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Q2 2014

RESIDENTIAL INVESTMENT MONITOR

- Pace of growth in capital values slowing standing 15.9% ahead of 12 months earlier.
- Rental value growth well ahead of long term trend at 2.5% over the year to the end of the second quarter, albeit with a slight tempering of the upturn in Q2.
- Gross residential yields fall further on the strength of capital values to 3.2% providing further impetus to value seeking investors.

Top performing submarkets

Capital value growth over 12 months to the end Q2 2014

Clapham	30%
Maida Vale	28%
Battersea	26%
Wandsworth	24%
St John's Wood	21%

Source: Cluttons

Signs of the inevitable slowing in capital value growth

Average house prices across the capital grew by 3.2% during the second quarter, half the unsustainable level of growth seen in Q1, although enough to push values nearly 16% higher than the same point last year. While the slowing pace of price inflation remains ahead of the long run average, we believe it is a marker for a change in tone in the market. The average value of a prime Central London home has now exceeded the £2 million milestone. Concerns over the sustainability of values, combined with affordability thresholds, have been magnified by the new Mortgage Market Regulations, leaving a growing number of potential buyers by the wayside.

The greatest pressure on capital values in prime Central London is being seen in locations popular with professional families. This is also being mirrored in markets that sit just outside the prime Central London core, such as Clapham, Battersea and Wandsworth which have all seen particularly strong growth. On average this area has seen values rise by 25.6% over the 12 months to the end of June. In a trend common to family markets across prime Central London, these high demand villages are seeing an increasing number of households opting to remain near schools and social networks, while extending and improving homes where possible. We do not see this trend changing given Stamp Duty thresholds and other tax proposals unsettling the market in advance of next year's election.

Turning point in rental growth

The pace of average rental growth seen across prime Central London in Q1, while not maintained in Q2, remained positive at 1.7%, ahead of both inflation and the long term trend. This translates to a growth in average rents of 2.5% over the 12 months to the end of June. This average masked a mixed and evolving picture of activity in the capital.

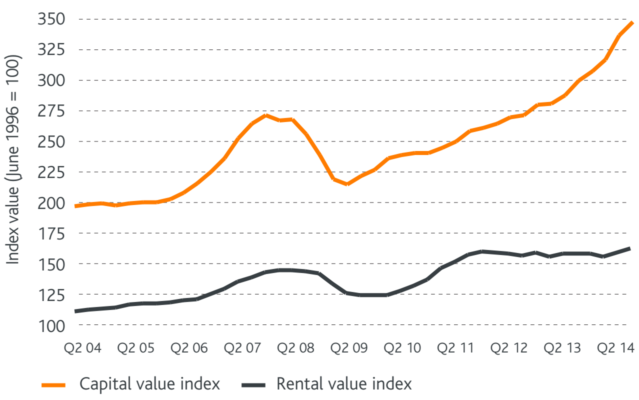
Areas in high demand by professional families as well as those offering greater value for money for couples and sharers saw a more marked upturn in rents. As in the sales market, areas such as Battersea, Clapham and Wandsworth have seen particularly strong demand for family homes, with average rents for such properties in these village markets rising by 22% in Q2, following four years of little change. Over 40% of our new tenancies in these areas have been for families with children. Many have either opted to rent while they compete to buy a home in the area, or have been priced out of the house market and have chosen to rent in order to remain close to schools and their local community infrastructure. Those who have successfully managed to secure a family home in the area are often choosing to sit tight, driving a record level of tenancy renewals and further depleting potential stock.

Areas such as the Isle of Dogs and Surrey Quays/Rotherhithe have also seen above average rental growth. The strengthening employment market in the City in particular, but also ongoing growth in the media and telecoms sector, have driven demand for well located flats in these markets perceived to offer good value for money. This is reflected in our tenant demand statistics for the areas in close proximity to the City and Canary Wharf, which show a sharp upturn in properties taken by households working in the banking and finance sectors as well as law. Less than half are British, but the majority have been living in London prior to taking their most recent rented property. Generally they are single, in their 20s or 30s and looking for a studio, or one bedroom property. Relocation agents also remain active with corporate budgets markedly improved on those prevalent over the last couple of years.

Yields at historic low

The variance in our rental and capital value indices at the end of Q2 2014 stands at an historic high. This is reflected in our average calculated gross yield which has dipped to 3.19%. The average yield for flats and houses at the end of the second quarter stood at 3.48% and 2.26% respectively, representing a marginal narrowing in disparity between the two. Reflecting the current dynamics of tenant demand, the markets most conveniently positioned relative to the City and Canary Wharf are currently amongst the highest yielding in prime Central London.

