Real Estate

Source: Refinitiv

Market data

EPIC/TKR	**RESI**
Price (p)	**95**
12m High (p)	98
12m Low (p)	86
Shares (m)	171m
Mkt Cap (£m)	162m
EV (£m)	243m
Free Float*	100%
Market	LSE

*As defined by AIM Rule 26

Description

ReSI invests in UK private independent living retirement properties, shared ownership and local authority homes. Its subsidiary ReSI Housing is a registered provider. It does not manage stock and uses experienced third-party managers.

Company information

Fund Manager	Ben Fry
CEO of TradeRisks	Alex Pilato
CEO ReSI Housing	Mark Rogers
CEO ReSI Capital	Jon Slater

+44 (0) 20 7382 0900
www.resi-reit.com

Key shareholders

Harris Allday private clients	10.1%
Close	7.8%
Aberdeen Standard	6.4%
Tilney	4.4%
West Yorkshire pensions	4.0%
Management and Directors	1.5%

Diary

Mid Aug'19	3Q div. declaration
Nov'19	Final results
Jan'20	AGM

Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

RESIDENTIAL SECURE INCOME

Inflation-linked dividends from positive social impact

96% of Residential Secure Income plc (ReSI) income is inflation-linked. ReSI is an REIT invested in UK residential sectors. At IPO, it projected a 3.0p dividend in year one and 5.0p thereafter; it is on track, with 2.5p in 1H'19. The equity is fully deployed in assets, primarily in southern England, with a geared equity average yield of 6.7%. With a mix of sectors – all residential – there is a spread of investment drivers; but, income streams benefit from below-market rents ensuring ongoing tenant demand or from less economically sensitive tenants. Shared owners risk their part ownership on any rent default. Local authority housing is via eight-year leases in refurbished properties.

- **Strategy:** ReSI invests in shared ownership residential, retirement and local authority homes, sectors with high covenant strength and predictable, growing income streams. It has secured experienced and credit-worthy property managers and the social housing regulator controls its subsidiary.

- **Achievement:** The £180m IPO proceeds were invested by summer 2018. The current portfolio comprises £320m assets (£257m at March 2019 balance sheet) in 2,674 units. There is a strong pipeline, especially in shared ownership. Asset management openings such as a lease extension have added value.

- **Valuation:** Several UK REITs target secure long-term income streams. We calculate their average rating to be 103% NAV. ReSI's strong prospects make the rating anomalous. Equity is fully deployed; it has reached initial dividend targets thus validating its IPO total return target of 8% plus.

- **Risks:** Leases vary in length, end-dates often at tenant discretion. Ca.40-year debt secured on shared ownership will be RPI-linked (mirroring built-in RPI+0.5% rent escalators); other debt, mostly 25-year fixed. IPO, naturally, had deployment risk but equity is invested, and a 50% LTV target now the aim.

- **TradeRisks – the manager:** TradeRisks provides risk management and other advice/debt financing globally within the housing, social infrastructure and public sectors. There is thus a team of nearly 30 people at TradeRisks and ReSI Capital Management combined, led by Alex Pilato, TradeRisks' group CEO. The management fee is 1% on the first £250m of NAV, tapering thereafter.

Financial summary and valuation

Year-end Sep (£m)	1H18 [1]	2H18	FY18	1H19
Income	3.78	6.63	10.41	9.64
Net property income	1.95	3.75	5.70	6.07
Revaluation	3.24	11.58	14.82	5.27
Finance income (cost)	-0.01	-1.06	-1.07	-2.03
EPRA profit	0.08	1.20	1.28	2.45
EPRA EPS (p)	0.05	0.66	0.71	1.43
Statutory EPS (p)	1.84	7.18	9.02	4.50
Dividend per share (p)	1.50	1.50	3.00	2.50
Net (debt)/cash	76.62	-39.77	-39.77	-81.27
Loan-to-value ratio (net)	cash	21.5%	21.5%	35.6%
EPRA NAV	98.80	105.10	105.10	107.90
Dividend yield	Half year	-	3.2%	Half year

1: Period from 12 July 2017

Source: Hardman & Co Research

Strategy and returns

ReSI investment case drivers:

Rental income linked to RPI

- Investor demand for inflation-linked income.

