

Alpha small company research

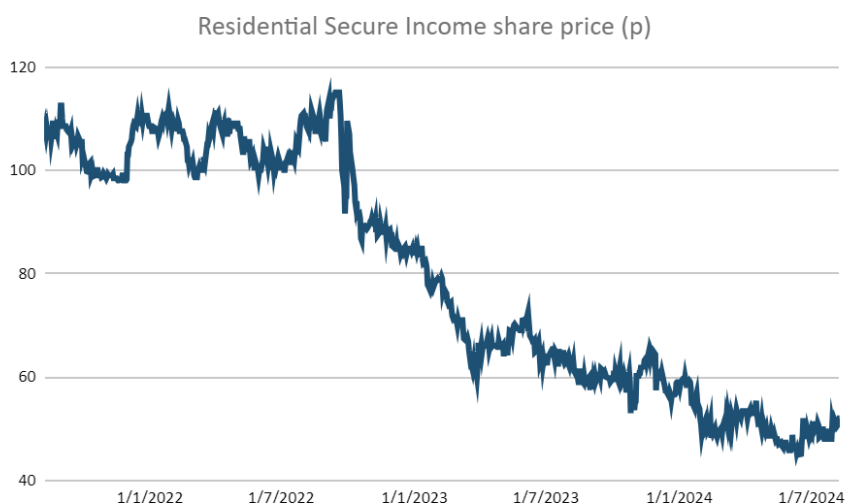
12 August 2024

A high-yielding property recovery play

'This well-managed Reit is set to benefit from strong structural tailwinds for its affordable shared ownership and retirement homes, and improving investor sentiment.'

Simon Thompson's view:

The sharp downturn in the listed commercial property sector is bottoming out as expectations of interest rate cuts, lower inflation and enhanced debt financing opportunities improve investor sentiment. The fall in property valuations in the past two years has been driven by a spike in property yields due to the sharp rise in gilt yields. However, with the spread that yields from real estate offer over the risk-free rate (i.e., the 10-year gilt) now back to its long-term average, this looks an opportune time to lock in the high dividend yields from quality real-estate companies. With an 8 per cent dividend yield and trading 38 per cent below net asset value (NAV), this property investment company offers just that.



Source: LSEG

Bull points

1. Strong structural tailwind for affordable housing.
2. Labour government supportive of the sector.

3. High occupancy and rent collection rates.
4. Low long-term cost of debt.
5. Substantial reversionary surplus is not reflected in the NAV.
6. Potential for positive yield shift as gilt yields fall.
7. Inflation-linked rent reviews.
8. Sale of local authority housing to pay down debt.
9. High dividend yield.
10. Potential for cash returns from future property disposals.

Bear points

1. Liquidity.
2. Rebased dividend.
3. Property disposal needed to pay off a maturing loan.

Residential Secure Income (RESI)	
Ticker	RESI
Current mid-price	51.5p
Bid-offer spread	51.2 - 51.8p
Target price	67.5p
52-week high	66p
52-week low	45p
Market cap	£95.4mn
Net debt	£175mn (30 June 2024)
Loan-to-value ratio	52 per cent (30 June 2024)
Rolling 12-mth dividend	4.12p a share
Dividend yield	8 per cent
EPRA Net asset value (NAV)	£142mn (76.7p)
IFRS NAV	£154.8mn (83.6p)
Discount to IFRS NAV	38.4 per cent
Shares in issue	185.2mn
Financial year-end	30 September
Next event	annual results December 2024
Website	https://greshamhouse.com/real-assets/uk-housing/residential-secure-income-plc/

Source: London Stock Exchange and company filings

The UK faces an acute shortfall of affordable homes with an estimated £34bn of annual investment needed in the sector, according to the British Property Federation (BPF) and Legal & General ('Delivering a Step Change in Affordable Housing Supply', March 2022).

The scale of the challenge ahead is immense: there are more than 1.2 million households waiting for affordable housing, and an increasing shortfall between the number of affordable homes available and the number required to meet this need. Research from the National Housing Federation and Crisis estimates the level of housing needed at 145,000 new affordable homes a year, or 95,000 more than are being delivered in England.

Not-for-profit housing associations have a maximum long-run capacity to deliver 77,000 homes per annum due to limits on indebtedness and interest cover, in particular. However, housing associations, which have historically been the primary investors in affordable housing, are now dealing with rent caps on their social and affordable rental portfolios in addition to allocating £10bn for fire safety and £25bn to upgrade the energy efficiency of their social rented stock by 2030. These financial pressures impact housing associations' ability to continue to fund their 43,000 homes per year development programmes, with many now looking to bring in partners to acquire some of their existing 200,000 shared ownership homes.

Furthermore, building 145,000 homes per annum will cost more than £50bn, and require £10bn of additional equity funding and £9bn-£14bn of additional subsidy per annum, depending on the tenure mix. Other than drastically increasing the level of subsidy per unit, only new equity investment entering the sector can overcome the sector's financial limitations and deliver the step change required. Equity can reduce pressure on borrowing limits, stabilise the sector's balance sheets and spur on a sustainable increase in development.

The solution to the affordable housing crisis is partnership between government, housing associations, and institutional investors. For-Profit Registered Providers were first permitted under the last Labour administration, which passed legislation in 2008 to expand the availability of choice of provider at all levels in the provision of social housing. The legislation allows For-Profit Registered Providers to own social housing and receive a social housing grant, thus enabling institutional investors to play a greater role in the provision of social and affordable housing.

Importantly, the aims and objectives of institutional investors are closely aligned with the societal purposes of affordable housing, with investors benefiting from a long-term cash flow and households benefiting from security of tenure and high quality affordable accommodation.