Capital and rental value indices



Source: Cluttons

Top performing submarkets

Rental value growth over the 12 months to the end Q2 2014

Battersea	28%
Isle of Dogs	21%
Wandsworth	18%
Surrey Quays / Rotherhithe	18%
Knightsbridge	13%

Source: Cluttons

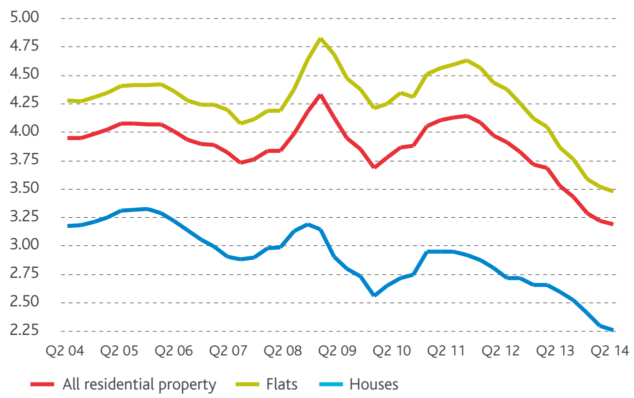
Highest yielding submarkets

Gross calculated yields for flats, Q2 2014

Rotherhithe / Surrey Quays	5.42%
Isle of Dogs	5.41%
Maida Vale	4.67%
Limehouse	4.36%
St. John's Wood	4.29%

Source: Cluttons

Gross residential yields



Source: Cluttons

Further expansion in private investor activity

Despite rising capital values and the growing prospect of a base rate rise later this year, the private investor market has seen sharp acceleration in activity over the last 12 months, adding to the steady growth seen since 2011 as illustrated in the graph. In April, 8,400 buy to let loans were issued for property purchase. When compared to the same point last year, this reflects a 43% increase in the number of loans and 57% increase in the overall value. This upturn in activity is also reflected in the results of a survey by the National Landlords Association (NLA). This found that a quarter of 'amateur' landlords, who comprise over 70% of the private rented sector, plan to add to their property portfolios. These landlords surveyed by the NLA reported an average portfolio size of four, although this figure masks a long tail of landlords owning just one or two properties. As the strong appetite for residential assets persists, alternative routes to investment are emerging to meet the needs of both retail and institutional investors.

Broadening range of investment opportunities

During the last quarter Brandeaux disposed of its prime Central London reversionary and direct residential investments. The sale presented acquisition opportunities for Central London specialists building on existing portfolios in the capital.

However, aside from such strategic acquisitions, investment in the capital's prime core has been dominated by overseas investors and focused on trophy assets, or those with a development driven capital growth, rather than income story. In the London commuter zones, particularly 2 and 3, as well as core economic centres outside the South East, investment activity continues to be buoyed by the prospect of improved rental growth.

Intermediate and affordable housing offering an attractive return profile for institutional investors in particular continues to attract interest. In the latest in a series of loans to housing providers, Legal & General has agreed a £40 million loan to Rooftop Housing Group to fund the development of up to 900 affordable homes by 2018. It is also notable that there is growing interest amongst local authorities to bring the development and management of affordable housing in-house. A spectrum of models is likely to evolve but with investor interest in the affordable homes sector it is likely one such model will encompass life or pension fund partners.

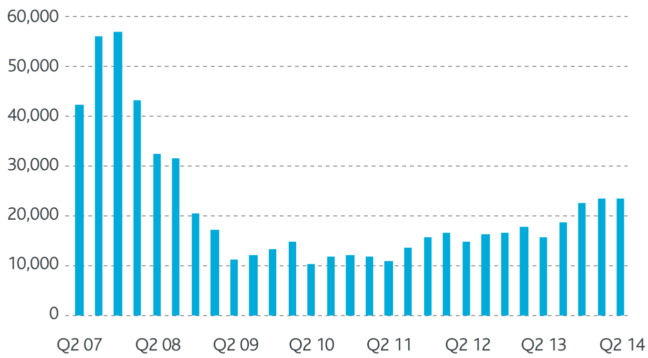
The prospect of residential REITs continues to attract attention and there is considerable work underway in the background to address some of the largely tax based stumbling blocks. While the appetite for investment vehicles that have come to the market has proved mixed, successful listings are inevitable over the coming years with the maturation of the sector. The next test case will be Urban Exposure's planned £500 million IPO in the form of Urban Exposure Investment Management.

Prime central London residential

	Q 2 2014	Q1 2014	Q4 2013
Gross residential yield	3.19%	3.22%	3.29%
Capital value growth	3.15%	6.20%	3.00%
Rental value growth	1.68%	2.30%	-1.50%

Source: Cluttons

Number of BTL loans advanced for purchase



Source: CML

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