ReSI's target is focused on specific segments

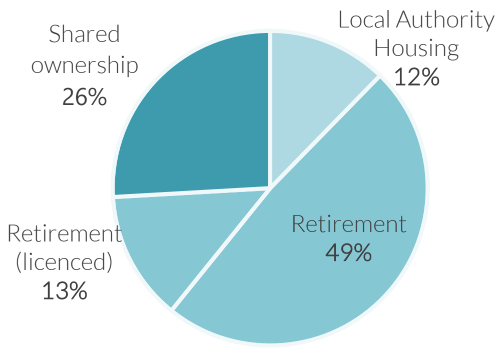
- ReSI's investment targets the UK's housing shortage.

Contractually RPI+0.5%

- Shared ownership is acquired by ReSI through the planning system (section 106 arrangements, see below) and from private developers. ReSI's subsidiary is an RP (registered provider) and can access grant funding to convert private units into shared ownership (thus delivering affordable housing above that which planning requires). RPs' increasingly constrained balance sheets limit their retention of such assets. This all helps drive the beneficial value for ReSI at purchase.
- Retirement housing for lifetime-secure rent is a very small market in terms of supply but makes eminent sense as a major alternative to ownership.
- Local authorities (LAs) are increasingly reliant on expensive interim solutions (such as hotels/B&Bs) to house their constituents and so long leases at around market level are in high demand.

All assets benefit: rents are at or below-market levels, ensuring ongoing tenant demand; diverse income streams from less economically sensitive tenants and/or strong counterparty covenants and managers

Asset allocation



Source: Hardman & Co Research

What ReSI (a REIT) offers investors

A real estate investment trust

- 96% of ReSI's income is directly or indirectly inflation-linked (majority RPI).

5.1% yield on gross monies deployed

- It has achieved a 5.1% yield on gross capital deployed, with the benefit of particularly strong covenants (see below). Note, this figure is after due allowance for all (including cyclical) maintenance capital expenditure. While these are not ultra-long leases, Hardman & Co expects the blended average stay will prove to be about five to seven years, with some of the assets such as shared ownership being purchased at below open market costs and then eventually disposed of at market when tenants choose to purchase an additional stake in their home through the procedure termed "staircasing".

Yield on equity (geared) usefully over 6%

Shared equity debt is index linked (as is its income)

- ReSI is designed to pay 5.0p dividend (2017 IPO at 100p), growing at least with RPI and with a target total return in excess of 8%. Latest half-year paid 2.5p. The retirement rental portfolio, (post leverage), delivers a leveraged yield of 6.8%. The Local Authority housing portfolio, which is also leveraged, produces a leveraged yield of 6.7%. Shared ownership has a slightly lower initial yield but "built-in" capital appreciation potential, being purchased usefully below open market value.

Good growth prospects

- Shared ownership is a growing part of the portfolio. The forward pipeline includes a Housing Investment Partnership with Morgan Sindall, the developer.
- There is an identified near-term pipeline (in all asset classes) of more than £500m. At launch, one element of the ReSI pipeline did not follow through and it now has strong growth visibility. Growth momentum is proven.

The assets: more detail

We anticipate acquisitions in all four types; however, from now on, we expect them to be strongly weighted to Shared Ownership. Note that the Retirement (licensed) category is the block managers' accommodation, whereas Retirement is made up of elderly tenants (in Assured Tenancies), who typically remain in situ for around five years.

ReSI has appointed an experienced manager

The retirement rental segment has a £181m book cost, comprising 1,929 retirement rental homes within 640 purpose-built retirement housing blocks, plus 290 licensed rental homes. These are used to house the property manager. By definition, the latter cannot have meaningful voids. More than 80% of the portfolio is located in southern England (minimal central London). There is a new 10-year management and maintenance agreement in place with Places for People group a leading not-for-dividend RP, owning or managing 189,000 homes. RPs are government-regulated organisations providing homes. The risk of not filling empty properties which are available for rent should be modest as stock of retirement rental properties is very low.

Risk of void should be low

5.4% net initial yield; debt cost 3.5%; leveraged yield 6.8%

Annualised net rent, after ground rents, is £9.7m and yields 5.4%. ReSI secured £97m of 25-year partially amortising fixed-rate debt at a coupon of 3.46%. This takes the leveraged yield to 6.8%.

Specialist retirement accommodation addresses loneliness issues, the largest health problem for the elderly population, and supports independence for longer. Renting enables people to avoid the burdens and transaction costs of home ownership whilst freeing up large family homes for families.