Bearing this in mind, the new Labour government has recognised the need to address the country's housing crisis and has set an aggressive target of building 1.5mn new homes over the next parliament. Notwithstanding the requirement for greater private sector participation and collaboration to get anywhere near to hitting that ambitious target, the other major issue is that the UK simply lacks the manpower to build 300,000 new homes each year.

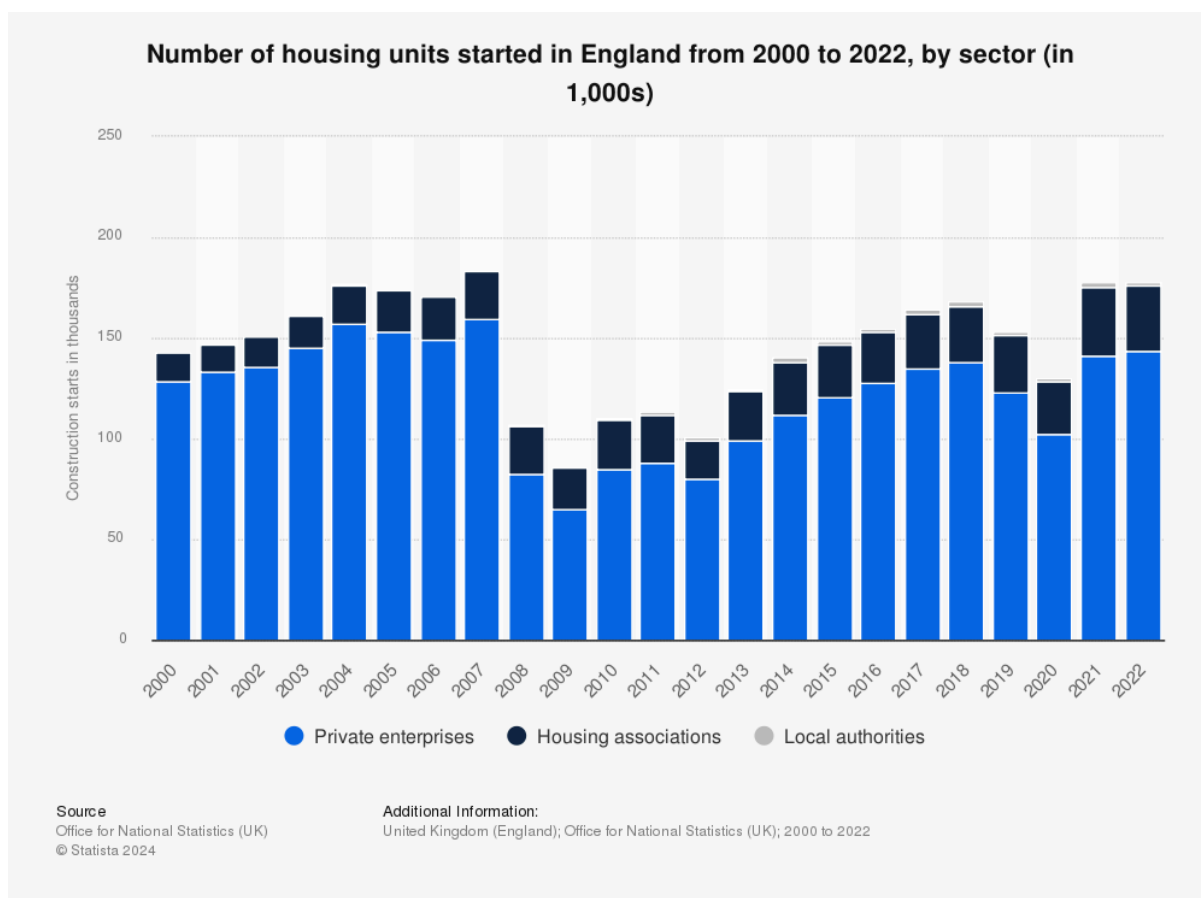


Indeed, the number of workers employed in the UK construction industry has declined by more than 0.5mn from a peak of 2.6mn in 2006 when the country employed significant numbers of foreign workers pre-Brexit. It also reflects a skills shortage as construction workers have left the industry due to retirement or sought more stable employment in other sectors.

The other obvious challenge facing the new Labour government is that even during the housing boom years in their last term of office, the maximum number of new homes built in England never exceeded 185,000, of which private housing accounted for more than 80 per cent of the total. England accounts for more than 80 per cent of the UK's population, so it takes a leap of faith that house builders can somehow build 300,000 new homes with a much reduced labour force.

That said, by easing up planning restrictions and bottlenecks, the new government can quickly implement self-help measures that will assist. It's also reasonable to expect Labour's push to deliver more affordable homes will bring in new institutional capital into the sector, assuming funding terms are acceptable.

Either way, the backdrop is undoubtedly favourable for one below-the-radar real estate investment trust, **Residential Secure Income (RESI)**, that offers investors secure inflation-linked returns by focusing on two resilient sub-sectors of the UK residential market: affordable shared ownership housing and independent retirement rentals. The sectors are underpinned by an ageing demographic and untapped, strong demand for affordable home ownership.



Investment objective

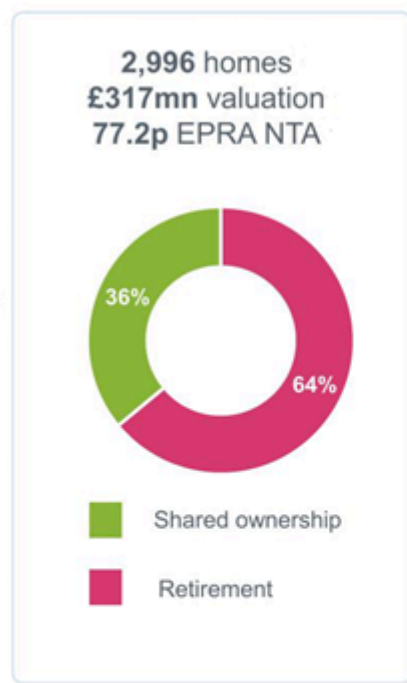
In July 2017, the company raised £180mn at 100p a share when it listed on the premium segment of the main market of the London Stock Exchange. The company's strategy is to deliver a long-term, inflation-linked annual dividend by investing in affordable, safe, high-quality homes.

