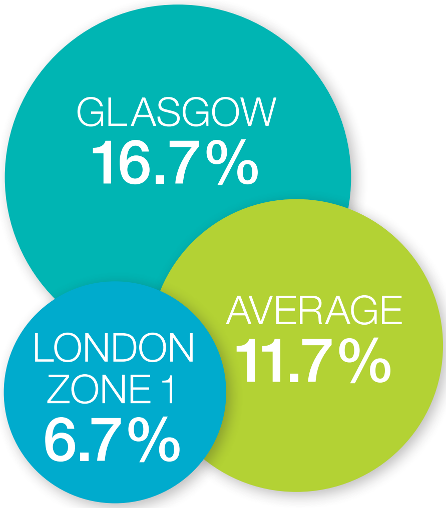
Wellcome Trust's purchase of 56-60 Lancaster Gate represented a further investment into the Residential Investment sector. The 32 apartments in the five adjoining terraced freehold properties are fully tenanted. The key drivers for investment included the good capital growth prospects in Bayswater, and the potential to add value through refurbishment and reconfiguration. The acquisition, completed for c.£60m with a yield of less than 3%, shows how the **appetite for central London property is still strong, linking into the demand for centrally located rented accommodation.**

Port East Apartments, Canary Wharf

Aberdeen Asset Management PLC invested around £17m in a residential block of 30 apartments in Canary Wharf. The Grade I Listed converted warehouse located on West India Quay provided a gross yield in the region of 5%. The drivers behind the purchase were the strong rental return and also the capital growth prospects, strongly linked to the opening of Crossrail in 2018 which will dramatically cut journey times across London, highlighting the **importance of transport links for existing and new units within the private rented sector.**

FIGURE 3

Average discounts for PRS investment



Source: Knight Frank Residential Research

PRS Index

City	Average rental growth	Average capital growth	Average initial gross yields	Average discount
London zone 1	1.7%	7.6%	4.3%	7%
London zones 2-3	2.0%	12.9%	5.0%	8%
London zones 3-6	3.6%	13.5%	6.6%	10%
Bristol	3.1%	2.9%	6.6%	14%
Birmingham	2.1%	4.2%	8.1%	14%
Manchester	4.0%	4.3%	7.9%	13%
Leeds	4.2%	3.6%	8.2%	16%
Glasgow	1.5%	3.2%	7.8%	17%

Source: Knight Frank Residential Research

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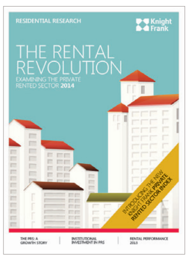

Private Rented Sector Report 2014

London Development Report 2014

Prime Central London Rental Index Jul 2014

Crossrail Report 2013

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