Shared ownership characteristics:

ReSI can draw grants to support delivery of private units as shared ownership

The shared ownership segment is acquired by ReSI: i) through the planning system; and ii) also with government grant funding available to convert use from private to social. We believe ReSI has drawn £1m to date and will draw a further £5m on a project's practical completion. Grants can only be accessed by an RP and ReSI has achieved registration qualifying as a for-profit RP through its subsidiary ReSI Housing Ltd.

Tenants' rents stand at or below open market value

The sector enables individuals and families to take first steps onto the housing ladder with lower deposit requirements and annual payments than Help to Buy or an outright purchase. Much shared ownership (for ReSI and others) is in London. Shared owners benefit from a rent subsidy of £86,000 net present value on a £500,000 home. Much of this subsidy is from the government as opposed to ReSI; however, rental yields for ReSI's shared ownership assets are below those for the other segments. Shared ownership lease lengths are, by definition, unknown (the tenant may exercise the right to buy-in).

This reduces covenant risk to de-minimis levels and also introduces a long-term valuation escalator

The benefit to ReSI is a "copper-bottomed" covenant as, were the rent to be in default, the occupier would potentially lose the whole asset. Shared owners have the option to staircase (i.e. to purchase a bigger share in the property at the then market value), crystallising expected valuation growth for ReSI. Yield on cost stands at 3.4% but it is

Net initial yield thus is below open market: 3.4% but debt can be RPI-linked matching rent escalators anticipated that debt will be taken on index-linked at 0.3% cost giving a leveraged yield on cost of 6.5%. In this context, it is important that rents are index-linked.

The chairman states: "Shared ownership presents a very scalable investment opportunity, and we expect to be focussing our future deployment in this area."

Good yield; some eventual contractual void risk but nil anticipated; valuation is not above vacant possession

The Local Authority housing portfolio, which is also now leveraged, produces a leveraged yield of 6.7%. This comprises stock refurbished in 2016 and 2017 and with a weighted average remaining lease term, to Luton Borough Council, of 8.0 years. The Local Authority housing portfolio provides a cost saving of £200 per unit per week to local authorities compared with a room in a hotel or bed & breakfast. The yield at cost, through two acquisitions totalling £34m, exceeded 5% and a leveraged yield of 6.7%.

Risks and mitigation

The ratio of gross to net is important in real estate but can be particularly tasking in residential. There is refurbishment needed between tenancies in the retirement sector. This is readily modelled and is factored into the stated yields.

There may be legislative changes in any aspect of business and there are none anticipated here; however, retirement housing is a high-profile business. Issues there have surrounded service charges and ground rents, both of which are totally irrelevant to ReSI leases. Maintenance is outsourced to a leading supplier (of scale and reputation).

House prices are potentially volatile. The market in individual retirement home flats is notoriously illiquid. ReSI assets are typically purchased at and valued at a discount to their vacant possession value. ReSI's target returns are based only on rental income.

The commercial market in specialist residential assets is at an early stage. This brings opportunities as well as risks. The pedigree of TradeRisks, the manager, is encouraging. It is a risk advisory firm and financing arranger, focused specifically on social housing and other specialist residential property and social infrastructure sectors with an 18-year track record. TradeRisks has advised on and arranged funding of over £10bn for social housing and other specialist residential property.

Financial summary

Year-end Sep (£m)	1H18[1]	FY18	1H19[2]
Gross rental income	3.78	10.41	9.64
Property operating expenses	-1.83	-4.72	-3.57
Net property income	1.95	5.70	6.07
Administrative expenses	-1.86	-3.35	-1.59
EPRA3 EBIT	0.09	2.35	4.48
Revaluation	3.24	14.82	5.27
Finance cost	-0.01	-1.07	-2.03
Reported profit before and after tax	3.32	16.11	7.72
EPRA profit before and after tax	0.08	1.28	2.45
Statutory EPS (p)	1.84	9.02	4.50
EPRA EPS (p)	N/M	0.71	1.43
Dividends per share (p)	1.5	3.0	2.5
Net (debt)/cash	76.62	-39.77	-81.27
Loan-to-value ratio	cash	21.5%	35.6%
Shares in issue (average) (m)	180.22	178.54	171.62
Investment properties	139.07	252.87	1H19[2]
NAV share (p)	98.8	105.1	107.9

1 Period 12 July 2017 to end-March 2018; 2 Reported 20 May; 3 EPRA European Public Real Estate Association *Source: Hardman & Co Research*

Notes

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/legals/research-disclosures. Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

(Disclaimer Version 8 – Effective from August 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com