Specifically, ReSI aims to make a meaningful contribution to alleviating the UK housing shortage by meeting demand from housing developers (housing associations, local authorities and private developers) for long-term investment partners to accelerate the development of socially and economically beneficial affordable home ownership to young families and key workers.

The key differentiators of the company's investment approach are:

- Secure rents underpinned by pensions, housing welfare or shared owner stakes.
- Diversified income stream from thousands of homes and residents.
- Over £30,000 of government subsidy received for each new shared ownership home delivered through the company's wholly-owned For-Profit Registered Provider of social housing, allowing the company to provide below-market rents to residents compared to private rented housing.
- Unique proprietary shared ownership customer and environmental charters maximises social impact.

Residential Secure Income portfolio by location



Diversified by tenure and location



Source: Residential Secure Income interim results (18 June 2024)

Shared ownership housing

Excluding a portfolio of local authority properties that is currently in the process of being sold (see 'Disposals' section below), ReSI is solely focused on shared ownership housing and independent retirement rentals.

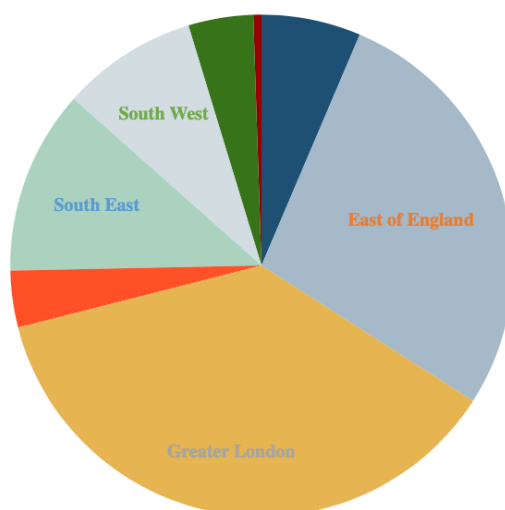
The shared ownership portfolio consists of 758 homes that have an average vacant possession valuation of £330,000 and account for 36 per cent of ReSI's total portfolio valuation. Homebuyers purchase a 25 per cent share of the residential property and pay a below market rent on the remaining 75 per cent owned by ReSI. Typically home buyers fund their initial equity stake with a 90 per cent mortgage and are responsible for maintenance, repair and insurance, creating a strong alignment of interest.

Shared ownership is required to be affordable to incoming shared owners, which typically means no more than 40 per cent of post-tax income of new shared owners can be spent on total housing costs (mortgage, rent and any service charge). The average monthly rent of ReSI's properties is £483. Shared owners have the option to staircase their equity interest by purchasing a larger

share in the property at the then market value, thus releasing bulk discounts to ReSI as well as reducing the share of the property they pay rent on. The portfolio has an average shared ownership stake of 38 per cent.

There are 252,000 shared ownership homes across England, and around 20,000 new shared ownership homes are delivered annually, making it one of the fastest growing housing tenures.

Shared ownership housing portfolio by region



Source: Residential Secure Income

Effectively, shared ownership opens the door to homeownership for home buyers who would otherwise be unable to afford to make a purchase, provides lifetime security of tenure through long-term leases and creates additional sub-market rental homes that the UK urgently needs. It's possible because ReSI receives capital grant funding from the UK government that enables it to offer a 30 per cent living-cost discount compared to market levels rents, making rents more affordable.

This is reflected in a net yield of 4 per cent that the properties generate for ReSI, although with the benefit of leverage the levered yield is 8.2 per cent. On the shared ownership portfolio, ReSI has borrowed £76mn from the Universities Superannuation Scheme (USS) with the debt inflating in-line with the RPI-linked rent in ReSI's leases. The USS borrowing facility has more than 40 years to maturity in May 2065, and has an average interest rate of 1.1 per cent.

However, the principal increases at a rate of the Retail Price Index (RPI) plus 0.5 per cent per annum, but with RPI capped at 5 per cent. The debt has an amortised cost of £87.3mn, but the rising rental income underpins valuations and means that the equity ReSI holds in the properties at their open market valuations is material. The 758 properties have an open market vacant possession valuation of £250mn, of which the shared ownership 38 per cent stake is £95mn. It

means that ReSI's share is worth £155mn, or £40mn (21p a share) more than the £115mn valuation of the properties in its latest accounts. Clearly, the properties would have to be sold on the open market to release the reversionary surplus, but it does highlight significant hidden balance sheet value.

Rising cost of living: the impact on our residents



Costs for our residents increasing at a slower rate when compared to alternative open market tenures

Shared ownership

- 2023 shared ownership rent increase capped at 7%, below average private rental sector growth of 11%
- Shared owners are less exposed to rising mortgage rates than outright owners when refinancing
- Efficient homes will save residents £55 per month on energy bills compared to average UK property

		2022	2023	Increase	%
Typical ReSI Shared ownership resident refinancing at today's rates	Rent and service charge	7,688	8,226	538	7%
	Mortgage costs	3,579	4,644	1,066	30%
	Energy bills	1,261	1,173	-88	-7%
	Total	12,527	14,043	1,516	12%
Typical ReSI Shared Ownership resident with fixed rate mortgage	Rent and service charge	7,688	8,226	538	7%
	Mortgage costs	3,579	3,579	-00	0%
	Energy bills	1,261	1,173	-88	-7%
	Total	12,527	12,978	450	4%
Average UK outright owner	Mortgage costs	14,315	18,577	4,263	30%
	Energy bills	1,971	1,834	-137	-7%
	Total	16,286	20,411	4,126	25%
Average UK rental accommodation	Housing costs	14,700	16,244	1,544	11%
	Energy bills	1,971	1,834	-137	-7%
	Total	16,671	18,078	1,407	8%

Source: Residential Secure Income 2023 annual results

Occupancy rates are 100 per cent, which is hardly surprising given the spike in mortgage rates and private rents in recent years has been fuelling demand for more affordable homes. Rent collection continues to exceed 99 per cent, so arrears are miniscule across the diversified resident base.

Shared ownership inflation-linked rents increased 7 per cent in April 2023, well below the 12.3 per cent annual increase that it could have made, to match the cap that the government applied to general needs housing properties. However, ReSI chose to pass on the full contractual 8.3 per cent rent increase (RPI plus 0.5 per cent) to its tenants this year after taking account of easing energy prices and the fact that shared owners are relatively insulated from the spike in mortgage costs compared with non-shared homeowners.

The increase in interest rates in the past three years has made the ambition of homeownership more expensive for all first-time buyers, but the impact is less severe for shared owners compared to those who own outright. That's because shared owners only initially acquire a portion of their home, so the size of the mortgage required to purchase their equity stake is typically much lower than someone buying a property outright. As a result, prospective shared owners are less

exposed to a rise in interest rates compared to typical first time buyers. The cost increase from a rise in interest rates for new shared owners is only one quarter of the increase experienced by a first time buyer purchasing a property outright.

ReSI's shared ownership portfolio generated annual net rental income of £5mn in the 2023-24 financial year, and in the latest interim results reported 8.3 per cent growth in this key metric to £2.6mn.

Shared ownership portfolio performance



Accelerating demand

- Fully occupied and income generating
- Rising mortgage rates and private rents fuelling demand

Secure income

- Underpinned by c.37% average shared ownership stake
- 99% rent collection

Strong rent growth

- Rents increase at RPI + 0.5% annually
- Apr 2024 increase of 8.3% in-line with earnings growth (April 2023: 7%)

H1 2024 key metrics	
Homes / Value	758 / £115mn
Occupancy	100%
Like-for-like rent increases	+6.8%
Margin	94%
Unlevered net initial yield	4.0% ²
Average VP Value	£330,000 per home
Average resident stake	38%



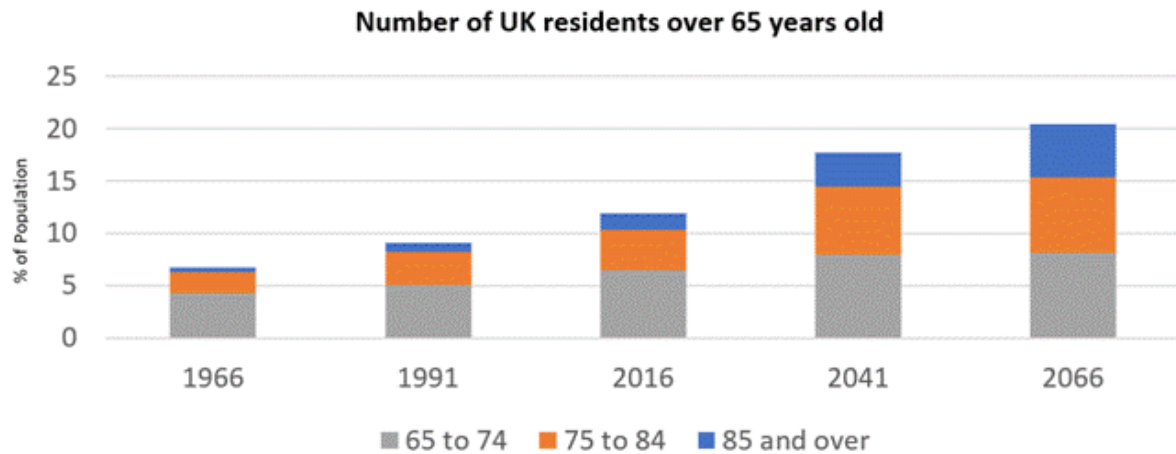
Source: Residential Secure Income interim results (18 June 2024)

ReSI's direct-let portfolio is relatively modern and energy efficient. The average build age is 19 years and 98 per cent of the properties have an EPC energy efficiency rating of C or above.

Retirement property portfolio

ReSI also owns the UK's largest retirement rental portfolio, providing 2,238 fit-for-purpose homes for retired people that allows them to maintain their independence without care provision.

Retirement living is a key solution to tackle the social isolation that is impacting an ageing UK population. The demographic of over 65 is expected to increase by almost 50 per cent within 40 years ('Housing for An Ageing Population Report', BFP and Cushman & Wakefield, 2023). Living with peers not only helps address loneliness, the largest mental health problem for an elderly population, but frees up large family homes, too. A survey by ReSI revealed that 60 per cent of residents have experienced an improvement in mental health.



Source: ONS

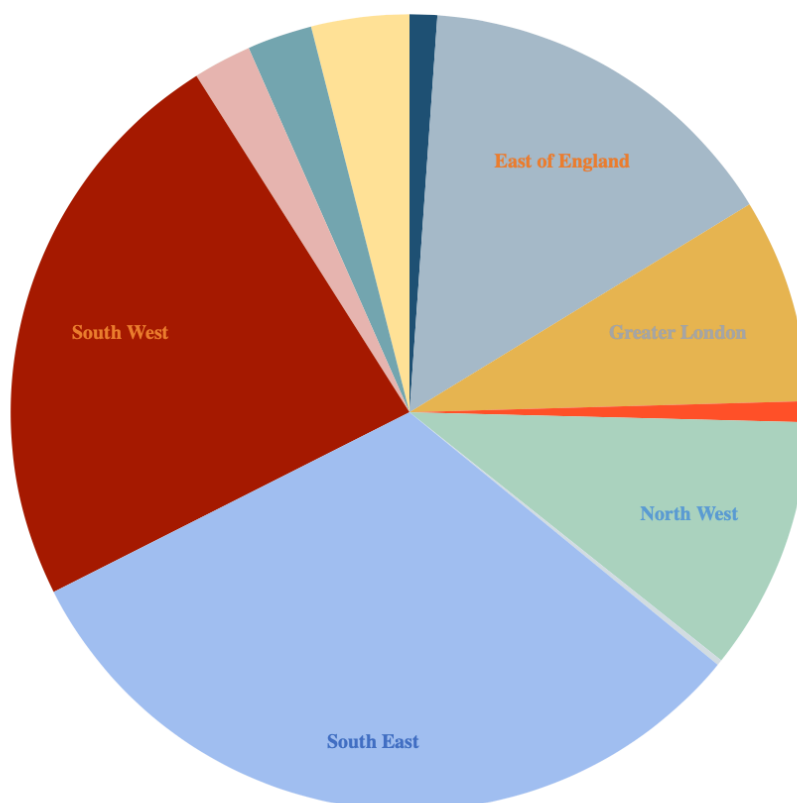
However, there is a limited pipeline of retirement developments in the UK, with only 3 per cent of consented developments being designed specifically for the elderly. The retirement housing stock is materially below levels in other countries, too. For instance, slightly above one per cent of over 60s in the UK live in purpose-built retirement housing, compared to 13 per cent in Australia and 17 per cent in the USA. Furthermore, construction activity is primarily focused on the top end of the market and is not competitive with ReSI's relatively affordable price points.

ReSI's properties are let on assured tenancies with the average length of lease around six years and the average monthly rent £854. Renting avoids the burdens and transaction costs of ownership and assured tenancy leases provide lifetime security of tenure. Demand is strong with occupancy rates around 96 per cent and rent collection rates above 99 per cent. Rental payments are relatively de-linked from the economy as tenants fund their rent through their pensions, income on savings and from other benefits such as housing benefit.

That said, rents are still RPI-linked so tenants face inflationary pressures. ReSI's portfolio delivered 6.1 per cent like-for-like rental growth in the six months to 31 March 2024, which underpinned 6.6 per cent higher net rental income of £5.8mn despite higher operating costs. Annualised net rental income of £11.6mn from the retirement portfolio is double that of the smaller shared ownership portfolio.

Valued at £202mn, the retirement portfolio of 2,238 properties has a vacant possession valuation of £243mn (£110,000 per flat), so there is reversionary surplus of £41mn (22p) that is not embedded in the company's reported EPRA (European Public Real Estate Association) and IFRS (International Financial Reporting Standards) net asset value. Leverage is comfortable - a £92mn drawn facility with Scottish Widows is secured by a first charge on the properties. It's fixed at an attractive interest rate of 3.5 per cent until June 2043. The retirement portfolio generates an unleveraged yield of 5.7 per cent and a leveraged yield of 7.6 per cent.

Retirement rental housing portfolio by location



Source: Residential Secure Income interim results (18 June 2024)

A portfolio rationalisation programme to drive economies of scale and reduce leakage has seen non-core retirement properties sold and bathroom upgrades to existing stock to improve rental returns on re-lettings. Currently, 16 retirement flats are under offer for sale and seven have been sold at an average 19 per cent premium to book value. This highlights the conservative nature of the valuations in the accounts.

Disposal programme

ReSI's portfolio of local authority properties is being sold. The first tranche of the sale programme completed in early April 2024, realising £5.9mn, which was used to pay down £4mn of a £20.6mn revolving credit debt facility with Santander that matures in December 2024.

The balance of the local authority properties will realise £14.8mn and the directors are confident the transaction, which is under exclusivity, will complete in the second half of the year following a

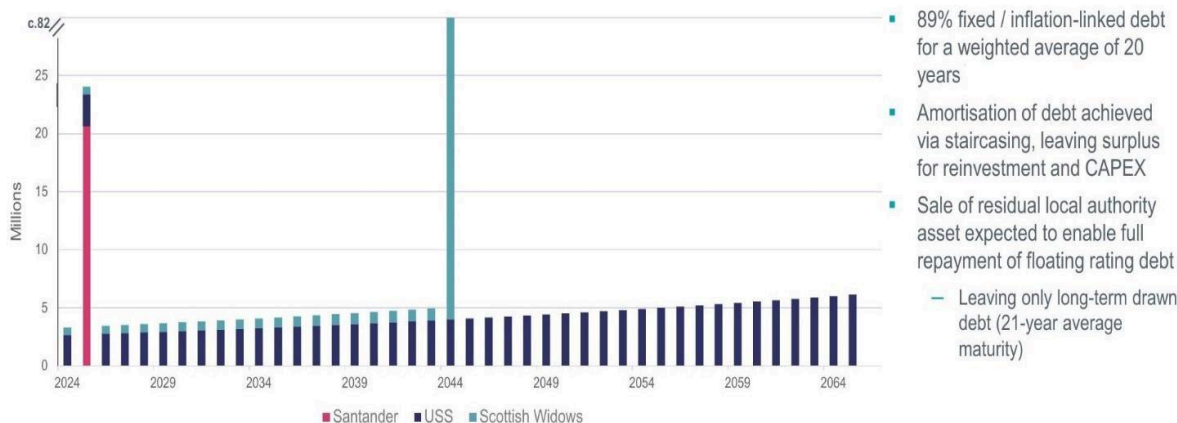
delay in obtaining building control sign off for works on fire safety systems that have already been completed. The board has the option of refinancing the Santander facility or selling the properties to an underbidder as a contingency plan if for some reason the purchaser fails to complete the transaction.

However, assuming completion of the transaction, the Santander debt will be paid off and pro forma net borrowings reduced from £180mn on 31 March 2024 to £160mn, implying a loan-to-value ratio of 50 per cent on the £317mn portfolio valuation. On this basis, the pro forma loan-to-value ratio falls to only 40 per cent after adding the £81mn (44p) reversionary surplus to the £317mn property valuation.

Long-dated investment-grade debt



20 years¹ Average debt maturity	49%¹ Fixed (3.5% coupon)	40%¹ Inflation linked (5.5% cap) (1.1% coupon)	52%² LTV (50% target)	45%³ Reversionary LTV
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Past performance is not necessarily a guide to future performance. Capital at risk.

Source: ReSI plc Interim report 31 March 2024

1. 49% of ReSI's debt is fixed with 19 years average maturity and 3.5% blended coupon. 40% is index linked (measured at fair value) with 23 years average maturity and 1.1% coupon and principle increasing with RPI + 0.5% (with a 0.5% floor and 5.5% cap).

2. LTV post £4m post balance sheet repayment of Santander facility. At the balance sheet date LTV was 53%.

3. LTV on c.£398mn of portfolio vacant possession value, which represents a 26% uplift over the fair value of ReSI's portfolio as at 31 March 2024. Source: Gresham House and Savills, as at 31 March 2024.

Source: Residential Secure Income interim accounts (18 June 2024)

That's well worth considering given that the reversionary surplus is not embedded in the company's reported NAV and is material, equating to 85 per cent of ReSI's current market capitalisation of £95mn. Also, the board are reviewing options to maximise value for shareholders and plan to prioritise the return of capital, although further disposal opportunities may take time to emerge.

Valuations have been under pressure, but the end is in sight

Like all companies in the property sector, the shift in interest rates since the end of 2021 has driven a sharp increase in cost of capital and pushed property yields higher. Valuers have been quick to reprice this higher rate environment, with valuation declines reported almost entirely across the listed Reit space. Although the inherent inflation linkage of the ReSI portfolio has limited the full impact of the outward yield shifts, the company's portfolio valuation has still been impacted by the negative yield movement.

Valuations – impact of Interest Rate rises

Rising discount rates over the past 18 months have driven down valuations despite strong rental growth

		Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	18 month Movement	18 month NOI Growth	Pence per Share impact on ReSI
Retirement	Value £1	219	209	209	210	202	202	202	-17	8%	9
	NIY ²	4.9%	5.3%	5.4%	5.5%	5.5%	5.7%	5.7%	0.8%		
Shared Ownership	Value £1	128	128	125	125	123	121	115	-13	18%	7
	NIY ²	3.0%	3.2%	3.3%	3.4%	3.4%	3.5%	4.0%	0.9%		
Local Authority	Value £1	28	25	21	21	20	20	20	-7	-	4
	NIY ²	6.8%	7.4%	8.8%	8.9%	9.4%	9.5%	9.2%	2.4%		
Total	Value £1	375	362	355	357	345	343	338	-37	9%	20
	NIY ²	4.4%	4.7%	4.8%	5.0%	5.0%	5.1%	5.2%	0.9%		

Source: Residential Secure Income interim accounts (18 June 2024)

In the results for the 2023-23 financial year, the company booked a net £38.9mn down valuation on its portfolio. This reflected a 0.8 percentage rise in the net initial yield used for valuation purposes, which was only partly mitigated by the positive impact of strong rental growth. On a like-for-like basis, the portfolio valuation declined by £40mn to £345mn (including head leases). This explains why EPRA net tangible asset (NTA) tumbled from 106.1p to 81.8p per share and IFRS NAV declined from 108.8p to 91.1p per share, taking it below the 100p a share IPO price.

Residential Secure Income key financial and operational metrics

Income	2023	2022	Change in Year
Like-for-like rental reviews	6.10%	4.50%	1.6%
Rent collection	99%	99%	-
Gross rental income	£27.9mn	£25.7mn	8.6%
Net rental income	£18.1mn	£17.0mn	6.4%
Adjusted EPRA Earnings	£8.7mn	£9.0mn	-3.3%
Adjusted EPRA EPS	4.7p	5.0p	-5.7%
Dividend paid per share - paid	5.16p	5.16p	-
Dividend cover	91%	97%	-6.0%
Changes in fair value of investment properties	£(38.9)mn	£3.2mn	-
Capital	30-Sep-23	30-Sep-22	Change in Year
IFRS net assets	£168.7mn	£201.4mn	-16.2%
IFRS NAV per share	91.1p	108.8p	-16.2%
IFRS Portfolio Valuation	£345.1mn	£374.8mn	-7.9%
EPRA NTA per share	81.8p	106.1p	-22.9%
EPRA NTA Total Return	-18.10%	3.30%	-21.3%
Loan to Value	50%	47%	3.0%

Source: Residential Secure Income 2022-23 annual accounts

In the interim results to 31 March 2024, Savills clipped 2 per cent off ReSI's property values to embed a further 0.2 per cent upward shift in the property yield, despite ReSI generating 7 per cent net rental income growth in the period.

However, in the most recent third quarter results the company delivered a positive total return despite a modest down valuation of £1.8mn due to a 0.1 per cent further rise in the property yield to 5.2 per cent.

Bearing this in mind, UK gilt yields have been tumbling since ReSI's valuers assessed the portfolio on 30 June 2024. The 10-year UK gilt yield has fallen from 4.38 per cent to 3.94 per cent in the past 11 weeks and is now 0.5 percentage points below the level which surveyors took account of when assessing valuations in ReSI's 2023 annual results.

The downward shift in gilt yields is also important because institutional investors are arguably more focused on the spread real estate offers over the risk-free rate, or the 10-year gilt. In the case of ReSI, the company's yield spread has widened to 1.3 percentage points above the 10-year gilt and is now in line with the MSCI Benchmark yield spread, which has almost mean reverted to the lower end of the long-term range of 1.5 to 2 per cent.

Residential Secure Income third-quarter NAV movement

	EPRA NTA		IFRS NAV	
	£'mn	Pence per share	£'mn	Pence per share
Net Asset Value at 31 March 2024	142.9	77.2	154.4	83.4
Net income for the Period	2.5	1.3	2.5	1.3
Property valuation change	-1.8	-1	-1.8	-1
Debt valuation / indexation*	0.4	0.2	1.6	0.9
Dividend paid	-1.9	-1	-1.9	-1
Net Asset Value at 30 June 2024	142	76.7	154.8	83.6
Total return	0.80%	0.80%	1.50%	1.50%

*In accordance with the EPRA Best Practice Recommendations, EPRA NTA reflects the amortised cost of indebtedness, rather than its fair value, and thus the EPRA NTA movement reflects the indexation of USS debt.

Source: Residential Secure Income third quarter results for 2023-24 financial year (1 August 2024)

Furthermore, money market expectations point to the Bank of England base rate falling more sharply, a positive for a recovery in sentiment towards companies in the real estate sector that have been growing rental income from quality tenants during the hiatus in the investment market in the past two years. ReSI looks well placed especially as its niche residential sub-sectors are both likely beneficiaries of a more benign UK Government policy that should attract capital flows to the affordable housing sector, and bring its conservative valuations into keener focus.

Dividend cover

ReSI lacks broker coverage which has created an information void to take advantage of. A good starting point is to make some adjustments to the recent interim results. (See the table on the next page.)

Adjusting for the £1.9mn loss of annual net rental income from the sale of the local authority portfolio, ReSI's pro forma annualised net rental income of £17.4mn easily covers management fees (£1.6mn – see section below), finance costs (£6mn after factoring in associated interest saving on Santander facility) and other overheads (£1.4mn). It means pro forma adjusted EPRA earnings have an annual run-rate of £8.4mn, or 4.57p a share, which covers the £7.6mn annual cash cost of the 1.03p a share quarterly dividend that underpins the 8 per cent dividend yield.

Although the board rebased the quarterly dividend per share from 1.29p to 1.03p at the start of the year, the directors may now consider an increase to the pay-out at the year-end, so there is scope for upside.

	H1 2024	H1 2023	Change
Gross rental income	£14.9mn	£13.6mn	+10%
Net rental income	£9.4mn	£8.8mn	+7%
First tranche sales profits	£0.04mn	£0.2mn	-81%
Net finance costs	£(3.4)mn	£(3.1)mn	+10%
Management fees	£(0.8)mn	£(1.1)mn	-24%
Overheads	£(0.7)mn	£(0.7)mn	+4%
EPRA Adjusted earnings	£4.5mn	£4.1mn	+9%
EPRA Adjusted earnings (p per share)	2.4p	2.2p	+9%
IFRS Adjusted EPS	(5.6)p	(16.2)p	+65%
Dividends Paid (p per share)	2.1p	2.6p	-20%
Dividend cover	117%	86%	+31bps

Source: Residential Secure Income interim accounts (18 June 2024)

Board

Non-executive chair **David Orr** has over 30 years' experience in chief executive roles, most recently at the National Housing Federation. He is chair of Clarion Housing Association, a previous President of Housing Europe and chair of Reall, an international development housing charity.

Finance director **Sandeep Patel** ACCA joined Gresham House in December 2022 and leads the finance function for the housing strategy, encompassing the full suite of financial reporting and analysis. He has over 15 years of senior finance experience spanning financial control, valuations, product control and finance business partnering, playing an active role in the delivery of strategic objectives.

Non-executive director **Gillian Rowley** has over 30 years of housing and housing finance expertise, with a focus on policy development within the framework of regulatory standards. She served as non-executive director for The Housing Finance Corporation from 2006-2012, where she was involved in business strategy, financial policy and governance. This overlapped with her

work at the former social housing regulator, the Homes & Communities Agency, where she was responsible for relationships with lenders, investors, advisers, and credit rating agencies operating in the social housing sector.

Ben Fry, managing director of housing at Gresham House Asset Management is the lead fund manager of both ReSI and Gresham House Residential Secure Income LP. He is also managing director of the two Registered Providers of Social Housing within these funds. Fry has worked at Gresham House for 12 years and has extensive experience in specialist residential accommodation and providing debt advisory services for housing associations.

Investment manager

At the start of 2024, ReSI's fund manager, Gresham House Asset Management, aligned its management fee more closely to the share price, having previously based its fee on the company's NAV. Remuneration is now calculated in respect of each quarter at a rate of one per cent of the average of the market capitalisation and NAV. A quarter of the fee is settled in shares and is subject to a 12-month lock-in period, and the balance is paid in cash.

In addition, ReSI Property Management Limited (RPML) a wholly owned subsidiary of the fund manager provides property management services to parts of the company on a cost pass through basis with no profit margin. In the 2022-23 financial year, RPML charged fees of £1.98mn in respect of costs incurred in providing property management services and £0.16mn in respect of non-recurring costs.

Peer group comparison

Shares in ReSI trade on a three percentage point lower discount to NAV than the peer group average discount of 42 per cent. However, ReSI's NAV excludes the £81mn (43.8p) reversionary surplus that is not reflected in the accounts. Factor this in and the shares are trading on the deepest discount in the sector.

Furthermore, the company's 8 per cent dividend yield stands out and is sustainable given that proforma EPRA earnings offer 111 per cent coverage in the latest six-month period, and the rent roll is rising.

True, NAV total return has lagged peers over one, three and five-years, but there are specific catalysts to suggest that a period of outperformance could be on the cards to narrow the ratings discount. Not only is the Labour government taking steps to address the current housing crisis, but expectations of interest rate cuts, lower inflation, and enhanced debt financing opportunities are all likely catalysts to improve investor sentiment. A re-rating is potentially on the cards.

Shareholders

ReSI's shareholder base is backed by a roll call of well-known institutional investors including Schroder, Close Asset Management, BlackRock and Premier Miton.

The top 12 largest shareholders hold 59 per cent of the shares in issue, but the shares are still liquid, trading on a 0.6p a share bid-offer spread. More than 1,000 bargains and 4.2mn shares have traded in the past fortnight with the largest single trade 175,000 shares, so trading volumes are decent, too.

Directors of ReSI and its fund manager, Gresham House Asset Management, have skin in the game, holding a total of 5.3mn shares, or 2.9 per cent of the 185.2mn shares in issue.

Residential Secure Income largest shareholders

Shareholder	Percentage of shares held
Schroder & Co.	11.96
Close Asset Management	9.95
CG Asset Management	6.39
Valu-Trac Investment Management	6.20
West Yorkshire Pension Fund	5.27
Gravis Capital Management	4.89
Premier Miton Group	4.16
Schroder Investment Management	3.71
City Asset Management	2.36
BlackRock Advisors (UK)	1.42
Beckett Asset Management	1.20
BlackRock Investment Management (UK)	1.08
Total	58.57

Source: FactSet (8 August 2024)

Target price

Investors in the real-estate sector have been patiently waiting for the Bank of England to start cutting interest rates and for the real estate yield premium to risk-free rates to mean revert to their long-term average.

The recent fall in UK gilt yields has accelerated the process with the MSCI benchmark yield spread premium to gilts closing in on its 1.5 per cent long-term average. The recent downward move in government funding costs is now being reflected in the pricing of residential and commercial loans and coincides with an upgrade to UK economic growth forecasts. The combination of lower funding costs, low inflation and a better economic outlook are all positive for investor sentiment in the real estate sector. ReSI looks primed to benefit from the change in the narrative.

In the circumstances, the high yielding shares are likely to attract increasing interest from investors looking to lock into the company's attractive 8 per cent dividend yield as BoE base rate falls further, so there are drivers for both income and capital growth. Interest rate cuts could be significant, too. For instance, economists at the International Monetary Fund (IMF) predict UK interest rates could fall to 3.5 per cent by the end of 2025, implying a 1.5 percentage point cut from current levels.

Although ReSI's shares are likely to continue to trade on a deep discount given the lacklustre performance in recent years, it wouldn't be farfetched to expect the current 38.4 per cent share price discount to IFRS NAV of 83.6p to halve in the coming year. Add to that prospects for an 8 per cent annual income return and the shares have potential to deliver a near 40 per cent total return if they hit my 67.5p target. Buy.

Risks

Significant or material fall in the value of the property market. The aim of ReSI is to hold the assets for long-term inflation-linked income, typically 20 years and longer, by focusing on areas of the market with limited and ideally countercyclical exposure to the wider property market. The board assesses market forecasts on a quarterly basis to put in place mitigations in the event of material fall in the value of the property market.

Furthermore, the investment manager stays abreast of market developments and forecasts, and, where necessary, seeks to adjust offer terms and its approach accordingly. Importantly, the board does not rely on realised revaluation gains to cover dividend payments.

Insufficient liquidity to meet obligations including debt repayments. ReSI typically uses long-term amortising debt which mitigates refinancing risk. The USS facility does not have loan-to-value debt covenants as it is fully amortising. The Scottish Widows facility has a value headroom covenant of £50mn (currently more than £100mn) and a debt interest coverage ratio of at least two times (currently 3.2 times). The working capital facility with Santander matures in December 2024 and is expected to be redeemed through asset sales, which are in exclusivity. Further contingency plans to redeem the debt, including bridge financing and raising additional secured portfolio debt, have been assessed.

Investments may be difficult or impossible to realise at a particular time. ReSI's aim is to hold the assets for long-term income and does not look to sell them if market conditions are not right. Returns targets are not premised on capital appreciation and disposals either. Debt is used to match underlying cash flows of the asset, so the company is not incentivised to dispose of assets that will create a mismatch.

Failure of ReSI Housing to meet the Regulatory Standards. To mitigate this risk, the fund manager continues to develop ReSI Housing's governance and operational structure with third parties, reflecting the maturity and growth of its portfolio.

Failure to remain a qualified Reit. In this scenario, rental income and gains will become subject to UK corporation tax. The fund manager monitors HMRC, Financial Conduct Authority (FCA) and other public announcements for any relevant release affecting the company. The board utilises third party legal, accounting and tax advisors for professional advice to maintain the company's Reit status.

Assumptions underpinning leverage are subject to uncertainties and contingencies. Debt is typically structured to match the anticipated cash flows from the secured assets, and rating agency review of ReSI Housing's debt provides independent review of this leverage. Amortisation of ReSI Housing's debt is generally financed out of staircasing cash flows, whose long-term average rate is 2.5 per cent per annum and typically ranges between 1-5 per cent.

Ongoing charges. The fund manager fee has been reduced to the average of NAV and market capitalisation (previously just based on NAV) and the investment manager is not entitled to any performance related fee or fees in connection with any sales of assets to the group.

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